CA FINAL

FINANCIAL REPORTING

Based on Revised Syllabus announced by ICAI

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BOOK 3

CA FINAL

TABLE OF CONTENTS

No.	Chapter	Page
1	IND AS 103 – BUSINESS COMBINATION	1
2	IND AS 110 – CONSOLIDATION OF FINANCIAL STATEMENTS	48
3	IND AS 32, 107, 109 –FINANCIAL INSTRUMENTS	88
4	IND AS 102 – SHARE BASED PAYMENT	150
5	IND AS 111 – JOINT ARRANGEMENTS	164
6	IND AS 28 – INVESTMENTS IN ASSOCIATES & JOINT VENTURES	184
7	IND AS 27 – SEPARATE FINANCIAL STATEMENTS	203
8	IND AS 19 – EMPLOYEES BENEFITS	210
9	IND AS 115 – REVENUE FROM CONTRACT WITH CUSTOMER	231
10	IND AS 101 – FIRST TIME ADOPTION	277
11	CORPORATE SOCIAL RESPONSIBILITY	292
12	ANALYSIS OF FINANCIAL STATEMENTS	301

FINANCIAL REPORTING – BOOK 3

CHAPTER

1

IND AS 103 – BUSINESS COMBINATION

CONCEPTS COVERED

1. INTRODUCTION
2. MERGERS AND DEMERGERS
   - A. MERGERS
   - B. DEMERGERS
3. BUSINESS COMBINATION
   - A. BUSINESS COMBINATION
   - B. BUSINESS
   - C. ELEMENTS OF BUSINESS
   - D. FURTHER ASSESSMENT
   - E. CONCENTRATION TEST
4. BUSINESS COMBINATION OR ASSET ACQUISTION
5. ACCOUNTING FOR BUSINESS COMBINATIONS
   - A. IDENTIFY THE ACQUIRER
   - B. DETERMINE THE DATE OF ACQUISITION
   - C. IDENTIFY AND MEASURE THE CONSIDERATION TRANSFERRED
   - D. IDENTIFY AND MEASURE IDENTIFIABLE ASSETS AND LIABILITIES ASSUMED
   - E. MEASURE THE NON CONTROLLING INTEREST
   - F. DETERMINE GOODWILL AND GAIN FROM BARGAIN PURCHASE

6. OTHER RELATED CONCEPTS
   A. MEASUREMENT PERIOD
   B. DETERMINE WHAT IS PART OF BUSINESS COMBINITION TRANSACTION
   C. SHARE BASED PAYMENT AWARDS
   D. NON REPLACEMENT AWARD
7. SUBSEQUENT MEASUREMENT AND ACCOUNTING
8. COMMON CONTROL TRANSACTION INCLUDING MERGERS
9. REVERSE ACQUISITION

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1. INTRODUCTION :

The existing AS 14 covers only those transaction which are true mergers, however with growing complexity in the world of business, the changes in the way business is conducted, there was a need for more comprehensive standard to look into various complexity involved.

The necessity of a standard on Business Combination in India assumes importance considering the fact that Indian companies are increasingly stretching their business in foreign countries for best-fit business combinations. Presently in India, Accounting Standard (AS) 14 'Accounting for Amalgamation' lays out specific treatment for Amalgamation and AS 21, 'Consolidated Financial Statements' are applied for consolidation. However, it is not matching the global reporting standards requirements.

After convergence of IFRS as Ind AS, Ind AS 103 which is in line with IFRS 3 takes care of the global requirements in case of business combinations worldwide.

2. MERGERS AND DEMERGERS :

A. Mergers :

It is a legal process by which two or more companies are joined together to form a new entity or one or more companies are absorbed by another company and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of the new or amalgamated company.

B. Demergers :

Demerger is an arrangement whereby some part /undertaking of one company is transferred to another company which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company.

3. BUSINESS COMBINATION:

A. BUSINESS COMBINATION :

Under Ind AS 103, Business combination occurs when an entity obtains **control** of a **business** by acquiring net assets or acquiring its significant equity interest.

As such, two elements are required for a transaction to be a business combination under Ind AS 103:

- the acquirer obtains control of an acquiree ("control" as defined in Ind AS 110); and
- the acquiree is a business

B. BUSINESS :

The term **'business'** is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing ***goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.***

As per paragraph B7 of the application guidance of the Ind AS 103, a business consists of **inputs** and **processes** applied to those inputs that have the **ability to create outputs**. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

C. ELEMENTS OF BUSINESS :

The three elements of a business are defined as follows:

(a) **Input** : Any economic resource that creates outputs or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.

Example :

Non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

(b) **Process** : Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates output or has the ability to contribute to the creations of outputs.

Example:

Strategic management processes, operational processes and resource management processes.

These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) **Output** : The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

D. FURTHER ASSESSMENT :

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.

Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

Substantive Process:

To determine whether acquired process is substantive, following has to be considered:

(1) If a set of activities and assets does not have output at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if-

(a) It is critical to the ability to develop or convert an acquired input or inputs into outputs; and

(b) The inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs.

Those other inputs could include-

(i) Intellectual property that could be used to develop a good or service;

(ii) Other economic resources that could be developed to create outputs; or

(iii) Rights to obtain access to necessary materials or rights that enable the creation of future Outputs.

(2) If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it-

(a) is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes); or

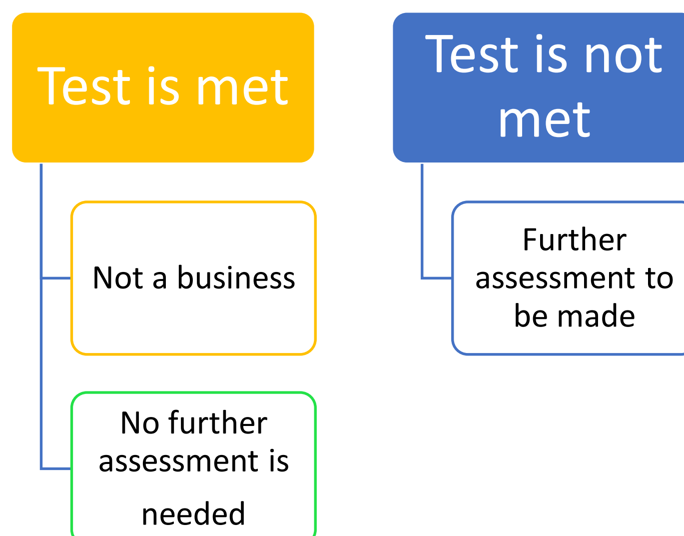
(b) significantly contributes to the ability to continue producing outputs and-

(i) is considered unique or scarce; or

(ii) cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

E. CONCENTRATION TEST :

As per paragraph B7A of the application guidance of Ind AS 103, an optional test (the concentration test) has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business. On the basis of the above test, following will be the consequences:



Following conditions should be present to meet concentration test: As per paragraph B7A of the application guidance of Ind AS 103, the concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. For the concentration test:

(a) gross assets acquired shall exclude cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities;

(b) the fair value of the gross assets acquired shall include any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired.

(c) a single identifiable asset shall include any asset or group of assets that would be recognized and measured as a single identifiable asset in a business combination;

(d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (or from an underlying asset subject to a lease, as defined in Ind AS 116, Leases), without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset;

(e) when assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics);

(f) the following shall not be considered similar assets:
   - (i) a tangible asset and an intangible asset;
   - (ii) tangible assets in different classes unless they are considered a single identifiable asset in accordance with the criterion in subparagraph (d);
   - (iii) identifiable intangible assets in different classes
   - (iv) a financial asset and a non-financial asset;
   - (v) financial assets in different classes; and
   - (vi) identifiable assets that are within the same class of asset but have significantly different risk characteristics.

Notes :

1) Concentration test is optional test and the decision to apply is made on a transaction to transaction basis.

2) Does not prohibit an entity from performing a detailed test assessment using definition of business given in this standard.

3) 3 Step process for concentration test:
   - a) Measure the Fair Value of Gross Assets acquired.
   - b) Identify the single identifiable assets or group of similar identifiable asset.
   - c) Determine if substantially all of the value determined in point (a) is concentrated in the value determined in point (b) then it is an asset acquisition otherwise needs to assess business definition as per Ind AS 103.

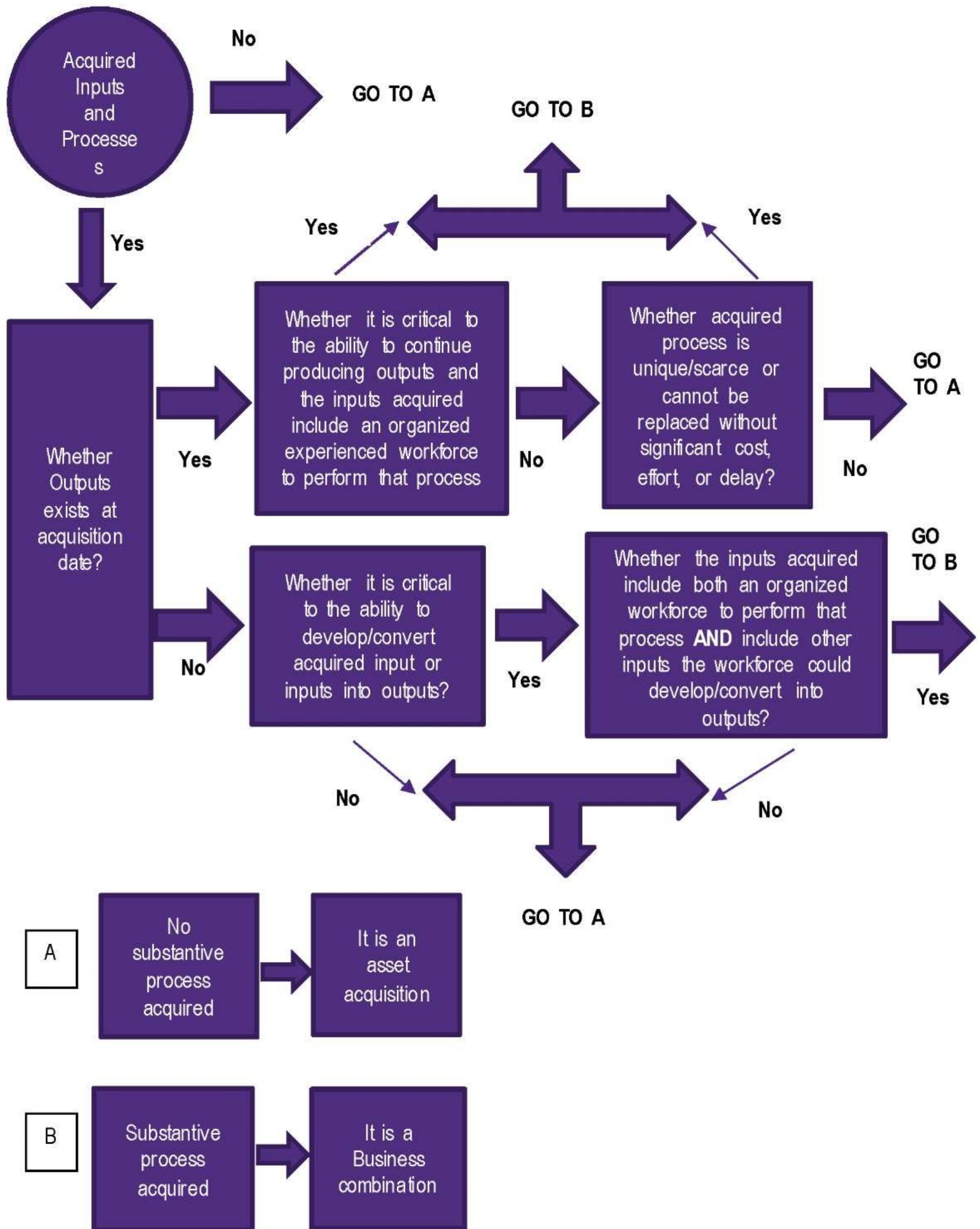
Fair value of gross assets shall be determined as follows (i + ii – iii):

i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)

ii) Fair value of liabilities assumed.

iii) Cash and cash equivalent and deferred tax assets and goodwill resulting from DTL's.

Summary to determine whether transaction is business or not:



Question 1 – RM Ltd.

RM Ltd. has a separate IT department what provides software solutions to various firms. RM Ltd sells its IT department to NISH Ltd. IT Department had Plant and Equipment working capital and staff. Can IT dept of RM Ltd be termed as separate business?

Question 2 – Company X

Company X is a liquor manufacturer and has traded for a number of years. The company produces a wide variety of liquor and employs a workforce of machine operators, testers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse and machinery and holds raw material inventory and finished products.

On 1st January 20X1, Company Y pays USD 80 million to acquire 100% of the ordinary voting shares of Company X. No other type of shares has been issued by Company X. On the same day, the four main executive directors of Company Y take on the same roles in Company X.

Can company X be referred as Business.

Question 3 – Company D

Company D is a development stage entity that has not started revenue- generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.

The value of the identifiable net assets in Company D is INR 750 million. Company A pays INR 600 million in exchange for 60% of the equity of Company D (a controlling interest). Does company D qualify to be known as business.

Question 4 – Company A

Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P’s leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner. Can Company P be referred to as business.

Question 5 – Company A

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short-term rental agreements that oblige Company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease management tasks (eg identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximise the quality of tenants and the rental income.

Question 6 – Company S

Company S is a manufacturer of a wide range of products. The company's payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions.

Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting cost centre or any head office functions. Company A is a competitor of Company S.

Question 7 – Company A

Company A is a property development company with a number of subsidiary companies, each of which holds a single development. After completion of the development, Company A sells its equity investment because the applicable tax rate is lower than that applicable to the sale of the underlying property.

Company a is planning to start the development of a large retail complex. Rather than incorporating a new company, it acquires entire share capital of a shell company. Can it be treated as business combination.

Question 8 – Company A

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company's has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

Required:

Does Company A constitute a business in accordance with Ind AS 103?

Question 9 –

Modifying the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

Question 10 – Company A

Company A is a Pharmaceutical Company. Since inception, the Company had been conducting in-house Research and Development Activities through its skilled workforce and recently obtained an Intellectual Property Right ((PR) in the form of Patents over certain drugs. The Company's has a Production Plant that has recently obtained Regulatory Approvals. However, the Company has not earned any Revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

(A) On the above facts, discuss whether Company A constitute a "Business" in accordance with Ind AS-103.

(B) If Company A had revenue contracts and a sales force, and Company B acquires all the inputs and processes other than the sales force, discuss whether Company A constitute a "Business" in accordance with Ind AS-103.

Question 11 – Company P

Company P, a Manufacturer of Textile Products, acquires 40,000 of the Equity Shares of Company X (a Manufacturer of complementary products) out of 1,00,000 Shares in issue. As part of the same agreement, Company P purchases an option to acquire an additional 25,000 Shares. The option is exercisable at any time in the next 12 months. The Exercise Price includes a small premium to the market price at the transaction date. After the above transaction, the Shareholdings of Company X's two other original Shareholders are 35,000 and 25,000 Each of these Shareholders also has currently exercisable options to acquire 2,000 Additional Shares. Has Company P acquired control of Company X in this case?

4. BUSINESS COMBINATION OR ASSET ACQUISTION :

For a transaction to meet the definition of business combination, the entity must gain the control of an integrated set of assets and activities that is more than the collection of assets or a combination of assets and liabilities. Some key difference between a business combination and an asset acquisition are summarized in the following table.

Area	Business Combination	Asset or Group of Asset Acquisition
Measurement of assets and liabilities	At Fair Value	Recorded at cost. Cost is allocated over the group of assets based on relative fair value
Transaction Costs	Expensed	Capitalized
Contingent liabilities assumed	Recognized if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit and loss	Not recognized, Subject to Ind AS – 37
Goodwill	May be recognized	Not Recognized
Deferred taxes	Deferred tax assets and liabilities, related to any temporary differences, tax carry forwards are recorded	Initial recognition exception applies. Deferred tax assets and liabilities for temporary differences are not recognized

Question 12 – Company B

Company B was in the business of operating Restaurants. It has cloosed these Restaurants. Some of the Assets pertaining to these Restaurants, such as, Land, Buildings, Leased Assets and Leasehold Improvements are acquired by Company A. Company A does not acquire employees, the rights to the trade name, or the processes from Company B. Is this a "Business Combination" under Ind AS-103?

Question 13 – RM Ltd.

RM Ltd purchased from Nisha Ltd a group of assets comprising of plant and machinery, furniture, equipment and software at combined price of Rs.400 lakhs. Assets do not constitute business as per Ind AS 103. How would RM Ltd. Measure these assets for the purpose of initial reorganization?

The fair value of these assets determined applying Ind AS – 113 fair value measurement is:

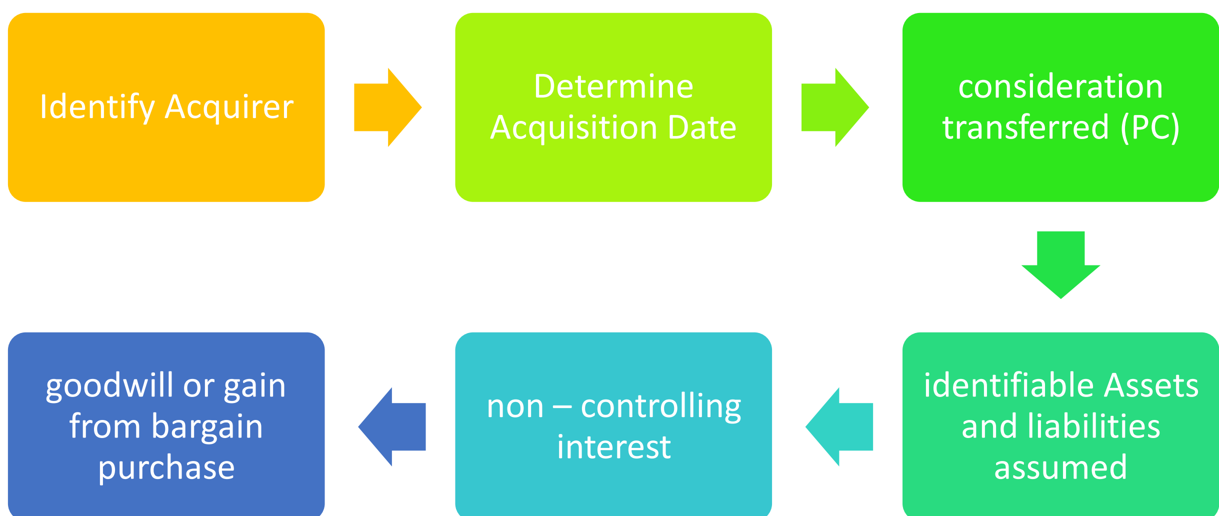
	Amount (Rs)
Plant and Machinery	200 lakhs
Furniture	30 lakhs
Equipment	50 lakhs
Licenses	70 lakhs
Total	350 lakhs

5. ACCOUNTING FOR BUSINESS COMBINATIONS :

The business combination is accounted by applying "Acquisition Method" – The nature of purchase.

The following are the steps for Accounting for Business Combinations

A. Identify Acquirer
B. Determine Acquisition Date
C. Identify and Measure the consideration transferred (PC)
D. Identify and Measure identifiable Assets and liabilities assumed
E. Measure non – controlling interest
F. Determine goodwill or gain from bargain purchase



A. INDENTIFY ACQUIRER :

All business combination within the scope of Ind AS 103 are accounted under the acquisition method (also known as purchase method).

- In order to apply the purchase method, the parties involved has to identify the acquirer i.e. the entity that obtains the control of another entity.
- The entity on whom the control is established is termed as acquiree.

The acquiring enterprise is the enterprise which obtains control and the determination of control is as per the guidance given in Ind AS 110. It may so happen that guidance in Ind AS 110 does not clearly indicate which of the combining entity is the acquirer. In such a case, Ind AS 103 provides additional guidance on identifying the acquirer.

ACQUISITION THROUGH PAYMENT OF CASH OR INCURRING OF LIABILITY :

In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

ACQUISITION THROUGH ISSUE OF EQUITY INSTRUMENT :

In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Reverse acquisition has been dealt in a separate section of this chapter.

OTHER FACTORS :

1. The relative voting rights in the combined entity after the business combination: The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
2. The existence of a large minority voting interest in the combined entity if no other owner or organized group of owners has a significant voting interest—The acquirer is usually the combining entity whose single owner or organized group of owners holds the largest minority voting interest in the combined entity.
3. The composition of the governing body of the combined entity—The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
4. The composition of the senior management of the combined entity—The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.
5. The terms of the exchange of equity interests—The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.
6. The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities. In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

Note : The identification of the acquirer assumes greater importance in this chapter because it's the Acquirer – who shall apply Ind AS 103.

Question 14 – Company A and Company B

Company A and Company B operate in Power Industry and both Entities are Operating Entities. Company A has much larger scale of operations than Company B. Identify the "Acquirer" when Company B merges with Company A.
Shareholders of Company B would receive 1 Equity Share of Company A for every 1 Share held in Company B. Such issue of Shares would comprise 20% of the Issued Share Capital of the Combined Entity. After discharge of purchase consideration, the pre-merger Shareholders of Company A hold 80% of the Capital in Company A.

REVERSE ACQUISITION :

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance above. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the **legal acquirer** because it issued its equity interests, and the private entity is the **legal acquiree** because its equity interests were acquired. However, application of the guidance given in above paragraph results in identifying:

1. The public entity as the **acquiree** for accounting purposes (the accounting acquiree); and
2. The private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles of Ind AS 103, including the requirement to recognize goodwill, will apply.

Question 15 – Company A and Company B

Company A and Company B operate in Power Industry and both Entities are Operating Entities. Company A has much larger scale of operations than Company B. Identify the "Acquirer" when Company B merges with Company A.

Shareholders of Company B would receive 10 Equity Shares of Company A for every 1 Share held in Company B Such issue of Shares would comprise 70% of the Issued Share Capital of the Combined Entity. After discharge of purchase consideration, the pre-merger Shareholders of Company A hold 30% of Capital of Company A. Post acquisition, the Management of Company B would manage the operations of the Combined Entity.

B. DETERMINE THE DATE OF ACQUISITION :

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

The acquisition date is a very important step in the business combination accounting because it determines when the acquirer recognizes and measures the consideration, the assets acquired and liabilities assumed. The acquiree's results are consolidated from this date. The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.

The acquisition date is often readily apparent from the structure of the business combinations and the terms of the sale and purchase agreement (if applicable) but this is not always the case.

"Acquisition Date will be the date on which the acquirer obtains control".

Question 16 – Company X

On April 1, Company X agrees to acquire the Shares of Company B in an all equity deal. As per the Binding Agreement Company X will get the effective control on 1 April. However, the consideration will be paid only when the Shareholders' approval is received. The Shareholders' Meeting is scheduled to happen on 30 April. If the Shareholder Approval is not received for issue of New Shares, then the consideration will be settled in cash. What is the Acquisition Date in this case?

Question 17 – Company A

Company A acquired 80% Equity Interest in Company B for cash consideration. The relevant dates are as under –

Date of Shareholder Agreement — 1st January
Appointed Date as per Shareholder Agreement — 1st April
Date of obtaining control over the Board Representation: — 1st July
Date of Payment of Consideration: — 15th July
Date of Transfer of Shares to Company A: — 1st August

Determine the "Acquisition Date" for Ind AS-103 purposes.

Question 18 – Shyam Ltd.

On 9 April 20K2, Shyam Ltd, a Listed Company started to negotiate with Ram Ltd, which is an Unlisted Company, about the possibility of merger. On 10 May 20X2 the Board of Directors of Shyam authorized their Management to pursue the merger with Ram Ltd. On 15 May 20X2, the Management of Shyam Ltd offered the Management of Ram Ltd 12,000 Shares of Shyam Ltd against their total share outstanding. On 31 May 20X2, the Board of Directors of Ram Ltd accepted the offer subject to Shareholder Vote. On 2 June 20X2, both the Companies jointly made a Press Release about the proposed merger. On June 20X2, the Shareholders of Ram Ltd approved the terms of the merger. On 15 June, the Shares were allotted to the Shareholders of Ram Ltd. The Market Price of the Shares of Shyam Ltd was as follows -

Date	9 April	10 May	15 May	31 May	2 June	10 June	15 June

Price	70	75	60	70	80	85	90

What is the Acquisition Date and what is Purchase Consideration in the above scenario?

STEP ACQUISITION :

In the case an entity acquires an entity step by step through series of purchase then the acquisition date will be the date on which the acquirer obtains control. Till the time the control is obtained the Investment will be accounted as per the requirements of other Ind AS 109, if the investments are covered under that standard or as per Ind AS 28, if the investments are in Associates or Joint Ventures.

In the case of step acquisitions, the investments held by the acquirer till the date of obtaining the control is recorded at acquisition date fair value and the difference between the fair value and the previous carrying cost is recorded as income or loss in the income statement.

Question 19 –

Select the Acquisition date for the below cases

Case 1. X Ltd acquires 15% of Y Ltd. on 1/4/2017 and further acquires 40% stake on 1/4/2018.

Case 2. X. Ltd acquires 55% of Y Ltd. on 1/4/2017 and further acquires 15% stake on 1/4/2018.

C. IDENTIFY AND MEASURE CONSIDERATION TRANSFERRED :

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the total of

- the acquisition-date fair values of the assets (including cash) transferred by the acquirer,
- the liabilities incurred by the acquirer to former owners of the acquiree and
- the equity interests issued by the acquirer.

Examples of potential forms of consideration include

- cash,
- other assets,
- a business or a subsidiary of the acquirer,
- *contingent consideration*,
- ordinary or preference equity instruments,
- options,
- warrants and
- member interests of *mutual entities*.

MUTUAL ENTITIES :

An ***entity***, other than an investor-owned ***entity***, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example,

a ***mutual*** insurance company, a credit union and a co-operative ***entity*** are all ***mutual entities***.

SHARE BASED PAYMENT AWARD :

Any portion of the Acquirer's share based payment award exchanged for awards held by Acquiring employee that is included in consideration transferred in the business combination shall be measured in accordance with the requirements of Ind AS 102 – share based payments.

TRANSFER OF ASSETS AND LIABILITIES :

The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognize the resulting gains or losses, if any, in profit or loss.

This means that if the acquirer has transferred a land as a part of the business combination arrangement to the owners of the acquiree then the fair value of the land will be considered in determining the fair value of the consideration. Consequently, the land will be de -recognized in the financial statements of the acquirer and the difference between the carrying amount of the land and the fair value considered for purchase consideration will be recorded in profit and loss.

However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognize a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

Question 20 – Company A

Company A is the Defendant in a Lawsuit in which Company B is the Plaintiff. A has recognized a Liability in the amount of 4 Lakhs related to this Lawsuit as per Ind AS-37. Now, A acquires B in a Business Combination, and pays cash consideration of Rs.50 Lakhs to B's Shareholders. The acquisition effectively settles the Lawsuit. The Fair Value of the Law suit at the date of acquisition is determined to be Rs.2.5 Lakhs. How should the above be dealt with?

CONTINGENT CONSIDERATION :

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability in accordance with the requirement of Ind AS 32 Financial Instruments: Presentation, or other applicable Indian Accounting Standards. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

Question 21 – Company A

Company A acquires Company B in April 20X1 for cash. The acquisition agreement states that an additional Rs.20 million of cash will be paid to B's former shareholders if B succeeds in achieving certain specified performance targets. A determines the fair value of the contingent consideration liability to be 15 million at the acquisition date. How shall this be accounted for keeping Ind AS 103 in mind.

DIRECT COST OF ACQUISITION :

The direct cost of acquisition is not included in determination of the purchase consideration. Cost which include like finder's fees, due diligence cost accounting, legal fees, investment banker fees, even bonuses paid to employees for doing a successful acquisition will not be included in the cost of acquisition.
Such cost should be expensed.

BUSINESS COMBINATION ACHIEVED WITHOUT TRANSFER OF CONSIDERATION :

An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

1. The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

2. Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

3. The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

In a business combination achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognized in accordance with this Indian Accounting Standard. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial

D. IDENTIFY AND MEASURE IDENTIFIABLE ASSETS AND LIABILITIES ASSUMED :

As of the acquisition date, the acquirer shall recognize,

1. Separately from goodwill,
2. the identifiable assets acquired,
3. the liabilities assumed and
4. any non-controlling interest in the acquiree.

The most important principle in a purchase price allocation exercise is to recognize and measure all the assets and liabilities acquired on the acquisition date.

RECOGNITION :

1. To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards issued by the Institute of Chartered Accountants of India at the acquisition date.
2. Acquirer should only record the assets and liabilities recorded as a part of the business combination which means only those assets and liabilities which have been assumed as a part of the business combination deal should only be recorded and not any other assets which are not related to the acquisition to which other applicable Ind AS should be applied.
3. When the acquirer applies the recognition principle under business combination it may record certain assets and liabilities which the acquiree had not recorded earlier in their financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

MEASUREMENT :

The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values. There are certain exceptions which are discussed in detail in the following paras.

EXCEPTIONS T0 RECOGNITION AND MEASUREMENT PRINCIPLE :

1. Contingent liability
2. Income Taxes
3. Employee benefits
4. Indemnification assets
5. Reacquired Rights
6. Intangible Assets
7. Share based payment transactions
8. Assets held for sale
9. Operating Lease
10. Assembled Workforce
11. Unearned Revenue

1. **Contingent Liability :**

AS per Ind AS – 103

The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if-

- it is a present obligation
- that arises from past events and
- its fair value can be measured reliably.

Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow resources embodying economic benefits will be required to settle the obligation.

Question 22 – Company B

A suit for damages worth Rs.10 Million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligations for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be Rs.2 million.

How would you deal with the above case as per Ind AS – 103.

2. **Income Tax :**

As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax **except** assets and liabilities acquired during business combination. Accordingly, the acquirer shall recognize and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes.

The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.

3. **Employee Benefits :**

The acquirer records the fair value of the obligations for any post retirement obligation as per the principles of Ind AS 19 which is an exception of the general fair value rule.

4. **Indemnification Assets :**

The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability.

For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller

will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset.

The acquirer shall recognize an indemnification asset at the same time that it recognizes the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts

Question 23 – Company A

Company A acquires Company B in a Business Combination. B is being sued by one of its customers for breach of contract The Sellers of B provide an indemnification to A for the reimbursement of any losses greater than Rs.100Lakhs. There are no collectability issues around this indemnification. At the acquisition date, Company A determined that there is a present obligation and the Fair Value of the Obligation would be Rs.250 Lakhs. What will be the accounting for these items?

5. Reacquired Rights :

These are the rights which the acquirer before acquisition may have granted to the acquiree to use certain assets which belongs to the acquirer.

For Example, license to use the brand name, Franchisee rights etc.

It does not matter whether the asset was recorded in the financial statement of the acquirer or not.

If an acquirer acquires an acquiree which had certain rights granted to it by the acquirer then the business combination results in settlement of the rights and accordingly any settlement gain or loss should be considered as a separate transaction form business combination and will be recorded in financial statement of the acquirer.

The acquirer shall measure the value of a reacquired right recognized as an intangible asset on the basis of the remaining contractual term of the related contract without considering the effect of potential renewals.

Question 24 – Nature Limited

Nature Limited is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient ltd is one of the franchisee of Nature ltd and is and operates number of store in south India.

Nature Ltd. decides to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1st April 2002. On the acquisition date, Nature determines that the license agreement reflects current market terms.

6. Intangible Assets :

The acquirer shall record separately from Goodwill, the identifiable intangible acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.

Question 25 – Company A

Company A, FMCG company acquires an online e-commerce company E, with the intention to start doing retailing. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?

Question 26 – A Ltd.

- A Ltd. acquires B ltd. The acquiree has three service contracts to supply certain items to Railways.
- Should this service contract be treated as a separate intangible asset?
- A similar contract requires a cost of Rs.10 Lakhs on tendering, deposits, and other expenses.

Question 27 – X Ltd.

- The acquiree X Ltd. is under acquisition deal with Z Ltd. which is evaluating intangible assets.
- X Ltd, has backlog orders of 100 ton supplies of its product to its customers which is contractual, Z Ltd. will complete the orders.
- Z Ltd. has evaluated that per order profit is Rs.1,00,000 and any competitor will like to spent Rs.2,000 per ton.

Question 28 – The acquiree

The acquiree possesses a show room on operating lease in a prime location of the city @ 1 million rent p.a. for a period of Rs.3 years.
It is a non-cancellable lease. Its current market value is Rs.2 million p.a. Should the acquirer recognize any intangible assets? (Discount factor 10%)

Question 29 – A Ltd.

A Ltd., acquirer, receives supplies from X ltd., the acquiree, under a 5-year agreement. On the date of business combination, there were two years left for the contract. On the date of acquisition, agreed rate is higher than the market rate by Rs.2 million p.a. Find out the amount of separate intangible asset be recognised which related to business combination. Discount rate is 8.5%.

7. Share based payments :

The acquirer shall measure a liability or an equity instrument related to share -based payment transactions of the acquiree or the replacement of an acquiree's share-

based payment transactions with share-based payment award of the Acquirer in accordance with the method of IND AS 102.

8. Assets held for sale :

The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, at fair value less costs to sell in accordance with that Ind AS.

9. Operating Lease :

- Acquiree is a lessee

  The acquirer shall measure no assets or liabilities related to an operating lease in which the acquiree is the lessee except:

  If the **terms of the operating lease are** favorable to the acquirer then it should record an intangible asset and if it is **unfavorable** then it should record a liability.

- Acquiree is the lessor

  If the Acquiree is a lessor then no adjustment is recorded for the asset which is recorded in the financial statements of the acquiree, however, the lease rentals are considered for determining the fair of the assets.

Question 30 – Company B

Company B has entered into certain lease arrangements which were appropriately classified as Finance Leases, based on facts and circumstances as at inception. Company B was acquired by Company A and consequently all the identifiable Net Assets including the Lease Arrangements were taken over by Company A. Based on facts and circumstances as at the acquisition date, Company A determines that the Lease Arrangement meets the criteria for Operating Lease How should Company A classify this Lease?

Question 31 – Motu Ltd.

Motu Ltd acquired chotu Ltd. During the anlysis of the financial statement they discovered that chotu Ltd has an existing lease arrangement where Chotu. is a lessee. The lease term is 5 years and is an operating lease for an office space at a prime location. The remaining lease period under the arrangement is 3 years. Motu Ltd,'s M&A head assess that that: (i) the lease is 'at-market'; and (ii) other market participants would not be willing to pay a premium for it.

The annual rentals are:

Year 1: INR 2,000
Year 2: INR 2,100
Year 3: INR 2,200
Year 4: INR 2,300

Year 5: INR 2,400
Chotu Ltd financial statements include an annual rent expense of INR 2,200 (determined on a straight-line basis) as lease rental increase is not linked to inflation and a deferred rent liability of INR 300 at the acquisition date. Please discuss the treatment of the lease arrangement in the business combination accounting?

10. Assembled Workforce :

The acquirer subsumes into Goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date

An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized separately from goodwill, any value attributed to it is subsumed into goodwill.

11. Unearned Revenue :

Unearned revenue arises because of the application of the revenue recognition criteria applied by the acquiree. It should be evaluated whether there is any obligation on the acquisition date to be fulfilled and accordingly an asset or liability against it should be recorded.

E. MEASURE NON CONTROLLING INTEREST :

For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest (under existing AS it is called as minority interest) in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

- fair value; or
- The present ownership instruments' proportionate share in the recognized amounts of the acquiree's identifiable net assets

Question 32 – RM Ltd.

RM Ltd. Acquires 800 shares of Nisha Ltd. that constitutes 80% of its capital. The Fair Value of shares of Nisha Ltd. was determined at Rs.160 / share. The Fair Value of Net Assets of Nisha Ltd. is determined at 120,000 on the date of Acquisition. Explain how the Non-controlling interest shall be calculated.

Question 33 – Company A

Company A acquired 90% Equity Interest in Company B on 1st April, for a consideration of Rs.85 Crores in a distress sale. Company B did not have any Instrument recognized

in Equity. The Company appointed a Registered Valuer with whose assistance, the Company valued the Fair Value of NCI and the Fair Value of Identifiable Net Assets at Rs.15 Crores and Rs.100 Crores respectively. How should the NCI be measured in this case?

F. DETERMINE GOODWILL OR GAIN FROM BARGAIN PURCHASE :

GOODWILL :

The acquirer shall recognize Goodwill as of the acquisition date measured as the excess of (a) over (b) below:

A. The aggregate of :

- The purchase consideration transferred at acquisition date fair value;
- The amount of any non-controlling interest in the acquiree measured in accordance with this Ind AS ; and
- In a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree.

B. The net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS.

Excess of (a) over (b) results in goodwill. This is recognised as an asset.

However, the excess of (b) over (a) results in a capital reserve.

CALCULATION OF GOODWILL/ Capital Reserve	
Consideration transferred	XXX
Add: Proportionate value of NCI	XXX
Fair value of previously held interest	XXX
Less: Fair value of the identifiable net assets acquired	XXX
GOODWILL / Capital Reserve	XXX

Question 34 – Company A

- Entity A acquired 15% of Entity B in 2009 for Rs.10,000
- In 2010, further acquired 60% stake, Consideration paid for Rs.60,000
- Entity A identifies the net assets of B as Rs.80,000, fair value of 15% shares is Rs.12,500
- Calculate goodwill

Question 35 – Company A

- A Ltd. acquired B ltd. on payment of 50 cr. cash and transferring a retail business, the fair value of which is 30 cr.
- Assets acquired and liabilities assumed in the acquisition is 72 cr. Find out Goodwill.

Question 36 – A Ltd.

A Ltd. purchased 60% shares of B Ltd. paying Rs.1050 million No. of issued capital of B Ltd. is 1 million.

Fair Value of identifiable assets of B Ltd. is Rs.1280 million and that of liabilities is Rs.100 million.

As on the date of acquisition, market price per share of B Ltd. is Rs.1550. Find out goodwill.

Question 37 – Entity A

- Entity A acquired 15% of Entity B in 2009 for Rs 10,000
- In 2010, fair value of shares of entity B is Rs.12,000, thus Rs 2,000 reported under OCI (Other Comprehensive Income)
- In 2010, further acquired 60% stake, Consideration paid for Rs.60,000
- Entity A identifies the net assets of B as Rs.80,000, fair value of 15% shares is Rs.12,500
- Hence, following will be transaferred to P&L
- Gain on disposal of 15% investment (Rs12,500-12,000) 500
- Gain previously reported in OCI (Rs 12,000-10,000) 2,000
- TOTAL - Rs.2,500

Calculate Goodwill.

Question 38 – X Ltd.

X Ltd. acquired Y Ltd. by transfer of its retail division (fair value of which is Rs.360 million) and 10,00,000 equity shares to the previous owners of Y Ltd. Market price of equity share of X Ltd. (par value Rs.10 each) as on the date of acquisition was Rs.350 per share. It was decided to pay the purchase consideration to the liquidator of Y Ltd.

Assets and Liabilities of retail segment of X Ltd.

(Amount in Rs million)

	Carrying Amount	Acquisition date fair value
Equipment	120	130
Inventories	120	150
Receivable	110	110

Trade Payable	30	30

As on the acquisition date assets and liabilities of Y Ltd. were as follows

(Amount in Rs million)

	Carrying Amount	**Acquisition date fair value**
Land and Building	30	50
Plant and Machinery	500	600
Equipment	20	10
Inventories	100	80
Receivable	100	80
Cash and Cash Equivalent	10	10
Total Assets	760	830
Loans	100	100
Trade Payable	30	30
Total Liabilities	130	130
Net Assets	630	700

Find out purchase consideration and goodwill on business combination. Show accounting entry of acquirer for business combination.

BARGAIN PURCHASE :

- In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the net assets value acquired in a business combination exceeds the purchase consideration.
- The acquirer shall recognize the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve.
- The gain shall be attributed to the acquirer and there will no allocation to the non-controlling shareholders.
- A bargain purchase might happen, for example in a business combination that is a forced sale in which the seller is acting under compulsion.

Question 39 – Pineapple Co.

- Pineapple Co. pays 8,000 for acquiring 80% shares of Biscuit Co. The fair value of 20% of non-controlling interest is 1,500 and identifiable net asset are 7,500.
- It also pays 10,000 for acquiring 75% shares of Cake Co. The fair value of 25% of non-controlling interest is 2,500 and identifiable net asset are 13,000.
- It also acquires Dessert Co by paying 5,500 for acquiring 60% shares. The non-controlling interest on the basis of its proportionate interest in identifiable net assets of Dessert Co is 4,750. The net identifiable assets are 2,500.
- Required: Calculate the goodwill / capital reserve in each case.

Question 40 – A Ltd.

- On 1st April 2015, A Ltd. acquires 80 percent of the equity interests of B Ltd., a private company, in exchange for cash of 150 million. Because the former owners of B Ltd. needed to dispose of their investments in the company by a specified date, they did not have sufficient time to market B Ltd. to multiple potential buyers.
- The management of A Ltd. initially measures that the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of Ind AS 103. The identifiable assets are measured at Rs.240 million and the liabilities assumed are measured at 40 million.
- A Ltd. engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in B Ltd. is Rs.45 million.
- The amount of B. Ltd.'s identifiable net assets of Rs.200 million exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. by Rs.5 million.
- Therefore, A Ltd. reviews the procedures it is used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in B Ltd. and the consideration transferred. After that review, A Ltd. decides that the procedures and resulting measures were appropriate. Deferred tax liability arising out of assets acquired Rs.3 million
- Show necessary accounting entry.

Question 41 – Mariplex

Mariplex acquires 75% of shares of Barnlet for $140 million. The identifiable assets are measured at $250 million and the liabilities assumed are measured at $5 million. The valuer appointed by Mariplex determines the fair value of the 25% non-controlling interest in Barnlet as $42 million.

Calculate goodwill/capital reserve by both methods and pass journal entries.

Question 42 – Company RM

Company RM acquired 90% equity interest in Company AJ on 1st April, 2018 for a consideration of Rs.85 crores.

The fair value of Net Assets of AJ was measured at 100 crores.

The fair value of NCI was measured at 15 crores

Required : Find the value at which NCI has to be shown in the financial statements. Calculate goodwill and pass journal entries.

Question 43 – Company RM

Company RM acquires 70% of Company SUSA on 1st April, 2018 for a consideration transferred of Rs.5 million.

Company RM intends to recognize the NCI at proportionate share of fair value of identifiable net assets. With the assistance of suitable qualifies valuation professional RM measures the identifiable net assets of SUSA at Rs. 10 million. RM Performs a review and determines that the business combination did not include any transaction that should be accounted for separately from the business combination.

Required

State whether the procedure followed by RM and the resulting measurement are appropriate or not. Also calculate the bargain purchase gain in the process.

Question 44 – Company A

- Company A and Company B are in power business. Company A holds 25% equity shares of Company B. On November 1, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:
- Consideration: Company A transfers cash of Rs.59,00,000 and issues 1,00,000 shares on November 1. The market price of Company A's shares on the date of issue is Rs.10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition equity capital of Company A.
- Contingent consideration: Company A agrees to pay additional consideration of Rs.7,00,000 if the cumulative profits of Company B exceeds Rs.70,00,000 over the next two years. At the acquisition date, Fair value of such consideration is determined to be Rs.3,00,000.
- Fair Value of NCI was determined at 7,50,000, Fair value of Net Assets at 60,00,000 and Fair value of previously held stake = 20,00,000
- Cost of Acquisition was 1,00,000
- Calculate goodwill or gain from bargain purchase.

Question 45 – A Ltd.

A Ltd has issued equity shares capital of 100 million. On 1/4/2018 H Ltd. acquired 60 million shares of A Ltd. from its shareholders by issuing 2 million shares @ 800 each. Market Price per share of A Ltd. is Rs.27. 50 per share. Fair value of identifiable assets and liabilities of A Ltd. are Rs.3000 million and Rs.500 million respectively. Based on the above information, H Ltd. wishes to recognize a goodwill of 100 million. Advice the company in the light of the requirement of Ind AS 103.

6. OTHER RELATED CONCEPTS :

A. MEASUREMENT PERIOD :

- Ind AS 103 provides a measurement period window wherein if all the required information is not available on the acquisition date then the entity will be requiring to do the purchase price allocation on a provision basis.
- During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date.
- During the measurement period, the acquirer shall also recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date.
- The measurement period shall not exceed one year from the acquisition date.
- Any change i.e. increase and 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.
- After the measurement period ends, any change in the value of assets and liabilities due to an information which existed on the valuation date will be accounted as an error as per Ind AS 8, "Accounting policies, Changes in Accounting Estimates and Errors".

Question 46 – Entity X

Entity X acquired 100% shareholding of Entity Y on 1 April 2001 and had complete the preliminary purchase price allocation and accordingly recorded net assets of INR 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax assets was not recorded due to lack of convincing evidence on the acquisition date. However, on 31st March 2002, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax assets was recorded on the carry forward losses on 31st March 2002. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

B. DETERMINING WHAT IS PART OF THE BUSINESS COMBINATION TRANSACTION :

A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquire (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

- a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- a transaction that remunerates employees or former owners of the acquiree for future services; and

- a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

Question 47 – Progressive Ltd

Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31 March 20X2, Progressive Ltd recognized a INR 10 million liability related to this litigation.
On 30 July 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for INR 500 million.
On that date, the estimated fair value of the expected settlement of the litigation is INR 20 million.

Question 48 – X Ltd.

X Ltd. acquired the business of Y Ltd. for Rs.40 cr. The purchase consideration includes payment for settlement of a law suit against X Ltd. Rs.30 lakhs. In the books of X Ltd. there is provision for the law suit amounting to Rs.40 lakhs. But Y Ltd. did not recognise any asset as it would have led to recognition of a contingent asset.
How should the company recognize the business combination transaction existing relationship? Assume that the tax authority will not allow any tax benefit on this settlement since the payment occurred during negotiation of the business combination.

Question 49 – X Ltd.

X Ltd. plans to acquire Y Ltd. It was identifying assets acquired and liability assumed. The company agrees to pay Y Ltd.'s existing management Rs.10 million for running the business of acquired business for 1 year during the post acquisition period and harmonization of post-acquisition activities.
Should this agreement be treated as a liability assumed in a business combination?

Question 50 – KKV Ltd.

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 10 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:
The EBIDTA margins of the Company after 2 years after the acquisition is 21%
The former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment wil be paid if the former shareholder does not complete the 2 year employement period.

C. ACQUIRER SHARE BASED PAYMENT AWARDS EXCHNAGED FOR AWARDS HELD BY THE ACQUIREE'S EMPLOYEES :

An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. The above share based payment awards will include vested and unvested shares.

The following procedure shall be followed to calculate and account for the same.

Step 1 : Calculate Fair Value of original award on Acquisition Date

Step 2 : Calculate Fair Value of Replacement Award on Acquisition Date

Step 3 : Pre – combination obligation

$$\text{Fair Value of original award} \times \frac{\textit{Vesting Period Completed}}{\textit{Higher of Original Vesting or New Vesting Period}}$$

Note : The Pre combination obligation will be included in purchase consideration

Step 4 : Post combination remuneration cost = Fair value of replacement award – pre combination obligation (Step 3)

Note : It will be post combination expense and it will be amortized as service cost over the remaining vesting period

Question 51 – Acquirer A Ltd.

Acquirer A Ltd. issues a replacement award under a business combination transaction market based measurement of which under Ind AS 102 is Rs.10 million. The original award of acquiree has a market based measure of Rs.9 million.

Under the replacement awards the employees are not required to provide any further service after the acquisition date, and vesting period has been completed under the acquiree's award.

Should the additional obligation be treated as liability assumed in business combination?

Question 52 – Green Ltd.

Green Ltd. acquired pollution Ltd. as a part of the arrangement Green Ltd. had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of 5 years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

Original awards: INR 500

Replacement awards: INR 600. As of the acquisition date, all awards are expected to vest.

Question 53 – Acquirer A Ltd.

Acquirer A Ltd. issues a replacement award under a business combination transaction, the market based measurement of which under Ind AS 102 is Rs.10 million. The employees are required to render 2 years' service after business combination to be entitled to the awards. The original award of acquiree has a market based measure of Rs.9 million on the date of acquisition, and a vesting period of 5 years which all the employees have completed. Should the additional obligation be treated as liability assumed in business combination? If not allocate the obligation into pre-combination obligation and post-combination remuneration.

Question 54 – Acquirer A Ltd.

Acquirer A Ltd. issues a replacement award under a business combination transaction, the market based measurement of which under Ind AS 102 is Rs.10 million. The employees are required to render 2 years' service after business combination to be entitled to the awards. The original award of acquiree has a market based measure of Rs.9 million on the date of acquisition, and a vesting period of 5 years of which the employees have completed 2 years only. Should the additional obligation be treated as liability assumed in a business combination?

Question 55 – Acquirer A Ltd.

Acquirer A Ltd. issues a replacement award under a business combination transaction, the market based measurement of which under Ind AS 102 is Rs.10 million. The employees are not required to render any service after business combination. The original award of acquiree has a market based measure of Rs.9 million on the date of acquisition, and a vesting period of 5 years of which the employees have completed 2 years only. Should the additional obligation be treated as liability assumed in a business combination?

D. NON REPLACEMENT AWARD :

Sometime the Acquirer does not replace the share based payment Award of the acquirer towards its employees. Such awards will become the part of Non-Controlling Interest.

If the Award is vested – The Share Based Payment Reserve should be credited to NCI

If the Award is not vested – The pre-combination obligation should be credited to NCI. The post combination cost should be debited to Employee cost and credited to NCI

Question 56 – P a real estate

P a real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share based payment scheme but reduced the remaining vesting period from 3 years to 2 years. Company P determines that the market based measure of the award at the acquisition date is INR 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102)

Question 57 – Wish Co.

On 1 April 2019 Wish Co. buys 80% shares for Rs.20,000 of Dish Co. Details of Dish Co at 31 March 2019 are:

Ordinary Share	Rs.20,000
Retained Earnings	Rs.2,000
The fair value of the non-controlling interest is	Rs.5,000

Account for the acquisition for Wish Co. applying both the methods of non-controlling interest.

Question 58 – X Ltd.

X Ltd. acquired the business of Y Ltd. comprising of all assets and liabilities excepting cash. Assets of the acquiree comprise of Tangible Fixed Assets Rs.100 million, Intangibles Assets 10 million Inventories 30 million, Trade receivables 30 million, Trade payables 30 million and loans 40 million. Trade receivables include amount due from X Ltd. 10 million. X Ltd. pays 130 million as purchase consideration.

Fair value of Assets and Liabilities : Tangible Fixed Assets 130 million, Intangible Assets 12 million, Inventories 25 million and Trade receivables excluding amount due from X Ltd. 18 million, Trade payables 30 million and Loan 40 million.

Tax base for tangible assets and intangible asset are 80 million and intangible asset 5 million respectively. Assume that for taxation purpose the tax base of the acquiree will apply. Tax benefit will be available on write down of inventories and trade receivables of the acquiree when actually expensed. Deferred tax assets or liabilities are measured applying effective tax rate of 25%.

X Ltd. agrees to pay the Managing Director of Y Ltd. a salary of 10 million p.a. during the post-acquisition period for a term of 1 year to oversee smooth merger of the business of Y Ltd. along with the businesses of X Ltd. It is proposed to include this obligation as part of business Combination. The purchase consideration of 130 includes 10 million.

Show accounting entries for business combination.

Question 59 – RM Ltd.

RM Ltd acquires 80% of Nisha Ltd for Rs. 60,000. The Asset of Nisha Ltd. at the date of Acquisition were 62,500.
In the year following the acquisition, but within 12 months of the acquisition date, it was identified that the value of land was 2,500 greater than that recognized on the acquisition date.
Calculate goodwill on the date of acquisition and accounting treatment on revaluation of land during measurement period?
udes 10 million.
Show accounting entries for business combination.

Question 60 –

Scenario 1 : New information on Fair Value of an Acquired Loan
Bank R Acquires Bank M in a business combination in Oct 2001. The loan by bank M to borrower B is recognized at its provisionally determined fair value. In Dec 2001, R receives borrowers B financial statements for the year ended sept 2001, which indicates significant decrease in borrowers B income from operations. Basis of this, the fair value of loan to B at the acquisition date is determined to be less than the amount recognized earlier on a provisional basis.
Scenario 2 : Decrease in fair value of acquired loan resulting from an event occurring during the measurement period.
Bank R acquires Bank M in a business combination in Oct 2001. The loan by Bank M to Borrower B is recognized at its provisionally determined fair value. In Dec 2001, R receives information that borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's Operations.
Required comment on the treatment done by Bank R.

Question 61 – Price Ltd.

Price Ltd. Holds 30% shares in Crown Ltd. which was acquired on 15/7/2014 at a cost of 200 million.
On 1st April 2017, Prince Ltd. acquired another 30% stake of Crown Ltd. for Rs.350 million. As on date of acquisition, fair value of identifiable assets and liabilities of Crown Ltd. were determined as Rs.1200 million and Rs.200 million respectively. Market price of previously held 30% interest is Rs.330 million. How should Prince Ltd. recognize the acquisition of controlling stake in Crown Ltd.?

7. SUBSEQUENT MEASUREMENT AND ACCOUNTING :

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, this Ind AS provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

a. reacquired rights;
b. contingent liabilities recognized as of the acquisition date;
c. indemnification assets; and
d. Contingent consideration.

Reacquired Rights :

A reacquired right recognized as an intangible asset shall be amortized over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Contingent Liabilities :

After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognized in a business combination at the higher of:

A. the amount that would be recognized in accordance with Ind AS 37; and
B. the amount initially recognized less, if appropriate, the cumulative amount of income recognized in accordance with the principles of Ind AS 18, Revenue from Contracts with Customers.

Indemnification Assets :

At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognized at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectability of the indemnification asset. The acquirer shall derecognize the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Question 62 – Sun Ltd.

- Sun Ltd. Has completed negotiation with Sky Ltd. for acquiring its business. Sun Ltd. agrees to issue 1 crore of its own shares to the shareholders of Sky Ltd. in exchange of their holdings. It also agrees to issue additional shares if prescribed revenue targets from the business of Sky Ltd. are met during the first year of post-combination operation.
- Fair value of identifiable assets and liabilities of Sky Ltd. is Rs.100 crores and Rs.20 crores respectively. On the date of acquisition, market price of Sun Ltd.'s share is Rs.100. Discount rate is 11%.

Revenue Target	Additional shares to be issued	Probability
Upto Rs.100 cr.	Nil	20%
More than 100 cr. upto Rs.150 cr	20,00,000	40%
More than 150 cr. upto Rs.200 cr	25,00,000	40%

1. How should the arrangement to issue shares be classified?
2. Find out Goodwill.

Question 63 – Kappa

- Kappa is an entity that regularly purchases subsidiaries. Kappa prepares financial statements to 30 September each year.
- On 30th June 2005 the entity acquired all the 100 million equity shares of Lambda by issuing one share in Kappa for every two shares acquired in Lambda. On 30th June 2005 the market value of a Kappa share was Rs.5.40 and the market value of Lambda share Rs.2.70.
- The directors of Lambda prepared a balance sheet as at 30th June 2005 and the net assets of Lambda that were included were measured at Rs.180 million (their fair values at that date). The directors of Kappa noted that the following assets of Lambda had not been included in the draft balance sheet prepared by the directors:
- Internally developed brands having an identifiable fair value of Rs.10 million at 30th June 2005.
- The value of future services of existing employees that was estimated to have a value of Rs.15 million at 30th June 2005.
- Required:
- Calculate the goodwill arising on initial consolidation of Lambda at 30th June 2005 and explain how its carrying amount at 30th September 2005 would be measured.

8. COMMON CONTROL TRANSACTION INCLUDING MERGERS :

Definitions :

- Transferor means an entity or business which is combined into another entity as a result of a business combination.
- Transferee means an entity in which the transferor entity is combined.
- Reserve means the portion of earnings, receipts or other surplus of an entity (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation.
- Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Examples of Common Control Transactions

A. Merger between fellow subsidiaries

B. Merger of subsidiary with parent

C. Acquisition of an entity from an entity within the same group

D. Bringing together entities under common control in a corporate legal structure

Question 64 – Company X

Company X, the ultimate parent of a large number of subsidiaries, reorganizes the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganization, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X's shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y.

Question 65 –

Company Long holds 100% of short. Short holds 60% of Fat. Company Long buys share of Short in Fat. Is this transaction classified as common control.

Accounting for Common Control Business Combinations :

Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

The pooling of interest method is considered to involve the following:

A. The assets and liabilities of the combining entities are reflected at their carrying amounts.

B. No adjustments are made to reflect fair values, or recognize any new assets or liabilities. The only adjustments that are made are to harmonies accounting policies.

C. The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

D. The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

E. The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

F. The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination.

G. The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

"The acid test in assessing common control transaction is that before and after the reorganization the entity should be controlled by the same shareholders."

Question 66 – Enterprise Ltd.

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.
On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was:

(Rs in Crores)

		Laptops	**Mobiles**	**Total**
Fixed Assets cost		250	500	750
Depreciation		(225)	(400)	(625)
Net Assets	(A)	25	100	125
Current Assets:		200	500	700
Less: Current Liabilities		(25)	(400)	(425)
	(B)	175	100	275
Total	(A+B)	200	200	400
Financed by:				
Loan Funds		-	300	300
Capital: Equity Rs.10 Each		25	-	25
Surplus		175	(100)	75
		200	200	400

Division Mobiles along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise ltd was holding 52% shareholding of the Company.
Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

Question 67 – AB Ltd.

AB Ltd. has 2 divisions - A and B. The balance sheet as at 31st October 2017 was as under:

(in Crores)

	A	**B**	**Total**
Fixed assets			
Cost	600	300	900
Depreciation	(500)	(100)	(600)
W.D.V.	100	200	300
Net current assets			
Current assets	400	300	700
Less : Current liabilities	(100)	(100)	(200)

Net Current assets	300	200	500
Total	**400**	**400**	**800**
Financed by:			
Loan funds	–	100	100
(Secured by a charge on fixed assets)			
Own funds :			
Equity capital			50
(Fully paid up Rs.10 shares)	?		
Reserves and surplus		?	650
Total	**400**	**400**	**800**

It is decided to form a new company B Ltd., to take over the assets and liabilities of B division.

Accordingly B Ltd. was incorporated to take over at balance sheet figures, the assets and liabilities of that division. B Ltd. is to allot 5 crores equity shares of Rs.10 each in the company to the members of AB Ltd., in full settlement of the consideration. The members of AB Ltd. are therefore to become members of B Ltd. as well without having to make any further investment.

1. You are asked to pass journal entries in relation to the above in the books of AB Ltd. and B Ltd. Also show the balance sheets of the 2 companies as on the morning of 1st November, 2017, showing corresponding previous year's figures.
2. The directors of the 2 companies, ask you to find out the net asset value of equity shares pre and post demerger.
3. Comment on the impact of demerger on "shareholders wealth".

Question 68 – Z Ltd.

The balance sheet of Z Ltd. as at 31st March, 2018 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

(All amounts in crores of Rupees)

	S Division	**W Division**	**Total**
Fixed assets : Cost			
	875	249	
Less: Depreciation	360	81	
Written-down value	515	168	683
Investments			97
Net Current assets:			
Current assets	445	585	
Less: Current liabilities	(270)	(93)	
	175	492	667
			1,447
Financed by : Loan funds			
		15	417

Own funds			
Equity share capital: Shares of Rs.10 each			345
Reserves and surplus			685
			1,447

Loan funds included, inter alia, bank loans of Rs.15 crore specifically taken for W Division and debentures of the paid up value of Rs.125 crore redeemable at any time between 1st October, 2017 and 30th September,2018. On 1st April, 2018 the company sold all of its investments for Rs.102 crore and redeemed all the debentures at par, the cash transactions being recorded in the bank account pertaining to S division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs.900 crore divided into shares of Rs.10 each. All the assets and liabilities pertaining to W division were transferred to the newly formed company; Y Ltd allotting to Z Ltd's shareholders its two fully paid equity shares of Rs.10 each at par for every fully paid equity share of Rs.10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs.218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to:

1. Show the journal entries in the books of ZLtd.
2. Prepare Z Ltd's balance sheet immediately after the demerger and the initial balance sheet of Y Ltd. (Schedules in both cases need not be prepared).
3. Calculate the intrinsic value of one share of Z Ltd. immediately before the demerger and immediately after the demerger; and
4. Calculate the gain, if any, per share to the shareholders of Z Ltd. arising out of the demerger.

Question 69 – Maxi Mini Ltd.

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

	Maxi Division	Mini Division	Total (in crores)
Fixed Assets:			
Cost	600	300	900
Depreciation	(500)	(100)	(600)
W.D.V. (A)	100	200	300
Net Current Assets:			
Current Assets:	400	300	700
Less: Current liabilities	(100)	(100)	(200)
(B)	300	200	500
Total (A+B)	**400**	**400**	**800**
Financed By:			
Loan Funds (A)	-	100	100
(Secured by a charge on Fixed assets)			

Own funds:			
Equity Capital			50
(fully paid up Rs.10 per share)			
Reserves and Surplus			650
(B)	?	?	700
Total (A+B)	**400**	**400**	**800**

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

- Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of Rs.10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.
  - a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.
  - b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.
  - c) Comment on the impact of demerger on "shareholders wealth".

Question 70 – AX Ltd.

AX Ltd. and BX Ltd. amalgamated on and from 1st Jan, 2002. A new company ABX Ltd. was formed to take over the business of the existing companies.

Summarized Balance sheet as on 31-12-2001

Rs. In '000

	Note No	AX Ltd.	BX Ltd.
Assets			
Non-Current Assets			
Property, Plant and Equipment		8500	7500
Financial Assets - Investments		1050	550
Current Assets			
Inventory		1250	2750
Trade Receivables		1800	4000
Cash and Cash Equivalent		450	400
TOTAL		**13050**	**15200**
Equity and Liabilities			
Equity			
Equity share capital (FV 10)		5500	7000
Other equity		3550	2700
Liabilities			

Non-current Liabilities			
Financial Liabilities – Borrowings		3000	4000
Current Liability			
Trade Payable		1000	1500
TOTAL		**13,050**	**15,200**

ABX issued requisite number of equity shares to discharge the claims of the equity shareholders of the transferor companies

Prepare a note showing purchase consideration and discharge thereof and draft the balance sheet of ABX Ltd.

A. Assuming that both the entities are under common control

B. Assuming BX ltd is a larger entity and their management will take the control of the entity. The fair value of the net assets of AX and BX limited are as follows

Assets	**AX Ltd**	**BX Ltd**
Fixed Assets	9500	1000
Inventory	1300	2900
Fair value of the business	11000	14000

C. The details of other Equity is as follows

	AX	**BX**
General Reserve	2000	2000
Profit and Loss A/c	1000	500
Investment Allowance Reserve	500	100
Export Profit Reserve	50	100
Total	3550	2700

Question 71 – Diverse Ltd.

The following is the balance sheet of Diverse Ltd. as on 31st March, 2018.

(Rs. in crores)

		Rs.	**Rs.**
Sources of funds:			
Shareholders' funds			
Share capital			
Equity shares of Rs.10 each fully paid in cash		250	
Reserves and surplus (Revenue)		1350	1,600
Loan funds			
Secured against: (a) Fixed assets	Rs.300 Cr.		
(b) Working capital	Rs.100 Cr.	400	
Unsecured		600	1,000
			2,600
Employment of funds			
Fixed assets			
Gross block		800	
Less : Depreciation		-200	600

Investment at fair value Net current assets: Current assets Less : Current liabilities		3,000 -2,000	1000 1,000
			2,600

Capital commitments : Rs.700 crores.

The company consists of 2 divisions.

1. Established division whose gross block was Rs.200 crores and net block was Rs.30 crores; current assets were Rs.1,500 crores and working capital was Rs.1,200 crores; the entire amount being financed by shareholders'funds.
2. New project division to which the remaining fixed assets, current assets and current liabilities related.

The following scheme of reconstruction was agreed upon.

1. Two new companies Sunrise Ltd. and Khajana Ltd. are to be formed. The authorised capital of Sunrise Ltd. is to be Rs.1,000 crores. The authorised capital of Khajana Ltd. is to be Rs.500 crores.
2. Khajana Ltd. is to take over investments at Rs.800 crores and unsecured loans at balance sheet value. It is to allot equity share of Rs.10 each at par to the members of Diverse Ltd. in satisfaction of the amount due under the arrangement.
3. Sunrise Ltd. is to take over the fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which Diverse Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of Rs.10 each as consideration to Diverse Ltd. Sunrise Ltd. made an issue of unsecured convertible debentures of Rs.500 crores carrying interest at 15% per annum and having a right to convert into equity shares of Rs.10 each at par on 31.3.2022. This issue was made to the members of Sunrise Ltd. as a right who grabbed the opportunity and subscribed in full.
4. Diverse Ltd. is to guarantee all liabilities transferred to the 2 companies.
5. Diverse Ltd. is to make a bonus issue of equity shares in the ratio of one equity share for every equity share held by making use of the revenue reserves.
6. None of the shareholders hold more than 50% and are not related to each other.

Assume that the above scheme was duly approved by the Honorable High Court and that there are no other transactions. Ignore taxation.

You are asked to:

1. Pass journal entries in the books of Diverse Ltd., and
2. Prepare the balance sheets of the three companies

Asset Swap

A. It entails simultaneous divesting and acquiring each other's business units by 2 companies

B. The difference in valuation is settled in cash/Equity shares/loans

Question 72 – Ksha Ltd. and Yaa Ltd.

Ksha Ltd. and Yaa Ltd. are two companies. On 31st March, 2018 their Balance Sheets were as under:

(Rs.in crores)

	Ksha Ltd.		Yaa Ltd.	
Sources of funds				
Share capital				
Authroised :		500		500
Issued: Equity shares of Rs.10 each fully paid up				
Reserves and surplus		300		200
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	10	750	5	450
Owner's funds		1,050		650
Loan funds		250		350
Total		**1,300**		**1,000**
Fund's employed in:				
Fixed assets :				
Cost	1,000		700	
Less : Depreciation	(400)	600	(300)	400
Net Current assets :				
Current assets	2,000		1,500	
Less : Current liabilities	(1,300)	700	(900)	600
		1,300		**1,000**

Ksha Ltd. has 2 divisions - very profitable division A and loss making division B. Yaa Ltd. similarly has 2 divisions-very profitable division B and loss making division A. The two companies decided to reorganise. Necessary approval's from creditors and members and sanction by High Court have been obtained to the following scheme.

1. Division B of Ksha Ltd. which has fixed assets costing Rs.400 crores (written down value Rs.160 crores). Current assets Rs.900 crores current liabilities Rs.750 crores and loan funds of Rs.200 crores is to be transferred at Rs.125 crores to Yaa Ltd.
2. Division A of Yaa Ltd. which has fixed assets costing Rs.500 crores (depreciation Rs.200 crores), current assets Rs.800 crores current liabilities Rs.700 crores and loan funds Rs.250 crores is to be transferred at Rs.140 crores to Ksha Ltd.
3. The difference in the two consideration is to be treated as loan carrying interest at 15% per annum.
4. The directors of each of the companies revalued the fixed assets taken over as follows:
   i. Division A of Yaa Ltd. taken over: Rs.325 crores.
   ii. Division B of Ksha Ltd. taken over : Rs.200 crores.

All the other assets and liabilities are recorded at the balance sheet values.

A.	The directors of both the companies ask you to prepare the balance sheets after reconstruction (showing the corresponding figures before reconstruction)
B.	Master Richie Rich, who owns 50,000 equity shares of Ksha Ltd. and 30,000 equity shares of Yaa Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above reorganization.

9. REVERSE ACQUISITION :

We have already studied the basic of Reverse Acquisition, let us consolidate your understanding on the same. Let me help you with the simple example.

B Ltd. a small sized firm acquires A Ltd. B Ltd has 1,00,000 shares issued and existing. To acquire A Ltd. it issues further 10,00,000 to the shareholders of A Ltd.
Now if we study carefully, B Ltd. has total issued capital of 11,00,000 shares out of which 10,00,000 are held by shareholders of A Ltd. Therefore it A Ltd. which will control B Ltd.

B Ltd. is legal Acquirer but is accounting Acquiree
A Ltd. is legal Acquiree but is accounting Acquirer

To Account for Reverse Acquisition, following steps should be followed

Step 1 : Identify Reverse Merger

Step 2 : Calculate the purchase consideration as per reverse acquisition. How much the legal Acquiree (Accounting Acquirer) would have paid for acquisition.

Step 3 : Calculate goodwill/capital reserve

PC as per Reserve Acquisition (Step 2)	XX
Less : Net Assets taken over by Accounting Acquirer	XX
Goodwill / Capital Reserve	XX

Step 4 : Prepare Financial Statements

Note : Financial statements should be prepared in the name of Legal Acquirer.

Step 5 : Consolidated Equity Instrument

Total Equity = Equity for the Accounting Acquirer + Consideration (Step 2)

Step 6 : Consolidated retained earnings will comprise of legal subsidiary (Accounting Acquirer) only.

Step 7 : Consolidated Assets and Liabilities

Accounting Acquirer = At Carrying Amount
Accounting Acquiree = At Fair Value (Revised Values)

Question 73 – Entity A

On September 30, 2001 Entity A issues 2.5 shares in exchange for each ordinary shares of Entity B. All the B's shareholders exchange their shares. Issued share capital of Entity shows 60 ordinary shares.

The fair value of each ordinary share of Entity B at September 30, 2001 is 40. The Quoted market Price of Entity A's ordinary shares at that date is 16.

The fair values of Entity A identifiable assets and liabilities at September 30, 2001 are the same their carrying amounts, except that the fair value of Entity A's non – current is 1500.

The Statement of financial position of Entity A and Entity B immediately before the business combination are

	Entity A	**Entity B**
Current Assets	500	700
Non-Current Assets	1300	3000
Total Assets	1800	3700
Current Liabilities	300	600
Non-Current Liability	400	1100
Total Liabilities	700	1700
Shareholders' Equity		
Retained Earnings	800	1400
100 ordinary shares	300	
60 ordinary shares		600
Total Shareholders' Equity	1100	2000
Total Liabilities and Equity	1800	3700

Prepare the balance sheet immediately after Business combination?

Thanks ....

CHAPTER

2

IND AS 110 – CONSOLIDATION OF FINANCIAL STATEMENTS

CONCEPTS COVERED

1. INTRODUCTION
2. FROM AS TO IND AS
3. SCOPE
4. DEFINITIONS
5. CONCEPT OF CONTROL
6. ASSEMENT OF CONROL
7. ACCOUNTING FOR SUBSIDIARIES
8. CONSOLIDATION OF BALANCE SHEET
9. CONSOLIDATION OF PROFIT AND LOSS STATEMENT
10. CONSOLIDATION OF CASH FLOW STATEMENTS
11. CHANGES IN SHARE OF NON CONTROLLING INTEREST
12. LOSS OF CONTROL
13. SELF PRACTICE QUESTIONS

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1. INTRODUCTION :

The objective of this IND AS is to establish principles for the presentation and preparation of Consolidated financial Statements when an entity controls one or more other entities.

This Standard defines control for all entities that could be consolidated.

This standard does not deal with accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination.

2. FROM AS TO IND AS :

Under the Companies (Accounting Standards) Rules 2006, the following accounting standards provided guidance on preparation of consolidated financial statements:

1. Accounting Standard (AS) 21 : Consolidated Financial Statements
2. Accounting Standard (AS) 23 : Accounting for Investments in Associates in Consolidated Financial Statements
3. Accounting Standard (AS) 27 : Financial Reporting of Interests in Joint Ventures

Under Ind AS, the guidance is much more detailed. As per the Companies (Indian Accounting Standards) Rules 2015, the following accounting standards provides guidance on preparation of consolidated financial statements:

1. Indian Accounting Standard (Ind AS) 110 : Consolidated Financial Statements
2. Indian Accounting Standard (Ind AS) 111 : Joint Arrangements
3. Indian Accounting Standard (Ind AS) 112 : Disclosure of Interests in Other Entities
4. Indian Accounting Standard (Ind AS) 27 : Separate Financial Statements
5. Indian Accounting Standard (Ind AS) 28 : Investments in Associates and Joint Ventures

Note :

1. The focus in Ind AS is on substance over form
2. The objective of Ind AS 110, Consolidated Financial Statements, is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities.
3. The objective of Ind AS 111, Joint Arrangements, is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (Joint arrangements).
4. The objective of Ind AS 112, Disclosure of Interests in Other Entities, is to require an entity to disclose information that enables users of its financial statements to evaluate.
5. The objective of Ind AS 27, Separate Financial Statements, is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.
6. The objective of Ind AS 28, Investments in Associates & Joint Ventures, is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates & joint ventures.

3. SCOPE :

A parent who controls one or more entities is required to present consolidated financial statements

However, a parent is not required to present consolidated financial statements if it meets all of the following four conditions

1. The parent is either a wholly owned subsidiary or a partially owned subsidiary of another entity. Further its other owners (including those not entitled to vote) have been informed and do not object, to the parent not presenting the consolidated financial statements.

2. The equity instruments or the debt instruments of the parent are not traded in a public market. The public market could be a domestic or foreign stock exchange or an over the counter market including local and regional markets.

3. The parent has neither filed nor is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

4. The ultimate or any intermediate parent, of the parent (that is required to present consolidated financial statements), produces financial statements that are available for public use and comply with Ind AS, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.

Further, a parent who fulfils the following two conditions is also not required to present consolidated financial statements:

1. The parent is an investment entity
2. The parent is required to measure all its subsidiaries at fair value through statement of profit or loss.

Refer to Question 1, 2

4. DEFINITIONS :

1. **Consolidated financial statements :**
   Consolidated financial statements are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

2. **Control of an investee :**
   An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

3. **Group :**
   A parent and its subsidiaries.

4. **Parent :**

An entity that controls one or more entities.

5. **Subsidiary :**

An entity that is controlled by another entity.

6. **Non–controlling interest :**

Equity in a subsidiary not attributable, directly or indirectly, to a parent.

7. **Power :**

Existing rights that give the current ability to direct the relevant activities.

8. **Relevant activities :**

For the purpose of this Ind AS, relevant activities are activities of the investee that significantly affect the investee's returns.

9. **Substantive rights :**

Substantive rights are those rights that an investor holds that gives it current ability to direct the investee's relevant activities. In order for a right to be substantive, the holder must have the practical ability to exercise the right.

Examples of substantive rights:

Voting rights held by the majority shareholder giving it the current ability to unilaterally direct relevant activities.

10. **Protective rights :**

Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

An investor that only holds protective rights, which meet this definition, has no power over an investee and consequently does not control the investee.

Examples of protective rights are:

- A lender's right to restrict borrower's activities (if these could change credit risk significantly to the detriment of the lender)
- Capital expenditure greater than that required in the ordinary course of business requiring approval by non-controlling interest holders
- Issue of debt or equity instruments requiring approval by non-controlling interest holders
- A lender's right to seize assets of a borrower in the event of default.

11. **Separate financial statements :**

Separate financial statements are those presented by a parent (i.e an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an

investee, in which the investments are accounted for at cost or in accordance with Ind AS 109, Financial Instruments.

12. **Significant influence :**
Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

13. **Associate :**
An associate is an entity over which the investor has significant influence.

14. **Equity method :**
The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

15. **Joint control :**
Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

5. CONCEPT OF CONTROL :

As per Ind AS 110, consolidation of an investee shall begin from the date the investor (parent) obtains **CONTROL** of the investee (subsidiary);

Thus:

1. Parent (Investor) is an entity that controls one or more entities;
2. Subsidiary (Investee) is an entity that is controlled by another entity;

CONTROL

An investor controls an investee if and only if the investor has all the following 3 elements:

1. Power over the investee;
2. Exposure, or rights, to variable returns from its involvement with the investee; and
3. The ability to use its power over the investee to affect the amount of the investor's returns.

POWER | RIGHTS TO VARIABLE RETURNS | ABILITY TO USE THE

POWER :

1. An investor has power over an investee when the investor:
   - has existing rights
   - that give it the current ability

- to direct relevant activities (activities that significantly affect the investee's returns).

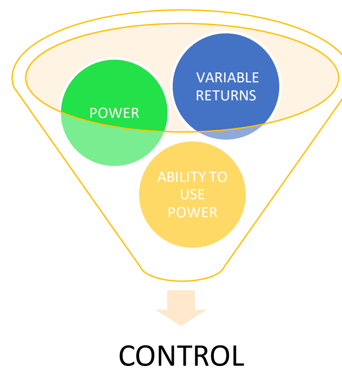
2. In simple situations, control can be demonstrated through voting rights. If an entity controls over 50% of voting rights, entity controls the investee;
3. However, in complex situations, voting rights may not be the sole indicator. As required by Ind AS, the principle of substance over form shall prevail.

EXPOSURE TO VARIABLE RETURNS :

1. An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement can vary because of investee's performance. The returns can be only positive, only negative or both positive and negative.
2. Even though only one investor can control the investee, more than one party can share the returns of an investee, such as holders of non – controlling interests.

ABILITY TO USE THE POWER :

1. An investor should, in addition to power and exposure to variable returns, have the ability to use the power to affect its return from the investee for determining control.
2. There could be a situation when a person (agent) may have the decision making rights in an investee and its remuneration is also based on the performance of the investee but it may be acting on behalf of another person (principal). In this situation, the agent does not control an investee.



6. ASSEMENT OF CONTROL

The following seven steps should be adopted to assess control. Steps 1 to 5 assist in establishing whether an investor has power over the investee. Step 6 discusses the exposure to variable returns whereas step 7 deliberates on link between power & returns.

1. What is the purpose of the investee?
2. What is the design of the investee?
3. What are the relevant activities of the investee that significantly affect its returns?
4. How decisions about the relevant activities are made?
5. Whether the decision maker is empowered and has the right to take those decisions?
6. The investor should examine whether it is exposed to or have variable returns from its involvement with the investee.
   Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative.
7. Link between power & variable returns.

This step needs examination whether the investor can use its power to impact the variable returns. If so, this condition is also satisfied.

STEP 1 : PURPOSE OF INVESTEE :

It should be determined that why the investee has been formed or incorporated? What is the purpose and objective of the investee? Whether it has been incorporated to implement a vertical or a horizontal expansion program of the investee? Whether the purpose is to enter into a new line of business? Whether it has been formed to comply with a particular regulatory requirement? What is the purpose to enter into collaboration with other entities or persons?

STEP 2 : DESIGN OF INVESTEE :

One has to look at the structure.

- Is it a firm, trust, listed company, public company, private company, society, SPV etc?
- Is it controlled through voting rights, shareholders' agreements, convertible instruments, contractual arrangements, exposure to risks & rewards?
- Who takes the decision for the design?

STEP 3 : RELEVANT ACTIVITIES :

Relevant activities are the range of operating and financing activities that significantly affect the investee's returns such as (the list is not exhaustive):

- Selling and purchasing of goods & services;
- Managing financial assets during their life;
- Selecting, acquiring or disposing of assets;
- Researching and developing new products or processes;
- Determining a funding structure or obtaining funding;
- Appointment, remuneration and termination of key managerial person.

Refer to Question 3

STEP 4 : DECISION MAKING PROCESS OF RELEVANT ACTIVITIES :

After having identified the relevant activities that significantly impact the investee's return, the next step is to determine how decision about the particular relevant activity is taken and what the process of making the decision is. Thus in step 4, it is identified, 'Who is the decision maker'.

Refer to Question 4, 5

STEP 5 : IS THE DECISION MAKER EMPOWERED AND HAS THE RIGHT TO TAKE THOSE DECISIONS:

1. In step 4, it was identified, 'Who takes the decisions about the relevant activities? It could be the shareholders. It could be the Board of Directors. It could be a contractually appointed person. But the question arises here is that whether the decision maker is empowered?

   In simple situations, the answer may be evident but there are complex situations. Whether the person taking the decision is a principal or infact an agent of the investor; this needs

to be examined or the decision making was inherent in the purpose & design of the investee.
The test is - who has the power?

2. Power arises from rights. Here the rights of the investor have to be examined. The investor should have the **current** ability to direct the relevant activities.

3. **The rights of the investor could be substantive rights or protective rights.** It is a matter of judgment which shall take into consideration all the facts and circumstances. Only substantive rights are to be considered.

Refer to Question 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17.

STEP 6 : WHETHER INVESTOR HAS EXPOSURE, OR RIGHTS, TO VARIABLE RETURNS FROM AN INVESTEE?

The investor should examine whether it is exposed to or have variable returns from its involvement with the investee. Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative. An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns.

Step 7: Is there a link between power & returns?

There should be link between the power and return, ie the investor should have the ability to exercise the power to vary the returns

Refer to Question 18, 19 , 20 , 21, 22, 23.

7. ACCOUNTING FOR SUBSIDIARIES :

Ind AS 110, ' Consolidation of Financial Statements' and Division II of Schedule III of companies Act 2013, should be applied for preparation and presentation of CFS, which includes

1. Consolidated Balance Sheet
2. Consolidated Statement of Profit and Loss A/c
3. Consolidated Statement for Changes in Equity
4. Consolidated Cash Flow Statement
5. Consolidated Notes to Financial Statements

PROCESS :

1. Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.

2. Consolidated financial statements:
   - combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

- offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Ind AS 103 'Business Combination' explains how to account for any related goodwill).
- eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).

3. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.

4. Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Non-Controlling Interest :

It Can be measured at FV or At Prop Share in Net Assets (Ind AS 103).

(Refer to Question no 24, 25)

It shall consist of 3 elements

a. On the date of Acquisition
b. Share in profits after acquisition
c. Share in reserves after acquisition

Calculation of Goodwill / Capital Reserve :

Goodwill should be calculated as Per Ind AS 103.

(Refer to Question no 26, 27, 28, 29, 30, 31, 32)

Acquisition of interest in subsidiaries at different dates :

1. An investor sometimes obtains control of a subsidiary in which it held an equity interest immediately before the acquisition date. Ind AS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.

2. In a business combination achieved in stages, the investor (parent) shall re-measure its previously held equity interest in the investee (now subsidiary) at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

3. In prior reporting periods, the investor (parent) may have recognized changes in the value of its equity interest in the investee in other comprehensive income. If so, the amount that was recognized in other comprehensive income shall be recognized on the same basis as would be required if the investee (parent) had disposed directly of the previously held equity interest.

(Refer to Question no 33, 34)

UNIFORM ACCOUNTING POLICIES :

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies

Refer to Question no 35

REPORTING DATE :

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date.

When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

8. CONSOLIDATION OF BALANCE SHEET :

PROFIT OR LOSS OF SUBSIDIARY COMPANIES

An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date.

An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non -controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. (As per AS 21 – if the share of minority interest goes negative it should be adjusted against reserve. Once subsidiary

starts making profits, the losses against reserve are adjusted first and then the share starts getting divided in holding and minority)

Refer to Question no 36

Note :

IND AS 110

Any further change in the parent's investment portion in subsidiary not resulting in loss of control will NOT affect Goodwill.

For eg – If RM acquires 70% stake in Nish Ltd and the cost of control was Rs. 50,000 as goodwill. Later RM sells 5% stake in Nish Ltd. The value of goodwill will not change.

Reasons :

1. When control is obtained on the acquisition date, the parent is able to control the entire economic resources of the entity
2. Further investments, or further sale will only increase/decrease the share in profits and will not bring any new asset under the control of the parent company.

AS 21

If the holding dilutes the stake in the subsidiary – goodwill will reduce proportionately.

PREPARATION OF CONSOLIDATED BALANCE SHEET :

- When preparing the consolidated balance sheet, assets and outside liabilities of the subsidiary company are merged with those of the holding company.
- Equity share capital and other equity of the subsidiary company are apportioned between holding company and non– controlling interests (erstwhile minority shareholders as per AS 21).
- These items, along with investments of holding company in shares of subsidiary company are not separately shown in consolidated balance sheet.
- The net amounts resulting from various computations on these items, shown as
  - (a) Non - controlling interest
  - (b) Cost of control
  - (c) Holding company's share in post-acquisition profits of the subsidiary company (added to appropriate concerned account of the holding company) are entered in consolidated balance sheet.

As per Ind AS 110, if an entity makes two or more investments in another entity at different dates and eventually obtain control of the other entity the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence.

As per Ind AS 103, goodwill is computed only once when control is obtained. Any previously held interests in the acquiree is fair valued and aggregated with consideration for computation of goodwill / bargain purchase gain.

Refer to Question no 37, 38, 39

INTRA GROUP TRANSACTIONS :

1. **Unrealized profit in inventories (Similar to AS 21) :**
   Where a group entity sells goods to another, the selling entity, as a separate legal entity, records profits made on those sales. If these goods are still held in inventory by the buying entity at the year end, however, the profit recorded by the selling entity, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group. On consolidation, the unrealized profit on closing inventories will be eliminated from the group's profit, and the closing inventories of the group will be recorded at cost to the group.

2. **Unrealized profit on transfer of non-current asset :**
   Similar to the treatment described above for unrealized profits in inventories, unrealized inter-company profits arising from intra-group transfers of Property, Plant and Equipment, Intangible Assets and Investment Property are also eliminated from the consolidated financial statements.

3. **Reversal of Unrealized Losses :**
   Unrealized loss **should not be reversed** unless the transaction is found be suspicious. Concept of prudence shall be applied.

Refer to Question no 40, 41, 42, 43

DIVIDEND RECEIVED FROM SUBSIDIARY COMPANIES (Similar to AS 21) :

Pre – acquisition = Should be credited to Cost
Post – Acquisition = Credited to Profit and Loss A/c

Dividends are recognized in profit or loss by an investor entity only when:

- The entity's right to receive payment of the dividend is established;
- It is probable that the economic benefits associated with the dividend will flow to the entity; and
- The amount of the dividend can be measured reliably.

As per para 12 of Ind AS 27, an entity shall recognize a dividend from a subsidiary in its separate financial statements when its right to receive the dividend is established.

As per the Companies Act, 2013, the entity's right to receive the dividend is established when it is declared by the shareholders in the annual general meeting of the Company.

Refer to Question no 44, 45, 46, 47, 48, 49

Full Consolidation Questions – 50, 51, 52, 53, 54, 55

9. CONSOLIDATION OF PROFIT AND LOSS STATEMENT :

For preparation of Consolidated Profit and Loss Account of holding company and its subsidiaries, the revenue items are to be added on line by line basis and from the consolidated revenue items inter-company transactions should be eliminated. For example, a holding company may sell goods or services to its subsidiary, receives consultancy fees, commission, royalty etc. These items are included in sales and other income of the holding company and in the expense items of the subsidiary. Alternatively, the subsidiary may also sell goods or services to the holding company. These inter-company transactions are to be eliminated in full.

If there remains any unrealized profit in the inventory of good, of any of the group company, such unrealized profit is to be eliminated from the value of inventory to arrive at the consolidated profit.

However, preparation of Consolidated Profit and Loss Account can prove to be a challenge when the fair value of net assets acquired at the acquisition date were different from the carrying amount specified in subsidiary's books. In such a case, the income and expense should be with reference to those fair values plus the values reported by the subsidiary and not simply the values reported by the subsidiary

Refer to Question no 56, 57, 58, 59, 60, 61, 62, 63, 64

10. CONSOLIDATION OF CASH FLOW STATEMENTS :

Same as consolidated Statement of Profit and Loss, the preparation of consolidated cash flow statement is also not difficult. All the items of cash flow from operating activities and financing activities are to be added on line by line basis and from the consolidated items, inter – company transactions should be eliminated.

11. CHANGES IN SHARE OF NON CONTROLLING INTEREST

A parent shall present non-controlling interests in the consolidated balance sheet within equity, separately from the equity of the owners of the parent.

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

Refer to Question no 65, 66, 67, 68

12. LOSS OF CONTROL :

A parent can lose control of subsidiaries in a number of ways. These include:

- Loss of control due to outright sale – where the entire stake is sold off;

- Loss of control due to partial sale – where the parent retains interest as an associate, jointly controlled entity or a financial asset;
- Deemed loss of control where no consideration is received but the parent's interest is diluted in some other manner such as
  - voting rights issued to a new investor;
  - control on relevant activities;
  - consolidation of voting rights of other shareholder's;
  - an investor acquiring substantial stake from the stock exchange.

If a parent loses control of a subsidiary, it shall:

- **Derecognize :**
  - the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
  - the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).
- **Recognize :**
  - the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
  - if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and
  - Any investment retained in the former subsidiary at its fair value at the date when control is lost.
- Reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind ASs.
- Recognize any resulting difference as a gain or loss in profit or loss attributable to the parent.

If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognized in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognized in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

Refer to Question no 69, 70, 71, 72, 73

13. SELF PRACTICE QUESTIONS :

Question 1 – Entity X

Entity X owns the following other entities:

1. 100% interest in entity Y. Entity Y owns 60% interest in entity Z.
2. 80% interest in entity M. Entity M owns 60% interest in entity N.

It is further stated that X is a listed company and prepares Ind AS Compliant consolidated Financial Statement. Entities Y and M do not have their securities publically traded & they are not in the process of issuing securities in public markets. Analyze if Entity Y and M are required to prepare the CFS.

Question 2 –

Analyze how can local regulations affects the preparation of consolidated financial statements?

Question 3 –

Identification of relevant activities

Entity PS Ltd. issues loan notes to investors in Rupees, but it purchases financial assets in Pound Sterling and USD. It hedges cash flow differences through currency and interest rate swaps. What would be its relevant activities?

Question 4 – B Ltd.

B Ltd. and C Ltd. had incorporated BC Ltd. to construct & operate a toll bridge. Construction of toll bridge will take 3 years. B Ltd. is responsible for construction. The toll bridge will be operated by C Ltd. Can it be concluded during the construction phase that when B Ltd. has all the authority to take decision that C Ltd. controls BC Ltd.?

Question 5 – In continuation

In continuation to the facts given in Illustration 2, further if it is given that the toll bridge will be constructed under supervision of NHAI by B Ltd. NHAI will reimburse the cost of construction. B Ltd. is entitled to a margin on the construction but from the cash flows of the toll collection before any payment to C Ltd. The toll revenue will be fixed by C Ltd. who is entitled to management fee. From the toll revenue amount the toll expenses will be paid, then margin will be paid to B Ltd. and then management fee will be paid to C Ltd. The balance will be shared equally by B Ltd. and C Ltd.

Question 6 – In investor

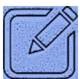
An investor holds a majority of the voting rights in the investee. Does the investor have current ability to direct the relevant activities given the fact that it takes 30 days to hold shareholder's meeting to take decisions regarding relevant activities?

Question 7 – An investor

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. Is the investor's forward contract a substantive right even before settlement of contract? Assuming 30 Day requirement to call meeting.

Question 8 –

If in the illustration given above, the investor's forward contract shall be settled in 6 months instead of 25 days, would existing shareholders have the current ability to direct the relevant activities?



Question 9 – A Limited

Suppose A Limited holds in a listed entity C Limited, optionally convertible debentures which are currently exercisable. C Limited is in loss and it is not likely to be in profits for some time in future. The conversion price is much higher than the listed price. Analyze Substantive Rights.

Question 10 – A Limited

A Limited has 48% of the voting rights of B Limited. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Does A Limited have sufficiently dominant voting interest to meet power criterion?

Question 11 – A Limited

An investor A Limited holds 45% of the voting rights of an investee. Eleven other shareholders, each holding 5% of the voting rights of the investee. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. Can we conclude that investor A Limited has power over the investee?

Question 12 – A Limited

A Limited holds 48% of the voting rights of B Limited. X Limited and Y Limited each hold 26% of the voting rights of B Limited. There are no other arrangements that affect decision-making. Who has power to take decisions in the present case?

Question 13 – Investor A

Investor A holds 40% of the voting rights of an investee and six other investors each hold 10% of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. Is the absolute size of the investor's holding and the relative size of the other shareholdings alone is conclusive in determining whether the investor has rights sufficient to give it power?

Question 14 – An investor

An investor holds 35% of the voting rights of an investee. Three other shareholders each hold 5% of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings — 75% of the voting rights of the investee have been cast at recent relevant shareholders' meetings. Does the investor have ability to direct the relevant activities of the investee unilaterally?

Question 15 – Entity P Ltd.

Entity P Ltd. develops pharmaceutical products. It has acquired 47% of entity S Ltd with an option to purchase remaining 53%. Entity S is a specialist entity that develops latest technology and does research in pharmaceuticals. Entity P has acquired stake in S Ltd. to complement its own technological research. The remaining 53% is held by key management of P Ltd. who are key to running a major project that will market a medicine with features completely new to the industry. However, if P Ltd. exercises the option the management personnel are likely to leave. They have unique technological knowledge in relation to the specific medicine. Option strike price is 5 times the value of entity's share price. Is the option substantive?

Question 16 – AB Ltd.

AB Ltd holds 40% in BC Ltd. CD Ltd holds 60% in BC Ltd. BC Ltd. is controlled through voting rights. AB Ltd. has call option exercisable in next 3 years for further 40% of investee. The option is deeply out of money and is expected to be the same over the life of the option. Further, investor would not gain any non-financial benefits from the exercise of option. Investor CD has been exercising its votes and is actively directing the relevant activities of the investee. Is right of AB Ltd substantive?

Question 17 – Investor A

Investor A and two other investors each hold one third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60% of the voting rights of the investee. Investor A would benefit from realizing synergies if the debt instruments were converted into ordinary shares. Does investor A have power over investee?

Question 18 – A decision maker

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to the investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10% pro rata investment in the fund and receives a market-based fee for its services equal to 1% of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10% investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision -making authority of the fund manager, but can redeem their interests within particular limits set by the fund. Does the fund manager have control over the fund?

Question 19 – The fund manager

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract. Considering the facts given, does the fund manager control the fund?

Question 20 – The fund manager

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract. Does the fund manager in this case control the fund?

Question 21 – The fund manager

The fund manager has a 20% pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20% investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry. Does the fund manager control the fund?

Question 22 – An investee Noor Ltd.

An investee Noor Ltd. is floated to invest in a portfolio of equity oriented mutual funds, funded by fixed rate debentures and equity instruments. The equity instruments will receive any residual returns of the investee. The transaction was marketed to potential debt investors as an investment in a portfolio of asset -backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 15% of the value of the assets purchased by Noor Ltd. A decision maker (the asset manager) of Noor Ltd. manages the portfolio by making investment decisions strictly as per investee's prospectus. For services rendered by manager, receives a fixed fee (i.e. 0.5 percent of assets under management) and performance-related fee (i.e. 2 percent of profits) if profits exceed 10% over & above of previous financial year. The asset manager holds 40 per cent of the equity in the investee. The remaining 60 per cent of the equity, and all the debentures are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors

Question 23 – Aditya Birla Money Ltd.

A decision maker Aditya Birla Money Ltd. (ABML) sponsors a debt oriented mutual fund, which issues its units instruments to unrelated third party investors. The transaction was marketed as an investment in a portfolio of highly AAA rated long-term & medium-term assets with minimal credit risk exposure of the assets in the portfolio. Various transferors sell above long term & medium -term asset portfolios to

the fund. Each transferor services the portfolio of assets that it sells to the fund and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralization of the assets transferred to the fund. The sponsor (ABML) establishes the terms of the fund and manages the operations of the fund for a market-based fee. The sponsor (ABML) approves the sellers permitted to sell to the fund, approves the assets to be purchased by the fund and makes decisions about the funding of the fund. The sponsor is entitled to any residual return of the fund and also provides liquidity facilities to the fund. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the funds fund's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Question 24 – A Limited

A Limited acquires 80% of B Limited at a valuation of Rs 150.00 crores (excluding control premium) by payment in cash of Rs 120.00 crores. Calculate the value of Non-Controlling Interest?

Question 25 –

Assume that the value of recognized amount of subsidiary's identifiable net assets is 130.00 crores, as determined in accordance with Ind AS 103.Determine the Value of NCI.

Question 26 –

Calculate goodwill of taking information from Question no 24 and 25.

Question 27 –

In the aforesaid example, if the consideration is Rs.90 instead of Rs.120.00 crore. Calculate

Question 28 – Ram Ltd.

Ram Ltd. acquires Shyam Ltd. by purchasing 60% of its equity for Rs.15 lakh in cash. The fair value of non-controlling interest is determined as Rs.10 lakh. The net aggregate value of identifiable assets and liabilities, as measured in accordance with Ind AS 103 is determined as 5 lakh.

How much goodwill is recognized based on two measurement bases of non-controlling interest (NCI)?

Question 29 – Seeta Ltd.

Seeta Ltd. acquires Geeta Ltd. by purchasing 70% of its equity for Rs.15 lakh in cash. The fair value of NCI is determined as Rs.6.9 lakh. Management have elected to adopt full goodwill method and to measure NCI at fair value. The net aggregate value of the identifiable assets and liabilities, as measured in accordance with the standard is determined as Rs.22 lakh.

Question 30 – Seeta Ltd.

Continuing the facts as stated in the above illustration, except that Seeta Ltd. chooses to measure NCI using a proportionate share method for this business combination.

Question 31 – X Ltd.

X Ltd. acquired Y Ltd. on payment of Rs.25 crore cash and transferring a retail business, the fair value of which is Rs.15 crore. Assets acquired and liabilities assumed in the acquisition are Rs.36 crore. Find out the Goodwill.

Question 32 – Raja Ltd.

Raja Ltd. purchased 60% shares of Ram Ltd. paying Rs.525 lakh. Number of issued capital of Ram Ltd. is 1 lakh. Fair value of identifiable assets of Ram Ltd. is Rs.640 lakh and that of liabilities is Rs.50 lakh. As on the date of acquisition, market price per share of Ram Ltd. is Rs.775. Find out the value of goodwill.

Question 33 – Entity A

On 31 December 20X1, Entity A holds a 35% non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40% interest in Entity B. When did Entity A gain control over Entity B.

Question 34 – Entity D

Entity D has a 40% interest in entity E. The carrying value of the equity interest, which has been accounted for as an associate in accordance with Ind AS 28 is Rs.40 lakh. Entity D purchases the remaining 60% interest in entity E for Rs.600 lakh in cash. The fair value of the 40% previously held equity interest is determined to be Rs.400 lakh., the net aggregate value of the identifiable assets and liabilities measured in accordance with Ind AS 103 is determined to be identifiable 880 lakh. The tax consequences have been ignored. How does entity D account for the business combination?

Question 35 – PQR Ltd.

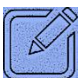
PQR Ltd. is the subsidiary company of MNC Ltd. In the individual financial statements prepared in accordance with Ind AS, PQR Ltd. has adopted Straight-line method (SLM) of depreciation and MNC Ltd. has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per Ind AS 110, Consolidated Financial Statements, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd. prepared as per Ind AS?

Question 36 – A Ltd.

A Ltd. acquired 70% of equity shares of B Ltd. on 1.04.20X1 at cost of Rs.10,00,000 when B Ltd. had an equity share capital of Rs.10,00,000 and other equity of Rs.80,000. In the four consecutive years B Ltd. fared badly and suffered losses of Rs.2,50,000, Rs.4,00,000, Rs.5,00,000 and Rs.1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. experienced turnaround and registered an annual profit of Rs.50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. recorded annual profits of Rs.1,00,000 and Rs 1,50,000 respectively. Show the non - controlling interests and cost of control at the end of each year for the purpose of consolidation.

Assume that the assets are at fair value.



Question 37 – A Ltd.

A Ltd acquired 60% shares in B Ltd on 31.3.2017. BS of A Ltd and B Ltd on that date were:

ASSETS	**A Ltd**	**B Ltd**
Non-Current Assets	175	100
Investments: Shares of B Ltd (60% shares in B Ltd)	75	
Total Assets	**250**	**100**
EQUITY AND LIABILITIES		
Equity		
Ordinary shares	100	50
Retained earnings	150	50
Total Liabilities	**250**	**100**

Prepare CBS.

Question 38 – Black Co.

Black Co. acquired 100% shares in White Co. on 31st December 2015. BS of Black and White on that date were:

	Black Co.		White Co.	
Non-current assets				
Tangible assets		60,000		35,000
Investments: Shares of White Co. (100% shares in White)		30,000		
Loan Stock of White Co.		5,000		
Current assets				
Inventories	10,000		8,000	
Receivables	8,000		9,000	
Cash at Bank	4,000	22,000	-	17,000
Total Assets		**1,17,000**		**52,000**
Equity and Liabilities				
Equity				
Ordinary shares	73,000		16,000	
Retained earnings	30,000	1,03,000	12,500	28,500
Non-current liabilities				
Loan Stock	-			10,000
Current Liabilities				
Bank Overdraft	-		3,000	
Payables	14,000	14,000	10,500	13,500
Total Liabilities		**1,17,000**		**52,000**

Prepare CBS.

Question 39 – P Ltd.

Given below are Balance Sheet of P Ltd. and Q Ltd. as on 31.3.2001

Balance Sheets	**P Ltd.**	**Q Ltd.**
Assets		
Non-current Assets		
Property Plant Equipment	1,07,000	44,000
Financial Assets:		
Non-Current Investments	5,000	1,000
Loans	10,000	
Current Assets		
Inventories	20,000	10,000
Financial Assets:		
Trade Receivables	8,000	10,000
Cash and Cash Equivalents	38,000	1,000

Total Assets	1,88,000	66,000
Equity and Liabilities		
Shareholder's Fund		
Share Capital	20,000	10,000
Other Equity	1,20,000	40,000
Non-Current Liabilities		
Financial Liabilities:		
Long Term Liabilities	30,000	10,000
Deferred tax liabilities	5,000	1,000
Long term provisions	5,000	1,000
Current Liabilities		
Financial liabilities:		
Trade Payables	6,000	2,000
Short term Provisions	2,000	2,000
Total Equity and Liabilities	**1,88,000**	**66,000**

Notes to Financial Statements	P Ltd	Q Ltd
Reserves & Surplus		
General Earnings	1,00,000	30,000
Retained earnings	20,000	10,000
	1,20,000	**40,000**
Inventories		
Raw Material	10,000	5,000
Finished Goods	10,000	5,000
	20,000	**10,000**

On 1.4.2001, P Ltd acquired 70% of equity shares (700 lakhs out of 1000 lakhs shares) of Q Ltd. at Rs.36,000 lakhs. The company has adopted an accounting policy to measure Non-controlling interest at fair value (quoted market price) applying Ind AS 103. Accordingly, the company computed full goodwill on the date of acquisition. Shares of both the companies are of face value Rs.10 each. Market price per share of Q Ltd. as on 1.4.2001 is Rs.55. Entire long term borrowings of Q Ltd. is from P Ltd. The fair value of net identifiable assets is at 50,000 lakhs. Prepare consolidated Balance Sheet as on 1.4.2001.

Question 40 – A parent owns

A parent owns 60% of a subsidiary. The subsidiary sells some inventory to the parent for 35,000 and makes a profit of Rs.15,000 on the sale. The inventory is in the parent's balance sheet at the year end.

Question 41 –

In the above illustration, assume that it is the parent that makes the sale. The parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for Rs.35,000 and makes a profit of Rs.15,000. On the sale the inventory is in the subsidiary's balance sheet at the year end.

Question 42 – A Ltd.

A Ltd, a parent company sold goods costing Rs 200 lakh to its 80% subsidiary B Ltd. at Rs 240 lakh. 50% of these goods are lying at its stock. B Ltd. has measured this inventory at cost i.e. at 240 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

Question 43 – Ram Ltd.

Ram Ltd., a parent company purchased goods costing Rs.100 lakh from its 80% subsidiary Shyam Ltd. at Rs.120 lakh. 50% of these goods are lying at the godown. Ram Ltd. has measured this inventory at cost i.e. at Rs.60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

Question 44 – A Limited

Consider a case where an entity A Limited receives dividend for the year ended 31st March 2002 from a subsidiary B Limited acquired on 1st October 2001. The dividend is declared in the annual general meeting of B Limited held on 25th May 2002 and received on 31st May 2002. How shall you deal with the dividend received?

Question 45 – XYZ Ltd.

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 2001 for Rs.1,40,000. The issued capital of ABC Ltd., on 1st April, 2001 was Rs.1,00,000 and the balance in the statement of Profit & Loss was Rs.60,000.

Assume, the fair value of non-controlling interest is same as the fair value on a per-share basis of the purchased interest*. All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is Rs.1,50,000.

What is the amount of non-controlling interest as on 1st April, 2001 and 31st March, 2002 using Fair Value method. Also pass a journal entry on the acquisition date.

For the year ending on 31st March, 2002 ABC Ltd. has earned a profit of Rs.20,000 and later on, it declared and paid a dividend of Rs.30,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. whenever it is received after approval in the ensuing annual general meeting.

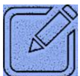
Question 46 –

From the facts given in the above illustration, calculate the amount of non-controlling interest as on 1st April, 2001 and 31st March, 2002 Using NCI's proportionate share method.

Also pass a Journal entry on the acquisition Date.

Question 47 –

The facts are same as in the above illustration except that the fair value of net identifiable assets is Rs.1,60,000. Calculate NCI and Pass Journal Entry on the acquisition date, using fair value method.



Question 48 –

The facts are same as in the above illustration except that the fair value of net identifiable assets is Rs.1,60,000. Calculate NCI and Pass Journal Entry on the acquisition date, using NCI's proportionate share method.

Question 49 –

From the following data, determine in each case:

1. Non-controlling interest at the date of acquisition and at the date of consolidation using proportionate share method.
2. Goodwill or Gain on bargain purchase.
3. Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be Rs 2,00,000 in each case

Case	Subsidiary Company	% of shares owned	Cost	Date of Acquisition 1.04.2001		Consolidation date 31.03.2002	
				Share Capital	Retained earnings	Share capital	Retained earnings
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	30,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	56,000

The company has adopted an accounting policy to measure Non-controlling interest at NCI's proportionate share of the acquiree's identifiable net assets.

Question 50 – Golu Ltd.

Golu Ltd. acquired 100% share in Molu Ltd. on 1/7/15.
Balance sheet of Golu Ltd. and Molu Ltd. as on 31/12/15 is as follow:

Particulars	**Golu Ltd.**	**Molu Ltd.**
Asset		
A. Non-Current Asset		
Property Plant & Equipment	68,000	42000
Financial Asset		
Investments in Molu Ltd.	30,000	-
Loan to Molu Ltd.	10,000	-
B. Current Asset		
Inventories	14,000	12,500
Financial Asset		
Trade Receivables	20,000	15,000
Cash	6,000	-
Total	**1,48,000**	**69,500**
Equity & Liabilities		
A. Equity		
Share Capital	85,000	25,000
Other Equity	44,750	16,000
B. Non-Current Liabilities		
Financial Liability		
Borrowings from Golu Ltd.	-	10,000
C. Current Liability		
Financial Liability		
Borrowings	-	8,000
Trade Payables	18,250	10,500
Total	**1,48,000**	**69,500**

Adjustments:

1. Trade Receivables of Golu Ltd. showed Rs.8,000 due from Molu Ltd. Whereas trade payables of Molu Ltd. include Rs.5,500 due to Golu Ltd.
2. Balance in other equity in Molu Ltd. on the date of acquisition was Rs.4,000.

Prepare Consolidated Balance Sheet.

Question 51 – Rubber Ltd.

Rubber Ltd. acquired shares of Pencil Ltd. on 1/10/15.
Balance sheet of Rubber Ltd. and Pencil Ltd. as on 31/12/15 is as follow:

Particulars	**Rubber Ltd.**	**Pencil Ltd.**
Asset		
A. Non-Current Asset		
Property Plant & Equipment	75,000	53,000
Financial Asset		

Investments in Pencil Ltd.	50,000	-
Loan to Pencil Ltd.	10,000	-
B. Current Asset		
Inventories	15,000	12,500
Financial Asset		
Trade Receivables	20,000	20,000
Cash	8,000	4,000
Total	**1,78,000**	**89,500**
Equity & Liabilities		
A. Equity		
Share Capital	1,15,000	40,000
Other Equity	44,750	25,000
B. Non-Current Liabilities		
Financial Liability		
Borrowings (Including 10,000 from Rubber Ltd.)	-	12,000
C. Current Liability		
Financial Liability		
Trade Payables	18,250	12,500
Total	**1,78,000**	**89,500**

Adjustments:

1. Trade Receivables of Rubber Ltd. showed Rs.10,000 due from Pencil Ltd. Whereas trade payables of Pencil Ltd. include Rs.6,500 due to Rubber Ltd.
2. Balance in other equity in Pencil Ltd. on the date of acquisition was Rs.22,000.
3. Rubber Ltd. acquired ordinary shares of Pencil Ltd. having par value of Rs.30,000 for Rs.50,000.
4. Fair value of Non-Controlling Interest on the date of acquisition was Rs.18,000.

Prepare Consolidated Balance Sheet.

Question 52 – Jack Ltd.

Jack Ltd. acquired 75% shares in Jill Ltd. on 1/7/16.

1. The Inventory of Jill Ltd. consist entirely of purchase from Jack Ltd. on 31/12/16. Jack Ltd. sold goods at 20% on cost.
2. The Fair Value of 25% NCI is 8,000.
3. The balance is P & L on 1/1/16 of Jill Ltd. was NIL.

Particulars	Jack Ltd.	Jill Ltd.
Asset		
A. Non-Current Asset		
Property Plant & Equipment	33,000	25,000
Financial Asset		
Investments (Shares of Jill Ltd.)	27,000	-
B. Current Asset		
Inventories	10,500	9,000

Financial Asset		
Other	4,000	13,000
Total	**74,500**	**47,000**
Equity & Liabilities		
A. Equity		
Share Capital	42,000	25,000
Other Equity	18,500	17,000
B. Non-Current Liabilities		
C. Current Liability		
Financial Liability		
Trade Payables	14,000	5,000
Total	**74,500**	**47,000**

Prepare Consolidated Balance Sheet as on 31/12/2016. Jill Ltd. started trading on 1/1/16.

Question 53 – Happy Ltd.

On 1/10/16 Happy Ltd. acquired 80% shares in Sad Ltd.

1. 50% of the Inventory of Happy Ltd. consist of purchase from Sad Ltd. Sad Ltd. sells goods at mark up of 20% on Selling Price.
2. Sad Ltd. started trading on 1/1/16.
3. The unrealized profit on Inventory will give rise to DTA. Tax rate applicable to both companies is 20%.
4. The 20% NCI at fair value is 7,500 at the acquisition date.

Particulars	Happy Ltd.	Sad Ltd.
Asset		
A. Non-Current Asset		
Property Plant & Equipment	43,000	25,000
Financial Asset		
Investment in Sad Ltd.	30,000	-
B. Current Asset		
Inventories	20,000	9,000
Financial Asset		
Other	15,500	23,000
Total	**1,08,500**	**57,000**
Equity & Liabilities		
A. Equity		
Share Capital	55,000	22,500
Other Equity	26,500	17,000
B. Non-Current Liabilities		
C. Current Liability		
Financial Liability		
Trade Payables	27,000	17,500

Total	1,08,500	57,000

Prepare Consolidated Balance Sheet.

Question 54 – Pokemon Ltd.

On 1/1/16 Pokemon Ltd. acquired 75% shares in Doremon Ltd.

1. On 1/4/16 Pokemon Ltd. sold Property Plant & Equipment worth Rs.20,000 to Doremon Ltd. for Rs.30,000
2. Doremon Ltd. change Depreciation @ 10%.
3. The reserve of Doremon Ltd. on the date of acquisition was NIL.
4. The Fair Value of NCI is 12,000.

Particulars	Pokemon Ltd.	Doremon Ltd.
Asset		
A. Non-Current Asset		
Property Plant & Equipment	43,000	35,000
Financial Asset		
Investment (Shares of Doremon Ltd.)	40,000	-
B. Current Asset		
Inventories	20,000	9,000
Financial Asset		
Receivables	10,000	12,000
Other	1,500	1,000
Total	**1,14,500**	**57,000**
Equity & Liabilities		
A. Equity		
Share Capital	45,000	24,000
Other Equity	42,000	22,500
B. Non-Current Liabilities		
C. Current Liability		
Financial Liability		
Trade Payables	27,500	10,500
Total	**1,14,500**	**57,000**

Prepare Consolidated Balance Sheet.

Question 55 – Nexa Ltd.

Nexa Ltd. acquired 30,000 shares in Hexa Ltd. On 1/7/15. Nexa Ltd. Issued 2 shares in every 3 shares of Hexa Ltd. Market Value of Nexa Ltd. shares was Rs.3. Nexa Ltd. has not accounted for the Purchase of this Investment.

Particulars	Nexa Ltd.	Hexa Ltd.
Asset		
A. Non-Current Asset		
Property Plant & Equipment	63,000	55,000

Financial Asset		
Investment	25,000	-
B. Current Asset		
Inventories	14,000	15,000
Financial Asset		
Receivables	20,000	13,000
Cash at Bank	5,500	-
Total	**1,27,500**	**83,000**
Equity & Liabilities		
A. Equity		
Share Capital	85,000	50,000
Other Equity	26,500	17,000
B. Non-Current Liabilities		
C. Current Liability		
Financial Liability		
Trade Payables	16,000	14,000
Bank Overdraft	-	2,000
Total	**1,27,500**	**83,000**

Additional Information:

1. Receivables of Nexa Ltd. include 8,000 due from Hexa Ltd. Payables of Hexa Ltd. includes Rs.5,000 due to Nexa Ltd.
2. The Balance in Reserves & Surplus on the date of Acquisition is Rs.10,000.
3. The Fair Value of NCI of 40% is Rs.50,000.

Prepare Consolidated Balance Sheet.

Question 56 – Cool Ltd.

Prepare Consolidated Profit & Loss A/c.

Cool Ltd. acquired 80% shares in Fab Ltd. on 1/1/18. The statement of Profit & Loss of Cool Ltd. and Fab Ltd. for Year 31/12/18 is as follows:

	COOL Ltd.	**FAB Ltd.**
Sales	80,000	50,000
- Cost of Sales	32,000	20,000
Gross Profit	**48,000**	**30,000**
- Administration	18,000	12,000
Profit before Tax	**30,000**	**18,000**
- Tax	10,000	6,000
Profit after Tax	**20,000**	**12,000**

Question 56 – Cool Ltd.

Prepare Consolidated Profit & Loss A/c.
Cool Ltd. acquired 80% shares in Fab Ltd. on 1/1/18. The statement of Profit & Loss of Cool Ltd. and Fab Ltd. for Year 31/12/18 is as follows:

	COOL Ltd.	FAB Ltd.
Sales	80,000	50,000
- Cost of Sales	32,000	20,000
Gross Profit	**48,000**	**30,000**
- Administration	18,000	12,000
Profit before Tax	**30,000**	**18,000**
- Tax	10,000	6,000
Profit after Tax	**20,000**	**12,000**

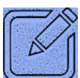
Question 57 – Summer Ltd.

Following is the Profit & Loss A/c for Summer Ltd. and Winter Ltd. for the year ended 31/12/18.

	Summer Ltd.	Winter Ltd.
Sales	1,00,000	54,000
- Cost of Sales	49,000	28,500
Gross Profit	**51,000**	**25,500**
- Administration	20,000	9,500
Profit before Tax	**31,000**	**16,000**
- Tax	5,400	4,000
Profit after Tax	**25,600**	**12,000**

Additional Information:

1. Summer Ltd. acquired 75% shares of Winter Ltd. on 30/6/18.
2. Prepare Consolidated Profit & Loss A/c.



Question 58 – Hat Ltd.

Hat Ltd. acquired 75% shares of Cat Ltd. on 30/6/19. The statement of Profit & Loss of Hat Ltd. and Cat Ltd. for Year 31/12/19 is as follows:

	HAT Ltd.	CAT Ltd.
Sales	1,25,000	67,500
- Cost of Sales	61,250	35,625
Gross Profit	**63,750**	**31,875**
- Administration	25,000	11,875
Profit before Tax	**38,750**	**20,000**
- Tax	6,750	5,000
Profit after Tax	**32,000**	**15,000**

Additional Information:

1. Cat Ltd.'s property was revalued from 2,00,000 to 2,50,000.

2. Prepare Consolidated Profit & Loss A/c and OCI for the year.

Question 59 – Monday Ltd.

From the following Prepare Consolidated Statement of profit and Loss A/c for the Group for Year ended 31/12/16 is as follows:

	Monday Ltd.	Sunday Ltd.
Sales	1,70,000	84,000
- Cost of Sales	99,000	36,000
Gross Profit	**71,000**	**48,000**
- Administration	28,000	12,500
Profit before Tax	**43,000**	**35,500**
- Tax	12,900	10,600
Profit after Tax	**30,100**	**24,900**

Additional Information:

Monday Ltd. Acquired 60% of Sunday Ltd. on 30/9/16

Question 60 – OPPO Co.

OPPO Co. Acquired 80% shares in VIVO Co. on 1/1/2016. The intra group sales were Rs.10,000, goods were sold at 20% on Selling Price.

	OPPO Co.	VIVO Co.
Sales	1,20,000	54,000
- Cost of Sales	40,000	20,000
Gross Profit	**80,000**	**34,000**
- Administration	22,500	12,500
Profit before Tax	**57,500**	**21,500**
- Tax	15,400	4,000
Profit after Tax	**42,100**	**17,500**

Prepare Consolidated P & L for each of the following cases

Case 1. OPPO Co. Sold goods to VIVO Co. Inventory of VIVO includes the above goods.

Case 2. OPPO Co. sold goods to VIVO Co. Inventory of VIVO Co. include 50% of the above goods

Case 3. VIVO Co. Sold goods to OPPO Co. Inventory of OPPO Co. includes 50% of goods from VIVO Co.

Question 61 – Alpha & Beta

The Summarised Statement for changes in Equity for Alpha & Beta for the year ended 31/3/2019 is given below:

Rs. in 000's

	Alpha	Beta
Op. Bal 1/4/18	1,20,000	85,000
+ Profit for Year	21,000	4,000
- Dividend Paid	8,500	6,000
Balance 31/3/19	**132500**	**83000**

1. On 1/10/16 Alpha Purchased 80% shares in Beta. Equity of Beta on the date of acquisition was 30 Million.
2. The Fair Value of NCI on date of Acquisition was 9 Million.
3. Prepare the Consolidated Statement for changes in Equity.

Question 62 – KOHLI

KOHLI Acquired 75% Shares in DHONI on 1/1/16.

1. On 1/1/2016 KOHLI had also advanced loan of 30,000 to DHONI.
2. Interest Received by KOHLI from DHONI is 2,500, while Interest paid by DHONI to KOHLI is Rs.3,000.
3. Fair Value of NCI on date of acquisition is Rs.10,000.

	KOHLI	DHONI
Sales	2,50,000	95,000
- Cost of Sales	1,20,000	52,500
Gross Profit	**1,30,000**	**42,500**
+ Other Income (Interest)	2,500	-
Total	**1,32,500**	**42,500**
- Administration (Including Interest)	45,000	22,000
Profit before Tax	**87,500**	**20,500**
- Tax	15,000	9000
Profit after Tax	**72,500**	**11,500**
+ Res b/f	2,500	-
	75,000	**11,500**

Balance Sheet

Particulars	**KOHLI Ltd.**	**DHONI Ltd.**
Asset		
A. Non-Current Asset		
Property Plant & Equipment	160000	69000
Financial Asset		
Investment (Shares of Dhoni Ltd.)	30000	-
B. Current Asset		
Inventories	16000	14000

Financial Asset		
Receivables	20000	4000
Loan	30000	-
Total	**256000**	**87000**
Equity & Liabilities		
A. Equity		
Share Capital	150000	40000
Other Equity	75000	11500
B. Non-Current Liabilities		
C. Current Liability		
Financial Liability		
Trade Payables	31000	10500
Loan	-	25000
Total	**256000**	**87000**

Prepare CFS of Group.

Question 63 – Fair Co.

Fair Co. acquires control over Square Co. by investing Rs.90,000 on 31st December 2016 when the carrying amount of its identifiable assets and liabilities are:

	Rs.
Non-Current assets	
Tangible assets	60,000
Current assets	
Inventories	32,000
Receivables	18,000
Total Assets	1,10,000
Equity and Reserves	
Ordinary Shares	70,000
Retained Earnings	10,000
Current Liabilities	
Payables	20,000
Bank Overdraft	10,000

Total Liabilities	1,10,000

On the date of acquisition the fair values were:
Inventories: Rs.36,000, Receivables: Rs.17,000, Payables: Rs.18,000.
Calculate the amount of goodwill and state the accounting treatment to be applied.

Question 64 – Patient Ltd.

Patient Ltd acquired 55% shares in Smart Ltd. on 1st January 2016. The retained earnings on the date of acquisition were nil. The fair value of the non-controlling interest on the date of acquisition was Rs.21,500.

The Balance Sheet of Patient Ltd. and Smart Ltd. as on 31st December 2016 are:

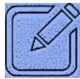
Assets				
Non-current assets				
Tangible assets			10,000	
Land	33,000	33,000	15,000	
Property, Plant & Equipment		27,000		25,000
Investments: Shares in Smart Co.				
Current assets				
Inventories	10,500		9,000	
Others	4,000	14,500	13,000	
Total Assets				22,000
		74,500		**47,000**
Equity and Liabilities				
Equity				
Ordinary Shares	42,000		25,000	
Retained Earnings	18,500	60,500	17,000	42,000
Current Liabilities				
Payables	14,000		5,000	5,000
Total equity and liabilities		14,000		
		74,500		**47,000**

The directors of Patient Inc carried out a fair value exercise on the net assets of Smart Co. on the date of acquisition. The following matters arose from the exercise:

1. On the date of acquisition, the fair value of Smart Co.'s land was Rs.5,000 more than its carrying amount and that of its plant was Rs.10,000 more than its carrying amount of Rs.5,000. Smart Co. charges depreciation at 10% (straight line method).
2. On 1st January 2016, Smart Ltd. had a brand name that was protected legally but was not included in the Balance Sheet because it did not meet recognition

criteria. The directors of Patient Ltd. considered that the brand had a market value of Rs.4,000 on 1st January 2016 and that it would give competitive advantage for 5 years from that date.

Required: Prepare the Consolidated Financial Statements for the group.



Question 65 – Entity P

Entity P sells a 20% interest in a wholly- owned subsidiary to outside investors for Rs.100 lakh in cash. The carrying value of the subsidiary's net assets is Rs.300 lakh, including goodwill of 65 lakh from the subsidiary's initial acquisition. Pass journal entries to record the transaction.

Question 66 – Entity A

Entity A acquired 60% of entity B two years ago for Rs.6,000. At the time entity B's fair value was Rs.10,000. It had net assets with a fair value of Rs.6,000 (which for the purposes of this example was the same as book value). Goodwill of Rs.2,400 was recorded (being Rs.6,000 – (60% x Rs.6,000). On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is Rs.20,000 and entity A pays Rs.4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is Rs.12,000 and the carrying amount of the non- controlling interest is Rs.4,000.

Pass journal entries to record the transaction.

Question 67 – Amla Ltd.

Amla Ltd. purchase a 100% subsidiary for Rs.10,00,000 at the end of 20X1 when the fair value of the subsidiary's Lal Ltd. net asset was Rs.8,00,000.

The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is Rs.18,00,000 (including net assets of Rs.16,00,000 & goodwill of Rs.2,00,000).

Calculate gain or loss on sale of interest in subsidiary as on 31st March 20X4.

Question 68 – A Ltd.

A Ltd. acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance sheet finalized as on 1.4. 2000:

Investment in Subsidiary (70% interest – at cost)	14,000
Purchase price of additional 10% interest	2,600
Consolidated financial statements :	
Non – controlling interest (30%)	6,600
Consolidated profit and loss account balance	2,000
Goodwill	600

The reporting date of the subsidiary and the parent is 31st March, 2010. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

Question 69 –

In March 2001 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares.

The carrying amount of goodwill is Rs.20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at Rs.12 per share, raising Rs.3,00,000.

The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were Rs.4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder.

Question 70 – A parent

A parent purchased an 80% interest in a subsidiary for Rs.1,60,000 on 1 April 2001 when the fair value of the subsidiary's net assets was Rs.1,75,000. Goodwill of Rs.20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs.8,000 was charged in the consolidated financial statements to 31 March 20X3. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 2004 for Rs.2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was Rs.2,25,000 (not including goodwill of Rs.12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary at cost, as permitted by Ind AS 27.

Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 2004.

Question 71 – AT Ltd.

AT Ltd. purchased a 100% subsidiary for Rs.50,00,000 on 31st March 20X1 when the fair value of the BT Ltd. whose net assets was Rs.40,00,000. Therefore, goodwill is Rs.10,00,000. The AT Ltd. sold 60% of its investment in BT Ltd. on 31st March 20X3 for Rs.67,50,000, leaving the AT Ltd. with 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd., excluding goodwill is Rs.80,00,000. Assume the fair value of the investment in associate BT Ltd. retained is proportionate to the fair value of the 60% sold, that is Rs.45,00,000.

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd's separate and consolidated financial statements as on 31st March 2003.

Question 72 – AT Ltd.

The facts of this example as same as example 71, except that the group AT Ltd. disposes of a 90% interest for Rs.85,50,000, leaving the AT Ltd. with a 10% investment. The fair value of the remaining interest is Rs.9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold).

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 2001.

Question 73 – A Ltd.

A Ltd acquired 70% of shares of B Ltd. On 1.4.2010 when the fair value of net assets of B Ltd. was Rs.200 lakhs. During 2010-11, B Ltd. made profit of Rs.100 lakhs. Stand alone and consolidated balance sheets as on 31/3/2011 are as follows

	A Ltd	**B Ltd**	**Group**
Assets			
Goodwill			10
PPE	627	200	827
Financial Assets			
Investments	150		
Cash	200	30	230
Other Current Assets	23	70	93
	1000	**300**	**1160**
Equity and Liabilities			
Share Capital	200	100	200
Other Equity	800	200	870

Non-Controlling interest			90
	1000	**300**	**1160**

Other information :

1. The profit made by B Ltd. for the year 100
2. A Acquired B on 1/4/2010

Purchase consideration	150	
30% Non-controlling interest		60
Total	**210**	
Fair Value of Net Assets	200	
Goodwill	10	

3. A Ltd purchases further 10% stake in B Ltd which reduces non-controlling interest to 20% for 32 lakhs.
4. Proportionate carrying amount of non-controlling interest is 30

Show the stand alone and consolidated balance sheet of the group immediately after the change in non – controlling interest.

Thanks ….

CHAPTER

3

IND AS 32, 107, 109 – FINANCIAL INSTRUMENTS

CONCEPTS COVERED

- IND AS 32 - FINANCIAL INSTUMENTS - PRESENTATION
- IND AS 109 - FINANCIAL INSTRUMENTS
- IND AS 107 - DISCLOSURE

IND AS 32

- CLASSIFICATION OF LIABILITY VS EQUITY
- OFFSETTING FA AND FL

IND AS 109

- RECOGNIZATION AND DE-RECOGNIZATION OF FA AND FL
- CLASSIFICATION OF FA AND FL
- MEASUREMENT OF FA AND FL
- HEDGE ACCOUTING

IND AS 107

- DISCLOSURE

These IND AS are largely aligned with the prevailing guidance in IFRS which require classification of a financial instrument based on substance of the arrangement between the parties rather than their legal form.

Looking at the concepts and the depth that are required to be covered in this IND AS's – this chapter is split into the following parts

1. Financial Instruments – Scope and Definitions
2. Financial Instruments – Equity and Financial Liabilities
3. Classification and measurement of financial Assets and Financial Liabilities
4. Recognition and Derecognition of Financial Instrument
5. Derivatives and Embedded Derivatives
6. Hedge Accounting
7. Disclosures

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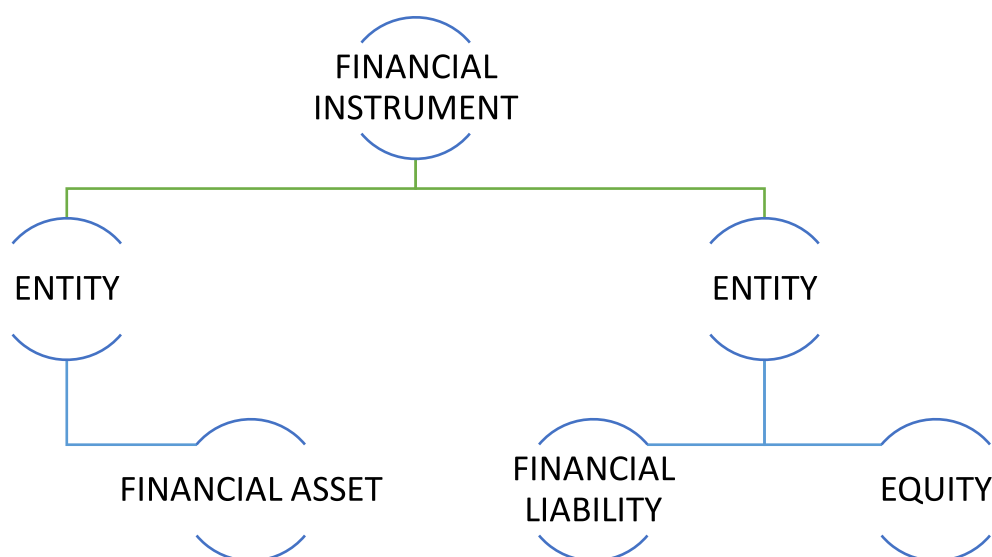
PART 1

• FINANCIAL INSTRUMENT - SCOPE AND DEFINITIONS

1. FINANCIAL INSTRUMENT :

A **financial instrument** is any **contract** that gives rise to a **financial asset** of one entity and a **financial liability** or **equity instrument** of another entity.



A Financial Instrument can be

- A Primary instrument
- A Derivatives instrument
- A Hybrid instrument.

Primary Instrument	• Trade Receivable, Trade Payables, Loans, Bonds, Borrowing, Equity instrument and so on
Deriviative Instrument	• Forwards, Swaps, Options, Futures.
Hybrid Instrument	• Convertible Debentures

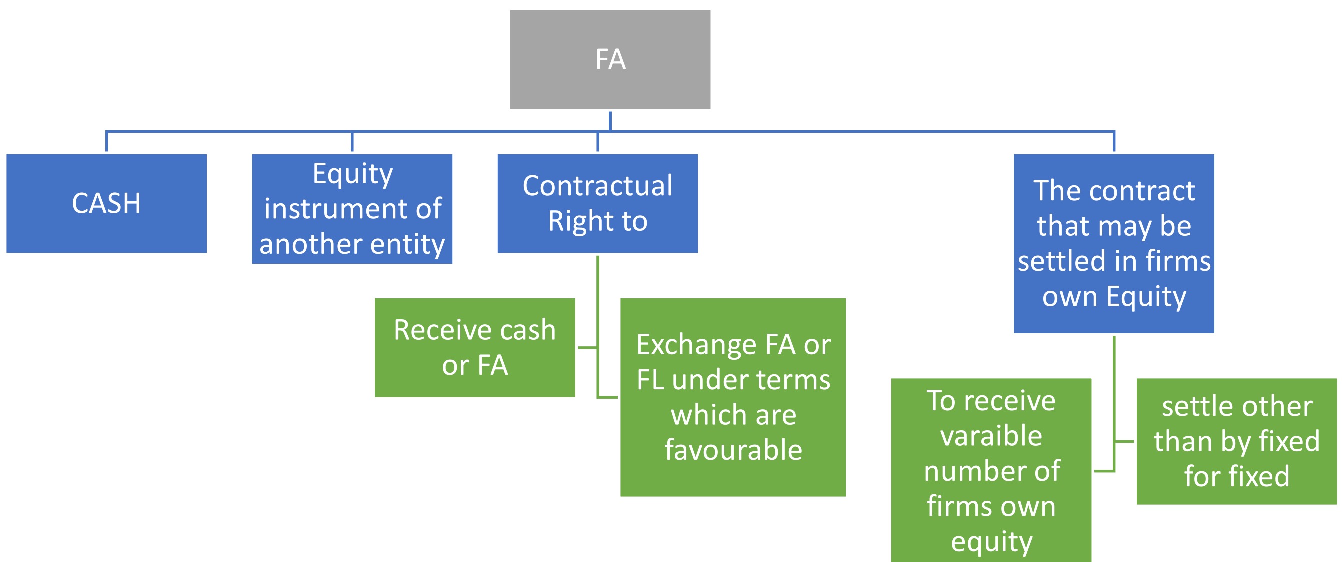
2. FINANCIAL ASSET :

A **'financial asset'** is any asset that is:

1. Cash;
2. An equity instrument of another entity;

3. A contractual right:
   I. <u>**to receive**</u> cash or another financial asset from another entity; or
   II. <u>**to exchange**</u> financial assets or financial liabilities with another entity under conditions that are <u>**potentially favorable**</u> to the entity; or
4. a contract that will or may be settled in **entity's own equity instruments** and is:
   I. a non-derivative for which the entity is or may be obliged <u>**to receive a variable number**</u> of entity's own equity instruments; or
   II. a derivative that will or may be settled <u>**other than by exchange of fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments.**</u> For this purpose, entity's own equity instruments do not include puttable financial instruments classified as equity instruments, instruments that impose on the entity an obligation to deliver to another party a pro-rata share of net assets of the entity on liquidation and are classified as equity instruments, or instruments that are themselves contracts for future receipt or delivery of entity's own equity instruments

<u>**Chart :**</u>



3. FINANCIAL LIABILITY :

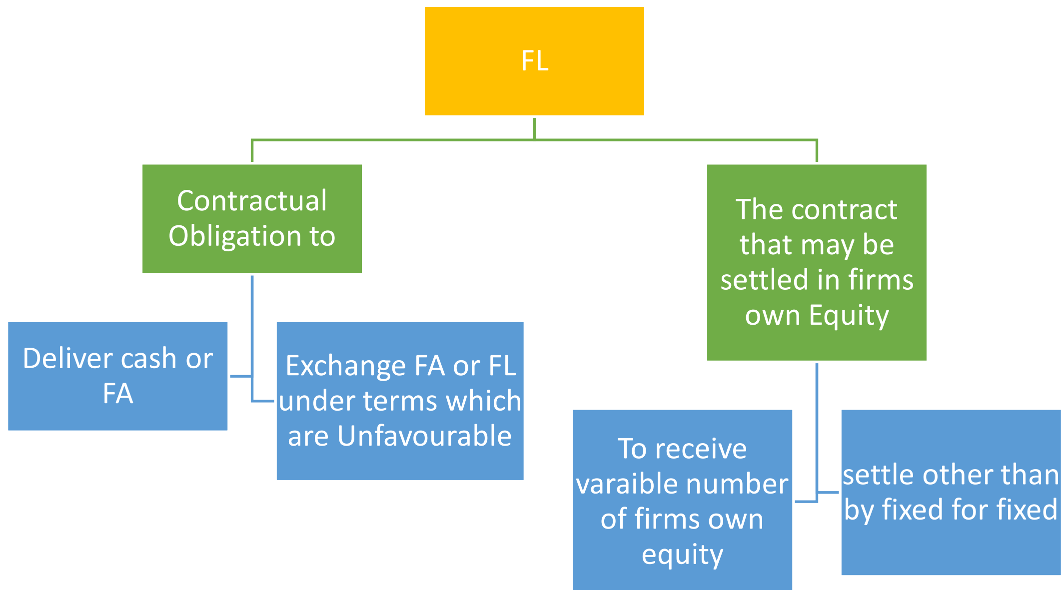
A **'financial liability'** is any liability that is:

1. A contractual obligation**:**
   i. <u>**To deliver**</u> cash or other financial asset to another entity; or
   ii. <u>**To exchange**</u> financial assets or financial liabilities with another entity under conditions that are <u>**potentially unfavorable**</u> to the entity;

2. A contract that will or may be settled in entity's **own equity instruments** and is:
   i. A **non-derivative** for which the entity is or may be obliged <u>**to deliver a variable number**</u> of entity's own equity instruments; or

ii. a **derivative** that will or may be settled **other than by the exchange of a fixed amount of cash or another financial asset for a fixed number** of the entity's own equity instruments.

Chart :



4. EQUITY :

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

EQUITY = ASSETS - LIABILITIES

The key characteristics of an equity instrument have been further explained as follows

No Contractual Obligation	• A key characteristic of equity instruments is that they carry no contractual obligation throughout for any payment or distribution towards the holders of such instruments. • However, following type of instruments as an exception are 'equity' classified even if they contain an obligation to deliver cash or other financial asset, provided certain requisite criteria are met 1. puttable financial instruments that meet certain conditions 2. an instrument, or a component of an instrument, that contains an obligation for the issuing entity to deliver to the holder a pro rata share of the net assets of the issuing entity only on its liquidation.
Settlement in own equity instruments	• Settlement in own equity instruments is equity classified only if it's a fixed-for-fixed transaction, ie, issue of fixed number of shares and involves a fixed amount of cash or other financial asset.

	• Where an entity enters into a non-derivative contract to issue a fixed number of its own equity instruments in exchange for a fixed amount of cash (or another financial asset), it is an equity instrument of the entity. But this does not apply for instruments that are equity classified being a puttable instrument or other instrument entitling the holder to pro-rata share in net assets that meet specified criteria • However, if such a contract contains an obligation for the entity to pay cash (or another financial asset), it also gives rise to a liability for the present value of the redemption amount. For example: a forward contract entered into by an entity to repurchase fixed number of its own shares for a fixed amount of cash gives rise to a financial liability to be recorded at present value of redemption amount.

Summary :

Chart 1

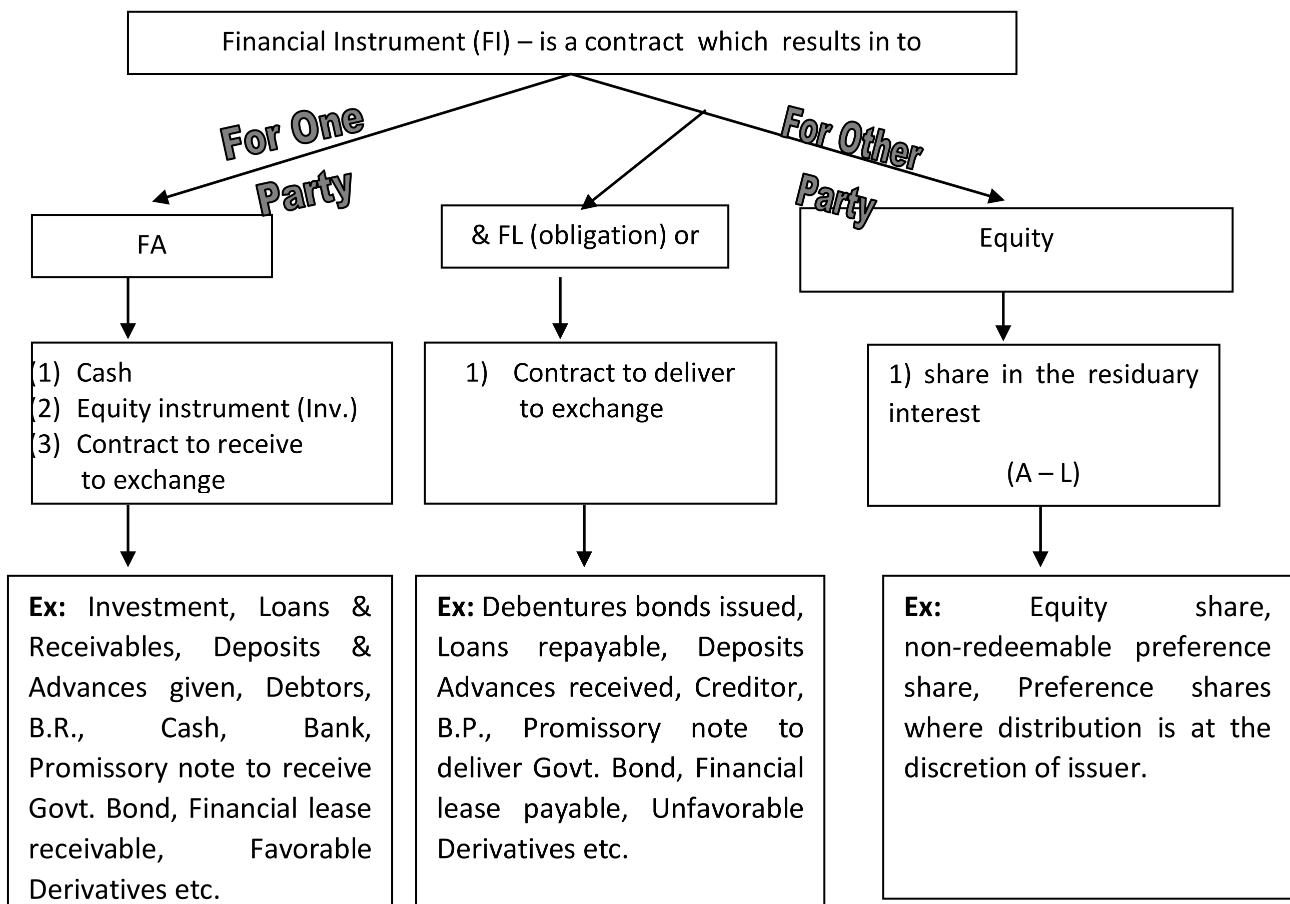
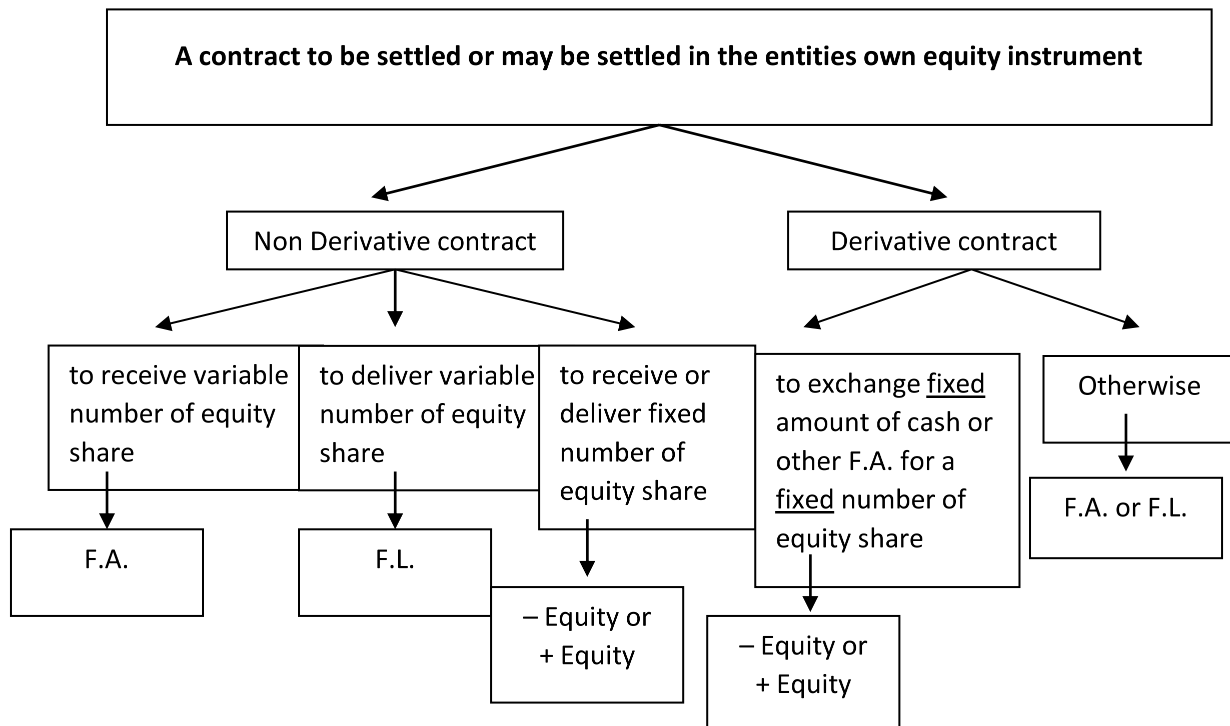


Chart 2



Note : In case of transactions in own equity, if it is fixed for fixed (i.e. shares to be delivered/received and consideration to be received/paid both are fixed) then its Equity otherwise it is FA or FL.

5. PREFERENCE SHARES :

Preference shares is a class of shares issued by Indian companies, whose terms may provide for redemption at a pre-determined amount or may be irredeemable, with a fixed return which may be cumulative or discretionary. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attached to the share to determine whether it exhibits the fundamental characteristic of a financial liability or an equity instrument, which is explained below

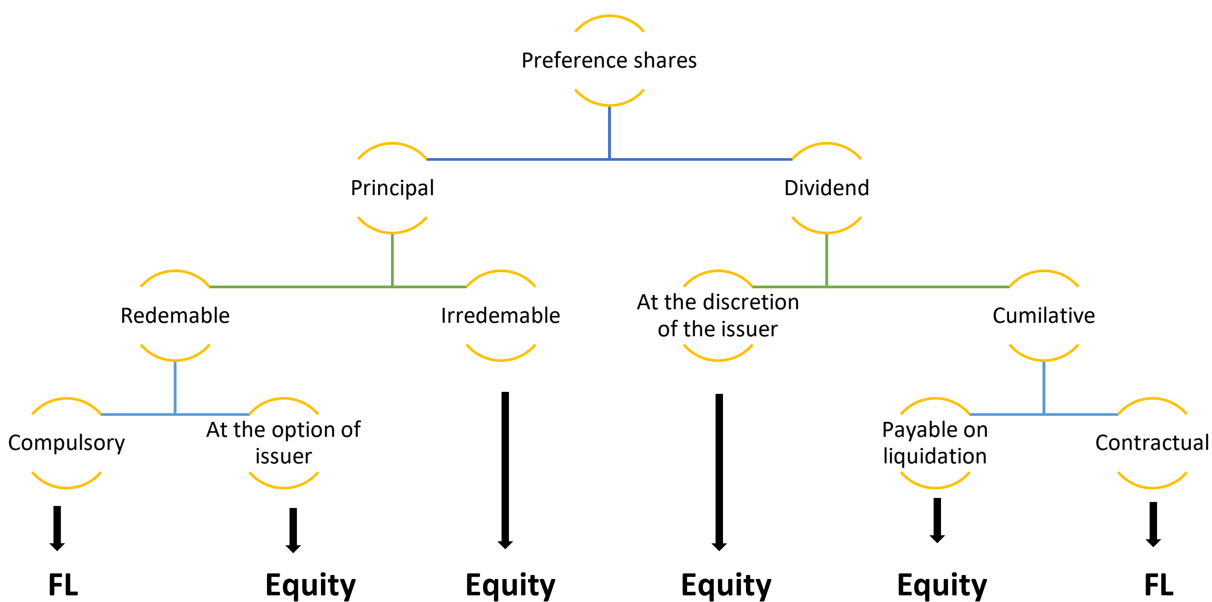
1. Redeemable Preference shares
   a. Redemption at a specified date : This contains a financial liability because issuer has an obligation to transfer financial assets to the holder of the share.
   b. Redemption at the option of issuer : This is equity because it does not contain the obligation to transfer cash or financial asset. The issuer has complete unconditional control over the outflow of resources. The outflow is avoidable. The date on which the issuer notifies the investor its intention to redeem the shares, the instrument will be reclassified from “Equity” to “FL”
2. Non – Redeemable Preference shares

   In this case, appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. Any

historical trend or ability of the Issuer does not affect the classification of an instrument as 'equity' or 'financial liability'.

3. Distribution of Preference shares
   a. Where dividends are at the discretion of the issuer - this is akin to an equity instrument.
   b. Where dividends are cumulative but payable only on liquidation– They are Equity
   c. If the Dividends are required to be paid contractually –
      (i) If the Preference shares are redeemable – they are FL
      (ii) If the preference shares are irredeemable – they are compound financial instrument.

Chart :



Note : Preference shares can have element of both Equity and Financial Liability. i.e it can be compound FI

6. DERIVATIVES :

It is a Financial Instrument or any other contract which fulfills all the 3 conditions given below

1. The value changes to the underlying Asset
2. No Initial Investment or Very low Initial Investments
3. Settlement at a future date.

Examples – Forward Agreements, Swaps, Futures, Options, etc.

7. NON FINANCIAL ASSETS / LIABILITIES :

1. Tangible Fixed Assets / Intangible Fixed Asset / Inventory / Gold Bullion
   – Such Assets gives opportunity to generate cash but does not give rise to a present right to receive cash or another financial asset.

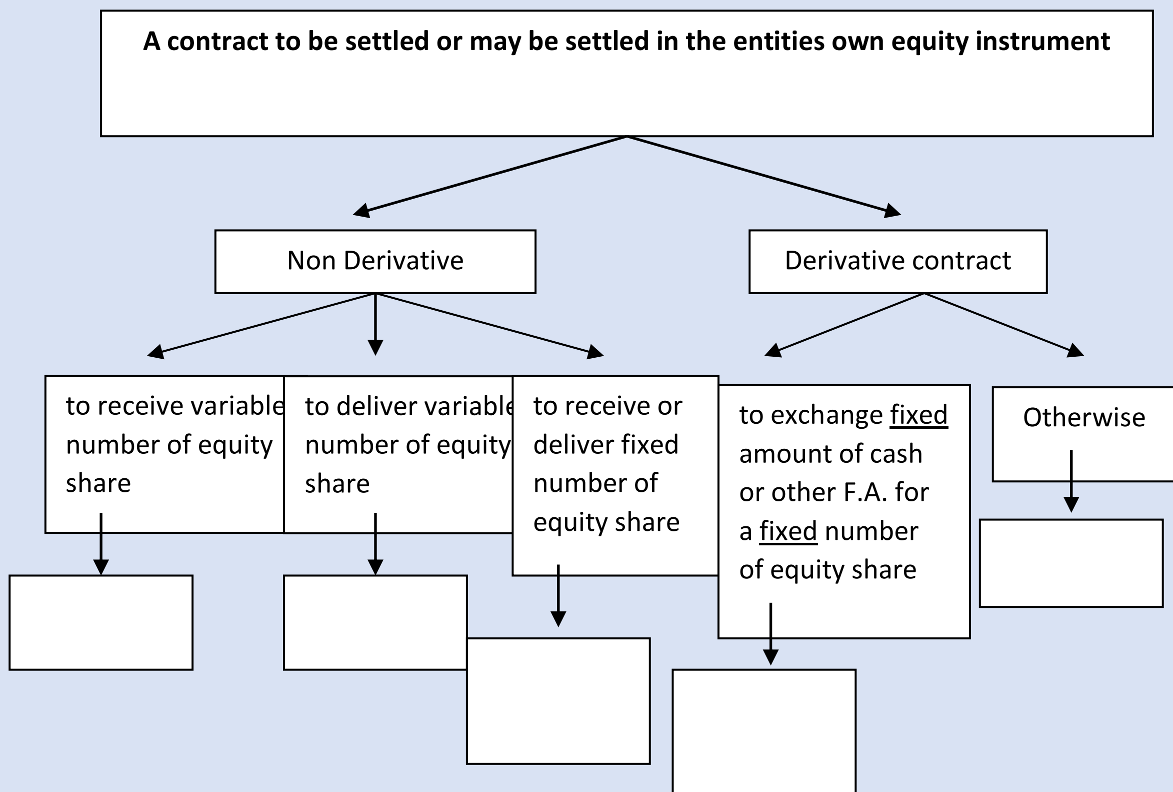
2. Prepaid Expenses, Deferred Income
   – Because it is not be settled by cash by services.
3. Operating Lease
   - Lessors continues to hold an asset and not receivables
4. Income tax payable / Refundable
   – because it is not contractual
5. Warranty obligations, Prov. For estimated litigation obligation
   – because it is not contractual

Questions :

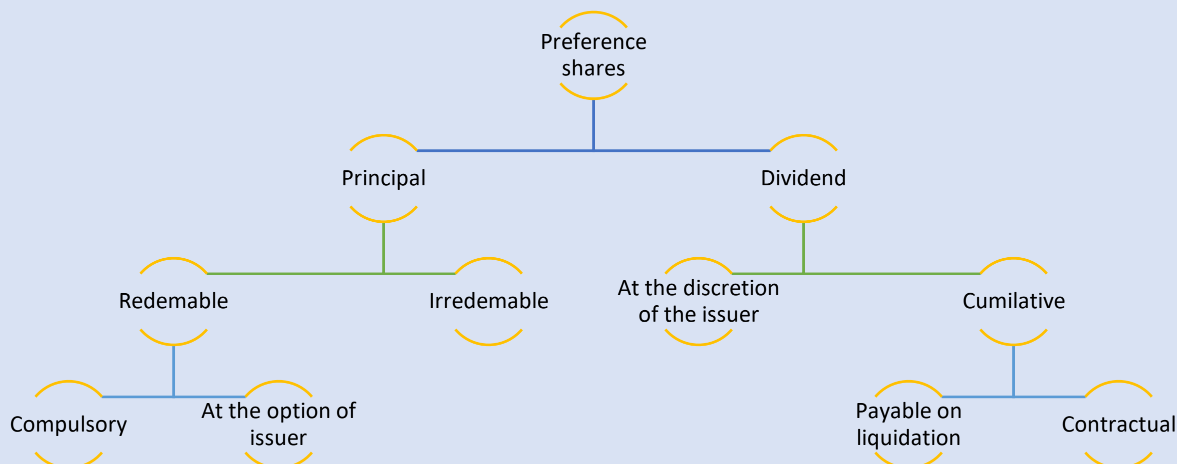
Question 1 – Define

1. Financial Instrument
2. Financial Assets
3. Financial Liabilities
4. Equity
5. Derivatives

Question 2 – Classify the following into FA / FL or Equity



Question 3 –



Question 4 – Classify the following into Financial Assets / Financial Liability

1. Cash
2. Cash Equivalents
3. Bank Balance
4. Deposits Given
5. Deposits Received
6. Trade and Other receivables
7. Trade and Other Payables
8. Bills Receivables
9. Bills Payables
10. Loans including Bank Loans
11. Investment in Equity
12. Investment in Debentures
13. Promissory Notes to Receive Govt Bonds
14. Promissory Notes to give Govt Bonds
15. Perpetual debt instrument held
16. Inventory
17. Prepaid Expenses
18. Property, Plant and Equipment
19. Intangible Assets
20. Advances given for goods and services
21. Advances received for goods and services
22. Deferred Revenue
23. Income Tax
24. Warranty Obligation
25. Financial Guarantee Received
26. Financial Guarantee Given
27. Patents
28. Trade Marks
29. Income tax Refundable
30. Land and Building
31. Gold
32. Gold Bond Held
33. Deferred Revenue held

Question 5 – A Ltd.

A Ltd. makes sale of goods to customers on credit of 45 days. The customers are entitled to earn a cash discount@ 2% per annum if payment is made before 45 days and an interest @ 10% per annum is charged for any payments made after 45 days. Company does not have a policy of selling its debtors and holds them to collect contractual cash flows. Evaluate the financial transaction ?

Question 6 – Z Ltd.

Z Ltd. (the 'Company') makes sale of goods to customers on credit. Goods are carried in large containers for delivery to the dealers' destinations. All dealers are required to deposit a fixed amount of Rs.10,000 as security for the containers, which is returned only when the contract with Company terminates. The deposits carry 8% per annum which is payable only when the contract terminates. If the containers are returned by the dealers in broken condition or any damage caused, then appropriate adjustments shall be made from the deposits at the time of settlement. How would such deposits be treated in books of the dealers?

Question 7 – A Ltd.

A Ltd issues a bond at principal amount of CU 1000 per bond. The terms of bond require annual payments in perpetuity at a stated interest rate of 8 per cent applied to the principal amount of CU 1000. Assuming 8 per cent to be the market rate of interest for the instrument when it was issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. Evaluate the financial instrument in the hands of both the holder and the issuer.

Question 8 – A Ltd.

A Ltd. (the 'Company') makes purchase of steel for its consumption in normal course of business. The purchase terms provide for payment of goods at 30 days credit and interest payable @ 12% per annum for any delays beyond the credit period. Analyze the nature of this financial instrument.

Question 9 – A Ltd.

A Ltd. (the 'Company') makes a borrowing for INR 10 lacs from RBC Bank, with bullet repayment of INR 10 lacs and an annual interest rate of 12% per annum. Does the above instrument meet definition of financial liability? Please explain.

Question 10 – A Ltd.

Silver Ltd. issued irredeemable preference shares with face value of Rs.10 each and premium of Rs.90. These shares carry dividend @ 8% per annum, however dividend is paid only when Silver Ltd declares dividend on equity shares. Analyze the nature of this instrument.

PART 2

- **FINANCIAL INSTRUMENT - EQUITY OR FINANCIAL LIABILITY**

Ind AS 32 lays down the accounting principles for classifying a financial instrument issued by an entity as either a financial liability or equity or both (a compound instrument). The classification of a financial instrument is governed by the substance of a contract and not its legal form.

Before we look at the two definitions in a comparative format, it is important to highlight here that the classification of a financial instrument under Ind AS 32 is done from the perspective of the issuer and not from the perspective of the holder.

FINANCIAL LIABILITY (IND AS 32 – para 11)	EQUITY (IND AS 32 – para 16)
A Financial instrument that fulfills **either of (A) or (B) below :** Condition A : An instrument **that is contractual obligation** To deliver cash or another financial asset to another entity or To exchange financial asset or financial liabilities with another entity under conditions that are potentially unfavorable to the entity. Condition B : An instrument that will or may be settled in the entity's own equity instrument and is A non derivative **for which the entity is or may be obliged** to deliver a variable number of the entity's own equity instrument, or A derivative that will or may be settled **other than by** the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.	A Financial instrument that fulfills **both (A) or (B) below :** Condition A : An instrument that **has no contractual obligation** To deliver cash or another financial asset to another entity or To exchange financial asset or financial liabilities with another entity under conditions that are potentially unfavorable to the entity. Condition B : An instrument that will or may be settled in the entity's own equity instrument and is A non derivative for **which the entity has no obigation** to deliver a variable number of the entity's own equity instrument, or A derivative that will or may be settled **only by** the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

Is there a contractual Obligation → NO → Not a Financial Instrument

↓ YES

Obligation to deliver cash or another Financial asset → YES → Financial Liability

↓ NO

Obligation to exchange financial assets or liabilities under potentially unfavorable conditions → YES → Financial Liability

↓ NO

A. Obligation to Issue own Equity Instrument, AND
B. Either of the consideration Received/Receivable or number Of equity instrument is VARIABLE → YES → Financial Liability

↓ No, This implies

A. Obligation to Issue own Equity Instrument, AND
B. Either of the consideration Received/Receivable or number Of equity instrument is FIXED → Equity Instrument

Note :
Ask the following questions
1. Is the cash outflow contractual?
2. Can the outflow be avoided i.e is it at the discretion of the issuer.

When an instrument requires mandatory redemption by the issuer for a fixed or determinable amount, a contractual obligation to deliver cash at redemption exists and therefore, the instrument is a Liability

Exceptions are

1. Puttable instruments
2. Certain instruments that contain an obligation to deliver a pro rata share of Net Assets at liquidation

Question 11 – A Ltd.

A Ltd. (issuer) issues preference shares to B Ltd. (holder). Those preference shares are redeemable at the end of 10 years from the date of issue and entitle the holder to a cumulative dividend of 15% p.a. The rate of dividend is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Question 12 – X Co. Ltd.

X Co. Ltd. (issuer) issues debentures to Y Co. Ltd. (holder). Those debentures are redeemable at the end of 10 years from the date of issue. Interest of 15% p.a. is payable at the discretion of the issuer. The rate of interest is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Question 13 – P Co. Ltd.

P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder). The loan is perpetual and entitles the holder to fixed interest of 8% p.a. Examine the nature of the financial instrument.

Question 14 –

Does the lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, will lead to change in contractual obligation?

Question 15 – D Ltd.

D Ltd. issues preference shares to G Ltd. The holder has an option to convert these preference shares to equity instruments of the issuer anytime up to a period of 10 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 10 years. Examine the nature of the financial instrument.

Question 16 – LMN Ltd.

LMN Ltd. issues preference shares to PQR Ltd. These preference shares are redeemable at the end of 5 years from the date of issue.
The instrument also provides a settlement alternative to the issuer whereby it can transfer a particular commercial building to the holder, whose value is estimated to be significantly higher than the cash settlement amount. Examine the nature of the financial instrument.

COMPOUND INSTRUMENT :

A Financial Instrument may be structured such that it contains both equity and liability components (i.e the instrument is neither completely a liability nor entirely an equity instrument) The requirement to separate out the equity and financial liability components of a compound instrument is consistent with the principle that a financial instrument must be classified in accordance with its substance, rather than its legal form.

Method to separate the liability and equity components

Calculation of Fair Value of Liability

Steps :

1. Classify the instrument as Compound Financial Instrument
2. Identify the contractual cash flows i.e cash flows which cannot be denied by the company
3. Identify the discount rate i.e rate on similar instrument without equity component (for eg rate on non-convertible Financial Instrument.
4. Calculate PV of Contractual CF discounted by using rate arrived at Step 3.
5. Calculate Equity i.e Equity = Total Liability – Financial Liability

Questions :

Question 17 – Entity A

Entity A issues 2000 convertible bond on 1 January 2005.
The bonds have a 3 year term and are issued at par with a face values of Rs 1000 per bond, resulting in total proceeds of Rs 2 million. Interest is payable annually in arrears at an annual interest rate of 6% Each Bond is convertible at the holders discretion at any time up to maturity into 250 ordinary shares. When the bonds are issued the market interest rate for similar debt without the conversation option is 9% (i.e. the market interest rate for similar bonds with the same credit standing having no conversation rights).

Question 18 – Entity A

Entity A issues a bond with a principal amount of $100000. The holder of the bond has the right to convert the bond into ordinary share of Entity A. On issuance, Entity A receives proceeds of $100000. By discounting the principal and interest cash flows of the bond using interest rates for similar bonds without an equity component, Entity A determines that the fair value of a similar bond without any equity component would have been $91000. Therefore, the initial carrying amount of the liability component is $91000. The initial carrying amount of the equity components is computed as the difference between the total proceeds (fair value) of $100000and the initial carrying amount of the liability component of $91000. Thus the initial carrying amount of the equity component id $9000. Pass the journal Entry.

Question 19 – Entity A

On October 31,20X5, Entity A issues convertible bonds with a maturity of 5 years. The issue is for a total 1000 convertible bonds. Each Bond has a par value of $100,000, a stated interest rate is 5%per year , and is convertible into 5000 ordinary shares of entity A . The convertibles bonds are issued at par the per share price for an entity a share is 15$. Quotes for similar bonds issued by entity A without a conversation option (i.e. bonds with similar principal and interest cash flow) suggest that they can be sold for $90000. Pass the journal Entry.

Question 20 – D Ltd.

On 1st April 2008 D Ltd. Issued Rs.3000000, 6% convertible debentures of face value of Rs.100 per debenture at par. the debentures are redeemable at a premium of 10% on 31.03.12 or these may be converted into ordinary Shares at the option of the holder the interest rate for equivalent debentures without conversion rights would have been 10%

Being compounded financial instrument, you are required to separate equity and debts portion as on 01.04.08.

Question 21 – Sigma Ltd.

On 1st April, 2008 Sigma Ltd. issued 6% convertible debentures of face value of Rs.100 per debenture at par. The debentures are redeemable at a premium of 10% on 30-03-2012 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%. Being a compound financial instrument, you are required to separate equity and debt portions as on 01-04-2008. Equity portion is Rs. 1,85,400. Find out the debt portion (Debenture amount). The present value of Re. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of Year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

Question 22 –

At the beginning of year 1, an enterprise issued 20,000 convertible debentures with face value Rs.100 per debenture at par. The debenture have six year term. The interest at annual rate of 9% is paid half yearly. The bond holders have an option to convert half of the face value of debentures in to 2 ordinary shares at the end of year 3. The bondholder not exercising the conversation option will be repaid at par to the extent of Rs.50 per debenture at the end of year 3. The non-convertible portion will be repaid at 10% premium at the end of year 6. At the time of issue the prevailing market interest

rate for similar debt without conversion option was 10%. Calculate Value of Debt and Equity and also pass journal entries.

Question 23 – A Ltd.

On 1-4-2008 A Ltd. Issued 8% debentures of Rs.1200000. These are redeemable at 10% premium or to be converted into equity shares at choice of company on 31-3-2011. Rate of interest for non-compound financial instrument is 14%. Calculate values of liability and equity and also pass journal entries.

Question 24 – ASF Ltd.

ASF LTD. Issued 9% convertible debenture of Rs700000 at 10% discount on 1.4.2008convertible on 31.3.2011. These are to be converted at 10% premium. Discount Rate on non-convertible debenture is 13%. Calculate Debt and Equity and pass journal entries.

Question 25 – ASF Ltd.

ASF Ltd. issued 10% convertible debentures for Rs.1000000 on 1.4.08. on 31.3.2011. Company will repay 40% debentures at 10% premium. On 31.3.2013 the company will convert remaining debentures into equity shares. Debenture holders will have the option to receive cash instead of shares. Similarly Debentures without conversion rights carry rate of interest of 12%. Calculate debt and equity.

Question 26 – A Ltd.

A Ltd. issued on 1.4.2010, 12% debentures of Rs.100 each for Rs.1000000 at a discount of 6%. These are to be converted into equity Shares. Date of conversion is 31.03.2013. Interest is charged yearly. Assume debenture without conversion right would be issued at 15%. Calculate debt and equity

Question 27 – A Ltd.

A Ltd. issued on 1.4.2008, 13% debentures of Rs.1500000at a discount of 10%. These are convertible into equity shares. Interest is paid yearly. At the end of year 3, the company has agreed to pay premium in cash @ 1%. Conversion date is 31.3.2013. Similar debentures, without conversion right can be issued at 18%. Calculate debt and equity. Prepare debt (financial Liability) A/c and debt (equity) A/c.

Question 28 – X Ltd.

On 1.04.2010 X ltd issued 9% Convertible Debentures Rs.800000 at 10% discount. The debentures are convertible at each redemption date into equity shares at the option of holder. The appropriate discounting rate is 20%.

31.03.2012	50% Redemption at 10% Premium
31.03.2013	30% Redemption at 10% Premium
31.03.2014	20% Redemption at 10% Premium

Calculate Financial Liability and Equity

CONTINGENT SETTELEMENT PROVISIONS :

- Financial instruments may be structured such that the obligation to deliver cash or another financial instrument arises only on the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument.
- The issuer does not have an unconditional right to avoid the obligation to deliver cash or another financial instrument and, therefore, such instruments are financial liabilities of the issuer unless:
  - the contingent settlement provision that could require payment in cash or another financial asset is not genuine; or
  - settlement in cash or another financial asset can only be required in the event of liquidation of the issuer; or
  - the instrument meets the specified criteria for a puttable instrument or an obligation arising on liquidation to be classified as equity.

Questions :

Question 29 – Entity A

- Entity A issues preference shares bearing 5 percent cumulative dividends.
- The shares will be redeemed if the applicable taxation or accounting requirements were to change.
- The contingent event of a change in taxation or accounting requirements is deemed to be genuine.
- The requirement for redemption on change of taxation or accounting requirements represents a contingent settlement provision (i.e. it is an uncertain future event beyond the control of both the issuer and the holder of the instrument).
- Is the instrument a financial liability?

Question 30 – Entity B

- Entity B issues shares for CU1 million. Dividends are discretionary. Entity B must redeem the shares for par in the event of a flotation/initial public offering (IPO) of the entity.
- Entity B cannot guarantee a successful flotation/IPO, but it does have discretion as to whether or not to instigate proceedings to float or to seek an IPO.
- Is the instrument a financial liability?

Question 31 – Entity C

- Entity C issues shares for Rs.1 million.
- Entity C must redeem the shares at par in the event that Entity C is not subject to a successful flotation/initial public offering (IPO) within five years from the date of issue of the shares.
- Entity C cannot guarantee a successful flotation/IPO, but it does have discretion as to whether or not to instigate proceedings to float or to seek an IPO.
- Is the instrument a financial liability?

Question 32 – Entity Y

Entity Y issues 6 % cumulative, non-redeemable preference shares with discretionary dividends that are subject to the availability of distributable reserves. The directors of Entity Y can decide at each period end whether and the extent to which a dividend will be paid on the preference shares. The term of the instrument include a dividend stopper i.e if no dividend is paid on the preference shares then no dividend is paid on Entity Y's ordinary shares.

Is the financial instrument an equity or financial Liability?

Question 33 – Entity M

Entity M issues non-redeemable preference shares bearing 6% discretionary Non-cumulative dividends that are subject to the availability of distributable reserves. The directors of Entity M can decide at each period end whether and the extent to which a dividend will be paid on the preference shares. The payments of dividends on Entity M's ordinary shares is also discretionary. However the terms of the instrument include a dividend pusher, i.e. if a dividend is paid on Entity M's ordinary shares, then a dividend must be paid on the preference shares.

Is the financial instrument an equity or financial liability?

CONVERTIBLE BOND WITH CALL FEATURE :

If company issues the bond which has convertible feature, the value of liability should be calculated as follows

Liability component (Disregarding Call) – Value of call payable by the Issuer

Value of Equity = Proceeds – Value of Liability

Question 34 – RM Ltd.

RM Ltd issues callable convertible debentures as issued at Rs.60. The value of similar debentures without call or equity conversion option Rs.57. The Value of call as determined using option pricing model is Rs.2. Determine the value of liability and equity component.

FOREIGN CURRENCY DENOMINATED CONVERTIBLE DEBT :

An Equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instrument is an equity instrument if the exercise price is fixed in any currency

Note : This is a carve out to IFRS. According to IFRS the instrument is designated as equity only if it is in functional currency.

Question 35 – RM

RM has a functional currency of Rs. RM Issues convertible bond denominated in $, that if converted, will result in the gross physical delivery of fixed number of RM's Rs denominated shares. Is the conversion option equity as per IND AS 32.

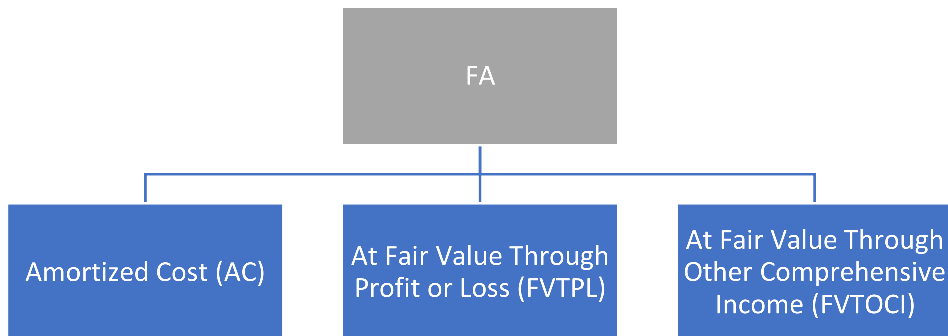
TREASURY SHARES :

The shares that company buys back and does not cancel the same are called Treasury shares. In India, companies are not allowed to hold treasury shares as a financial asset.

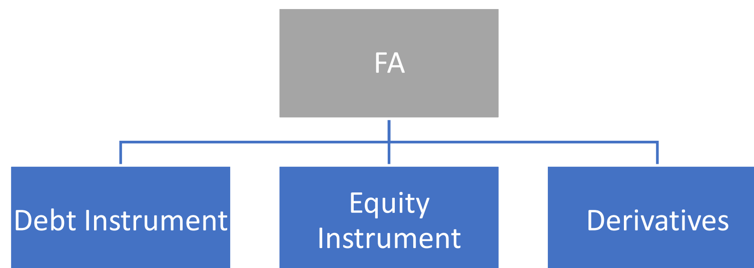
CLASSIFICATION OF FA

FA are classified in to following three categories based on their subsequent measurement:

FA measured at

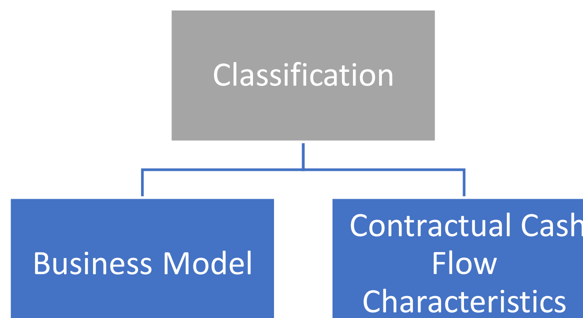


FA are further classified as Investments in



Entity shall classify financial assets on the basis of

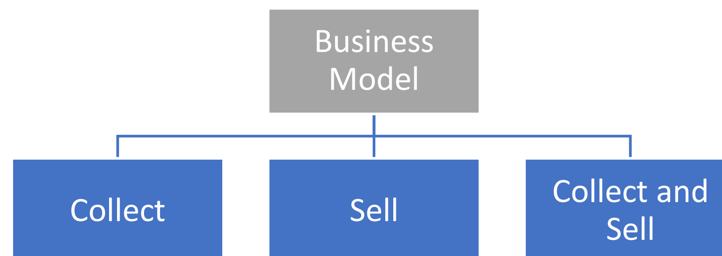
1. Business Model (BM) for managing the FA &
2. Contractual Cash Flow Characteristics (CCFC) and options elected by the entity:



BUSINESS MODEL

BM refers to how an entity manages its FA to generate Cash flows. Whether its objective is met by

1. Collecting contractual cash flows or
2. By selling financial assets or
3. By both.



Questions :

Question 36 – An entity

An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs.

The entity performs credit risk management activities with the objective of minimizing credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs.

Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.

Evaluate the business model.

Question 37 – An entity's

An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit impaired.

If payment on the loans is not made on a timely basis, the entity attempts to realize the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity's objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realizing cash flows by selling them.

In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.

Evaluate the business model.

Question 38 – Entity B

Entity B sells goods to customers on credit. Entity B typically offers customers up to 60 days following the delivery of goods to make payment in full. Entity B collects cash in accordance with the contractual cash flows of trade receivables and has no intention to dispose of the receivables.
Evaluate the business model.

Question 39 – An Entity

An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.
The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re- invest the cash in financial assets with a higher return. The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.
Evaluate the business model.

Question 40 – An Entity

An entity has a business model with the objective of originating loans to customers and subsequently selling those loans to a securitization vehicle. The securitization vehicle issues instruments to investors. The originating entity controls the securitization vehicle and thus consolidates it.
The securitization vehicle collects the contractual cash flows from the loans and passes them on to its investors. In the consolidated balance sheet, loans continue to be recognized because they are not derecognized by the securitization vehicle.
Evaluate the business model.

Question 41 – A financial institution

A financial institution holds financial assets to meet liquidity needs in a 'stress case' scenario (eg, a run on the bank's deposits). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realized.
However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realized if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs.

Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.
Evaluate the business model.

CONTRACTUAL CASH FLOW CHARACTERISTICS (CCFC) :

An entity has to asses that the contractual cash flows from a financial assets are solely collection of principal and interest on the outstanding principal or otherwise. Principal is the fair value at initial recognition and it will change over the life of the financial asset. Interest is the consideration for time value of money, for credit risk and for other basic lending risk & cost.

Questions :

Question 42 – Instrument A

Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.
Evaluate the Contractual cash flows characteristics test.

Question 43 – Instrument F

Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer. Analyze the nature of cash flows.

Question 44 – Instrument H

Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.
Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest. Analyse the nature of cash flows.

Question 45 – Instrument D

Instrument D is loan with recourse and is secured by collateral. Does the collateral affect the nature of contractual cash flows?

Solution :

The fact that a loan is collateralized (since with recourse) does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding. The collateral is only a security to recover dues.

Question 46 – Instrument G

Instrument G is a loan that pays an inverse floating interest rate (i.e. the interest rate has an inverse relationship to market interest rates). Analyze the nature of cash flows.

CLASSIFICATION OF FA :

Classification of Financial Assets (FA) – 1. At Amortized Cost (AC) 2. FVTPL 3. FVTOCI

Debt Instrument

At Amortized Cost if two conditions fulfilled:

1.BM- Collection of contractual cash flows.

2. CCFC- Periodic cash flow is repayment of principal &interest

At FVTOCI (with recycling) if two conditions fulfilled:

1.BM- Collection of contractual cash flows & selling of FA

2. CCFC- Periodic cash flow is repayment of principal &interest

Otherwise at FVTPL

Equity Instrument

At FVTPL if held for trading . Others also at FVTPL except as follows:

Exception: Entity can at initial recognition irrevocably elect to measure investment in equity instrument at FVTOCI (no recycling)

Derivatives

Always measured at Fair Value through Profit or Loss (FVTPL)

Special Note: Irrespective of what is stated in above chart an entity can at initial recognition irrevocably designate a Financial Asset as measured at FVTPL so as to avoid accounting mismatch

FA At Amortized cost (AC):

1. Debt instrument where
   - (a) Business model objective is met through collecting contractual cash flows and
   - (b) Contractual cash flows are only payment of principal and interest on it.

Questions :

Question 47 – An entity

An entity acquires a financial asset for Rs.100. Entity also pays purchase commission of Rs.2. The instrument is measured at Amortized Cost. How shall the instrument be measured?

Question 48 – RM

On Jan 1, 2005, RM Purchases a bond in the market for Rs.53,993. The bond has a principal amount of Rs.50,000 that will be repaid on Dec 31,2009. The bond has stated rate of 10% payable annually, and quoted market interest for the bond is 8%.

Required :

1. How shall bond be measured initially
2. Prepare the amortization schedule at the end year.

Question 49 – RM

On Jan 1, 2005, RM Purchases a bond in the market for Rs. 93,400. The bond has a principal amount of Rs.1,00,000 that will be repaid on Dec 31,2009. The bond has stated rate of 6% payable annually, and quoted market interest for the bond is 7.64%.

Required :

1. How shall bond be measured initially
2. Prepare the amortization schedule at the end year.

Question 50 – RM Ltd.

RM Ltd granted Rs.10,00,000 loan to its employees on Jan 1, 2009 at a concessional Rate of 4%. Loan is to be paid in 5 equal principal installments along with interest. Market rate of Interest for such loans is 10%.

Calculate the amount at which loan should recorded initially and amortized cost for all the subsequent years.

Question 51 – Temp Ltd.

Temp Ltd granted Rs.20,00,000 loan to its employees on Jan 1, 2009 at a concessional Rate of 5%. Loan is to be paid in 5 equal principal installments along with interest. Market rate of Interest for such loans is 10%.

Calculate the amount at which loan should recorded initially and amortized cost for all the subsequent years.

Question 52 – ABC Bank

ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fees@1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

- Rs.10 lacs for a term of 5 years
- Rs.8 lacs for a term of 3 years.

Compute the fair value upon initial recognition of the loan in books of ABC Ltd. and how will loan processing fee be accounted?

Question 53 – Nish Ltd.

Nish Ltd., borrows a sum of Rs.20 crore from RM Ltd repayable as a single bullet payment at the end of 5 years. The interest thereon is 5% payable at each year end. The current market rate for such loans is 8%. Nish was asked to pay origination fee of 2.4 crore. Show how Rm would recognize the loan and the annual interest thereon.

FA At Fair Value through Profit & Loss (FVTPL): This includes:

1. Derivatives always in this category.
2. FA which are Debt or Equity instrument and are Held for trading.
3. Debt instrument which at initial recognition irrevocably designated at FVTPL to remove accounting mismatch. It eliminates or significantly reduces a measurement or recognition inconsistency i.e. related FA & FL are measured or recognized on different basis (also known as an accounting mismatch)
4. Equity instrument other than those which at initial recognition irrevocably designated at FVTOCI.
5. Debt instrument which do not fit in FVTOCI or at AC

Questions :

Question 54 – Nish Ltd.

A Ltd. invested in equity shares of C Ltd. on 15th March for Rs.10,000. Transaction costs were 500 in addition to the basic cost of Rs.10,000. On 31 March, the fair value of the equity shares was Rs.11,200. Pass necessary journal entries. Analyze the measurement principle and pass necessary journal entries.

FA At Fair Value through OCI (FVTOCI):

1. Debt instrument where
   (a) Business model objective is met through collecting contractual cash flows and by selling of asset and

(b) Contractual cash flows are only payment of principal and interest on it.
Equity instrument which at initial recognition irrevocably designated at FVTOCI (no recycling).

Questions :

Question 55 – Metallics Ltd.

Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for Rs 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is Rs.45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income

MEASUREMENT OF FA :

Measurement of financial assets is driven by their classification and can be broadly explained with the help of following diagrammatic presentation:

Measurement of Financial Assets

Initial Measurement

Fair value
- Normally evidenced by the transaction price (i.e Fair value of consideration given or received)
- Where part of consideration is for other than the financial instrument, the entity shall measure fair value of the financial instrument

- Interest Dividend recorded in P & L
- Gains / losses also recorded in P & L

Subsequent Measurement

FA measured at Amortised Cost

Fair Value at initial Recognition
- Principal Repayments
- Cumulative interest using EIR

FA measured at Fair Value (FVTPL/FVTOCI)

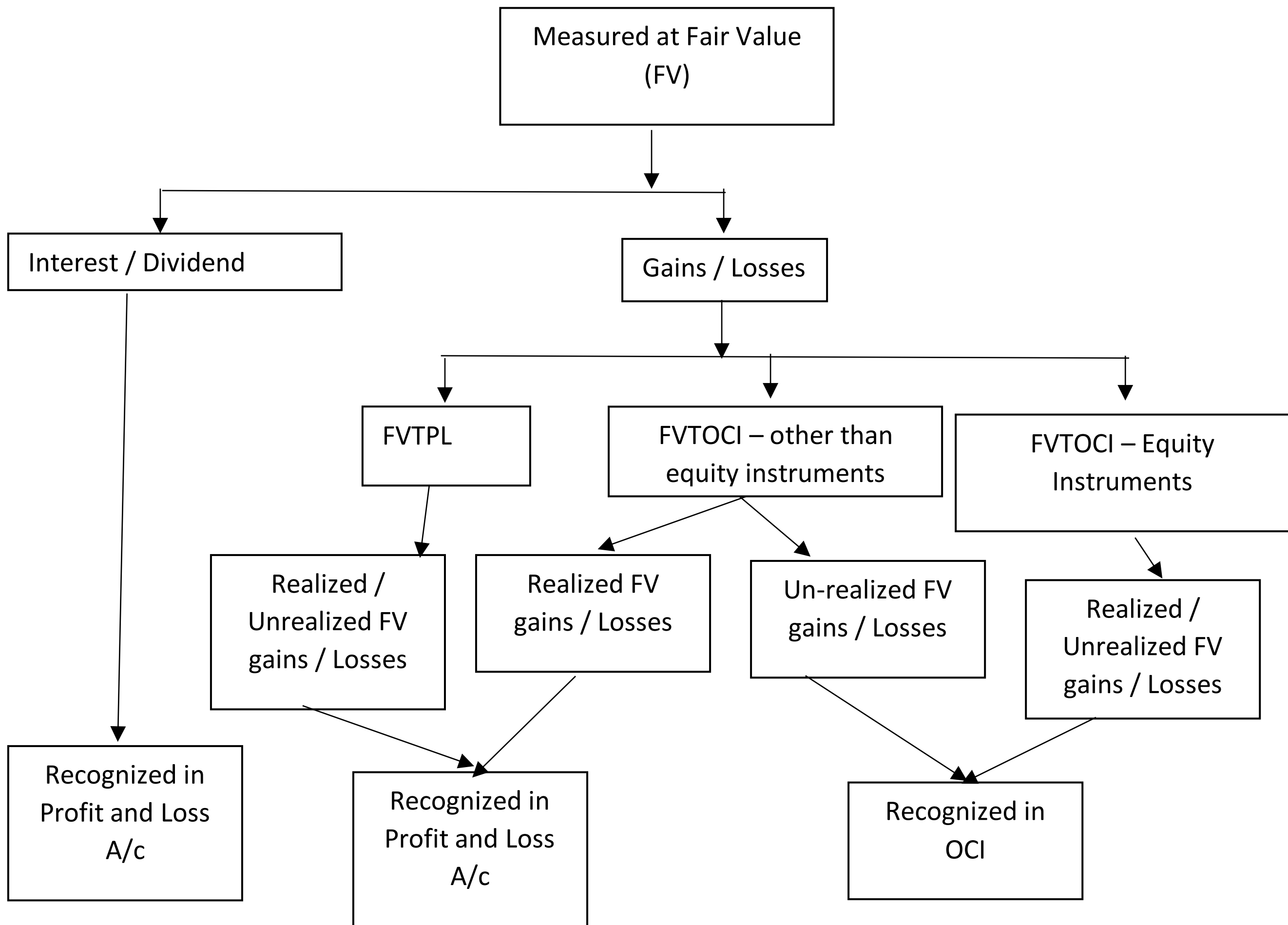
- Fair value determined periodically
- For equity instruments – cost may represent fair value in some situations

For FVTPL/FVTOCI debt instruments
- Interest / Dividend recorded in P & L
- Gains / Losses also recorded through P & L

For FVTOCI equity instruments
- Dividend recorded in P & L
- Gains /losses recorded in OCI

EIR – EFFECTIVE INTEREST RATE METHOD

SUBSEQUENT MEASUREMENT OF FA :



Financial Asset: Classification, Valuation & Recognition:

Item	At FVTPL	At Amortized cost	At FVTOCI (Debt Instrument)	At FVTOCI (Equity Instrument)	Trade Receivable
Initial Recognition at	Fair value	Fair value	Fair value	Fair value	Transaction value
Transaction cost	Charge to P&L	Add to above	Add to above	Add to above	Charge to P&L
Subsequent Measurement	Fair value	Amortised Cost	Fair value	Fair value	Original Transaction Value
Difference arising on re-measurement at fair value	Recognise in P&L	N.A.	Recognise in OCI	Recognise in OCI	N.A.
Subject to review for impairment	No	Yes	Yes	No	Yes
Impairment loss charged to	N.A.	P&L	In OCI	N.A.	P&L

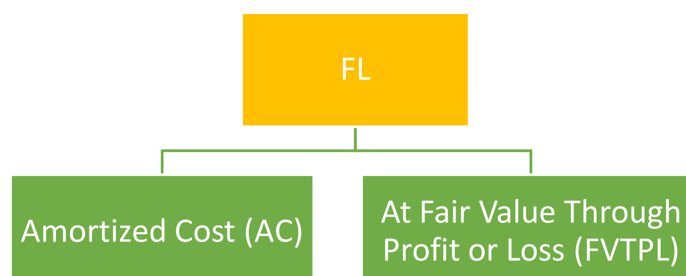
Reversal of impairment loss allowed	N.A.	Yes	Yes	N.A.	Yes

CLASSIFICATION OF FINANCIAL LIABILITY :

FL are classified in to following two categories based on their subsequent measurement:

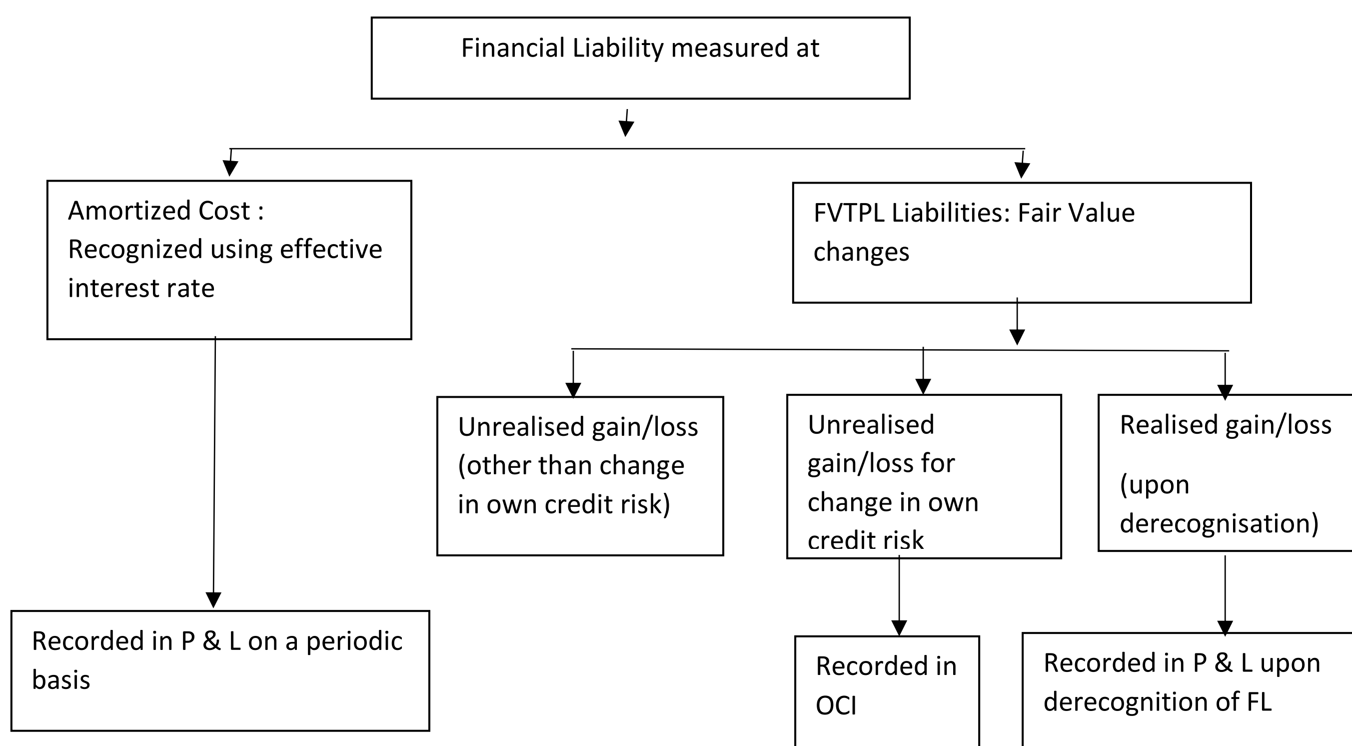
FL measured at

1. Measured at amortized cost
2. Measured at fair value through profit or loss:
   a. Liabilities that meet the definition of "held for trading"
   b. Contingent consideration recognized by an acquirer in a business combination
3. Designated at fair value through profit or loss



Note : Irrespective of above classification, any financial liabilities may be designated at fair value through profit and loss A/c

MEASUREMENT OF FINANCIAL LIABILITY :



Financial Liability: Classification, Valuation & Recognition

Item	At FVTPL- Held for Trading	At FVTPL- Designated	At Amortized Cost
Initial Recognition	At fair value	At fair value	At Fair value
Transaction cost	Charge to P&L	Charge to P&L	Deduct from above
Subsequent Valuation	At Fair Value. Change in value taken to P&L	At Fair Value. Change in value taken to P&L	Amortised Cost
Gain/loss due to changes in own credit risk	P&L	OCI	NA

Questions :

Question 56 – A Company

A Company purchases its raw materials from a vendor at a fixed price of Rs.1,000 per tonne of steel. The payment terms provide for 45 days of credit period, after which an interest of 18% per annum shall be charged. How would the creditors be classified in books of the Company?

Question 57 – Silver Ltd.

Silver Ltd. has purchased 100 ounces of gold on 10 March 20X1. The transaction provides for a price payable which is equal to market value of 100 ounces of gold on 10 April 20X1 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction price at Rs.10 per share on 10 April 20X1. Whether this is classified as liability or equity? Own use exemption does not apply.

Question 58 – A company

A company borrows Rs.100 lakhs from another company @ 12 % PA for 5 years. It has to pay Rs.40,000 fee for loan origination. Pass the journal Entries.

Question 59 – ABC Bank

ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fees@1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

- Rs.10 lacs for a term of 5 years
- Rs.8 lacs for a term of 3 years.

Compute the fair value upon initial recognition of the loan in books of Target Ltd. and how will loan processing fee be accounted?

Question 60 – A Ltd.

A Ltd has made a borrowing from RBC Bank for Rs.10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for Rs.500 and loan is payable 4 half-yearly installments of Rs.2,500 each. Details are as follows:

Particulars	Details
Loan Amount	10,000
Date of Loan (Starting)	1st April, 2001
Date of Loan (Ending)	31st March, 2003
Repayment	Starts on 31st Sept 2001 (to be paid half yearly)
Installment Amount	2500
Interest Rate	12.00 % PA
Interest charge	Interest is charged quarterly
Upfront Fee	500

How would loan be accounted in the books of A Ltd?

RECLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITY

FINANCIAL ASSETS: An entity shall reclassify financial assets, only if the entity changes its business model for managing those financial assets.

- Amortized cost to FVTPL
- Amortized cost to FVOCI
- FVTPL to Amortized cost
- FVTPL to FVOCI
- FVOCI to Amortized cost
- FVOCI to FVTPL

FINANCIAL LIABILITY : Financial Liability are not permitted to be reclassified

Questions :

Question 61 –

Bonds for Rs.1,25,000 reclassified as FVTPL. Fair value on reclassification is Rs.90,000. Pass the required journal entry. (Amortized cost to FVTPL)

Question 62 –

Bonds for Rs.1,25,000 reclassified as FVOCI. Fair value on reclassification is Rs.90,000. Pass the required journal entry. (Amortized cost to FVTOCI).

Question 63 –

Bonds for Rs.125, 000 reclassified as Amortized cost. Fair value on reclassification is Rs.90,000. Pass the required journal entry. (FVTPL to AC)

Question 64 –

Bonds for Rs.125,000 reclassified as FVOCI. Fair value on reclassification is Rs.90,000. Pass the required journal entry. (FVTPL to FVTOCI)

Question 65 –

Bonds for Rs.125,000 reclassified as Amortized cost. Fair value on reclassification is Rs.90,000. Pass required journal entries. (FVTOCI to AC)

Question 66 –

Bonds for Rs.125,000 reclassified as FVTPL. Fair value on reclassification is Rs.90,000. Pass the required journal entry. (FVTOCI to FVTPL).

PART 4 • RECOGNITION AND DERECOGNITION OF FI

4.1 INITIAL RECOGNISATION :

Recognize Financial Asset (FA) or Financial Liability (FL) when and only when entity becomes party to the contractual provisions of the instrument.

IND AS 109 provides certain examples of applying the aforementioned accounting principle

Nature of Contract	Recognition Principle – When are assets or liabilities recognized?
Unconditional receivables or payables	When the entity becomes a party to the contract and as a consequence, has a legal right to receive or a legal obligation to pay cash.
Firm commitment to purchase or sell goods or services	When at least one of the parties has performed under the agreement i.e until the ordered goods or services have been shipped, delivered or rendered
Firm commitment to purchase or sell goods or services designated as measured at fair value through profit or loss	Net fair value is recognized as an asset or a liability on commitment date
Forward Contracts	On commitment date. When a entity becomes a party to forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero (refer to Note 1). If the net fair value of the right and obligation is not zero, the contract is recognized as an asset or liability.
Option Contracts	When the holder or writer becomes a party to the contract (refer to Note 1)
Planned Future Contracts	Never

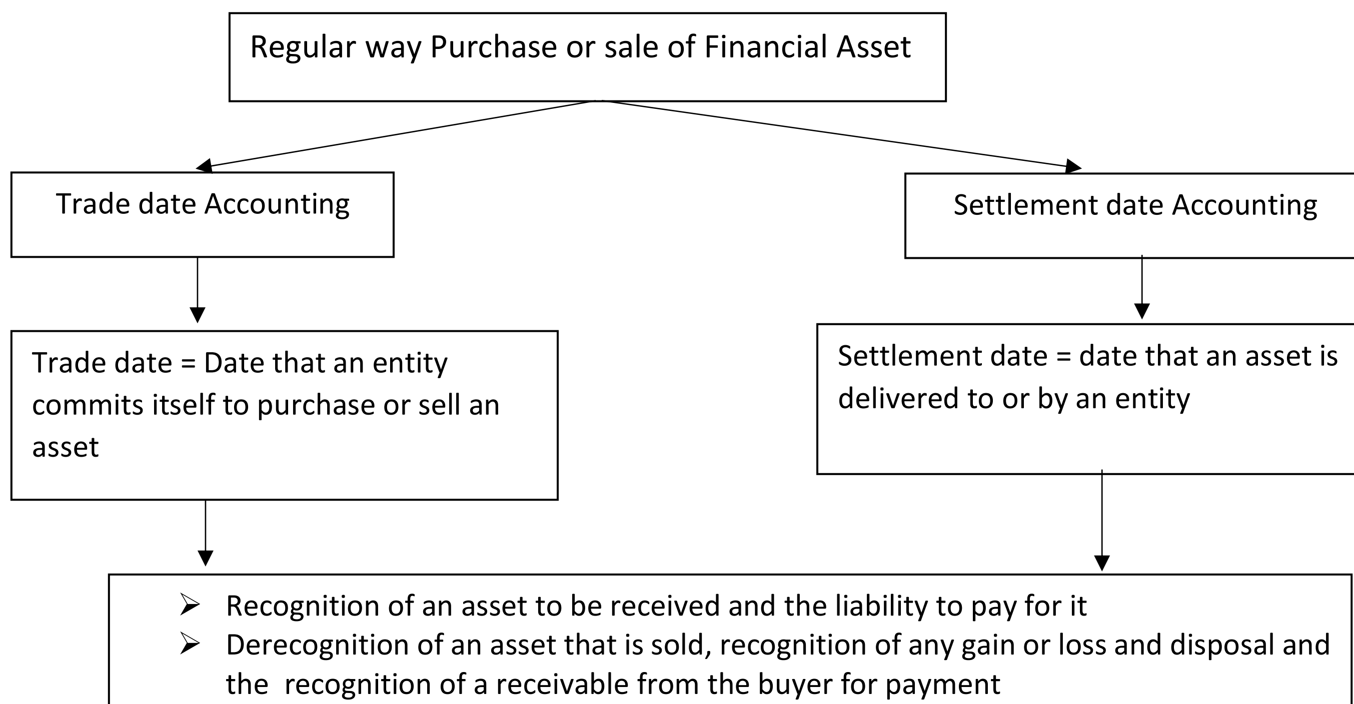
Note 1 : Generally, no upfront premium is paid by one party in a forward contract to the other at the inception of the contract. This is indicative of the fact that the fair value of a forward contract on inception is approximately zero. On the other hand, the option holder generally pays an upfront premium to the option writer at the inception of the option contract. This provides evidence that there is some fair value of the rights and obligations of the parties at the inception of an options contract.

Note 2 : Contracts to buy or sell non- financial assets that can be settled net or by exchanging financial instruments are treated as if they are financial instruments, that is, derivatives unless they were entered into and continued to be held to meet the entity’s normal purchase, sale or usage requirements

4.2 REGULAR WAY PURCHASE OR SALE OF FINANCIAL ASSETS

Ind AS 109 defines a regular way purchase or sale as,

- a **purchase or sale** of a financial asset
- under a **contract**
- whose terms require **delivery** of the asset
- within the **time frame**
- established generally by **regulation or convention in the marketplace** concerned



Questions :

Question 67 –

On March 30, 2014, fair value per ordinary DEBENTURE of A Ltd. Was Rs.45. On this date, B Ltd. Committed to buy 10,000 of these DEBENTURES at fair value. B Ltd. paid the price and accepted delivery of these DEBENTURES on April 3, 2014. B Ltd. Closed its annual accounts on March 31, 2014. Fair value of A Ltd. DEBENTURES was Rs.45.40 on March 31, 2014 and Rs.45.30 on April 3, 2014.

Show journal entries in the books of B Ltd. In respect of above in the following three cases:

A. B Ltd. classifies its investments in A Ltd. as 'Amortized cost category'.

B. B Ltd. classifies its investments in A Ltd. as 'financial asset as fair value through OCI'

C. B Ltd. classifies its investments in A Ltd. as 'financial asset as fair value through profit or loss'.

4.3 DE-RECOGNITION :

Derecognition is the removal of a previously recognized financial asset or financial liability from an entity's balance sheet.

4.3.1 DE-RECOGNITION OF FINANCIAL ASSET :

- Asset is derecognized
  - when contractual right to cash flow expires **or**
  - when contractual right to cash flow is transferred

  Transferred
  - if risk and reward substantially all – transferred – derecognize
  - if risk and reward substantially all – retained – keep it i.e. do not derecognize
  - if risk and reward substantial all – neither transferred nor retained then
    - if control transferred – derecognize
    - if control not transferred – keep it – continuing involvement

- Derecognition of part of F.A. can be made if and only if
  1. these are specifically identified cash flows from FA

  Ex. Interest component of a loan asset is transferred but principle is retained or vice a versa. **or**

  2. fully proportionate share of cash flows from FA

  Ex. 40% portion of Interest & principle of a loan asset is transferred. **or**

  3. fully proportionate share of a specifically identified cash flows.

  Ex. 80% portion of Interest component of a loan asset is transferred.

  4. In all other cases derecognize in full

- Assets transferred and servicing rights retained for a fee.
  - If Servicing Asset – allocate carrying asset amount between asset transferred and servicing asset in proportion to their respective fair value.
  - If Servicing Liability – value at fair value.
  - New asset, liability created – at fair value.

- Part derecognized – carrying amount allocated between the part derecognized and part retained on the basis of fair value.

- **On Derecognition – whether derecognize in full or in part profit or loss (including amount kept in OCI) recognized in P&L.**

Questions :

Question 68 – ST Ltd.

ST Ltd. assigns its trade receivables to AT Ltd. The carrying amount of the receivables is Rs.10,00,000. The consideration received in exchange of this assignment is Rs.9,00,000. Customers have been instructed to deposit the amounts directly in a bank account for

the benefit of AT Ltd. AT Ltd. has no recourse to ST Ltd. in case of any shortfalls in collections.

State whether the derecognition principles will be applied or not.

Question 69 – Mr.B.

A has given a loan of Rs.10,000 to Mr.B. He transferred a part of that asset at a fair value of Rs.9,460 and he retained the remaining part whose fair value is rs.3,740. Pass the journal entries.

Question 70 – B Ltd.

B Ltd has given 10% Loan to X Ltd for Rs.10,00,000. B Ltd has securitized it for 9% rate of interest with ARCIL. Term of loan is 5 years.

Journalize.

Question 71 – B Ltd.

B Ltd has given 10% Loan to X Ltd for Rs.10,00,000.

B Ltd has securitized it for 12% rate of interest with ARCIL. Term of loan is 3 years. B Ltd has only securitized only interest strip

Journalize.

Question 72 – A Ltd.

A Ltd. has Loan of Rs.10,00,000 on interest Rate of 10% p.a. It Securitised 40% of principal and 7% Interest strip on remaining principal (with interest there on). Period of Loan is 3 Years. Discount rate used by Arcil is 15%.

Pass journal Entry.

Question 73 – ASF Ltd.

ASF Ltd. has lent a sum of Rs.10 lakhs @ 18% per annum for 10 years. The loan had a Fair value of Rs.12,23,960 at the effective interest rate of 13%.

ASF Ltd. transferred its right to receive the Principal amount of the loan on its maturity with interest, after retaining rights over 10% of principal and 4% interest that carries Fair Value of Rs.29,000 and Rs.1,84,620 respectively.

The consideration for the transaction was Rs.9,90,000.

The interest component retained included a 2% fee towards collection of principal and interest that has a Fair Value of Rs.65,160.

You are required to show the journal Entries to record derecognition of the Loan.

Question 74 – Entity A

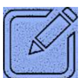
Entity A sells a financial asset for Rs.10,000. There are no strings attached to the sale, and no other rights or obligations are retained by Entity A.

Question 75 – Entity A

Entity A sells an investment in shares for Rs.10,000 but retains a call option to repurchase the shares at any time at a price equal to their current fair value on the repurchase date.

Question 76 – Entity C

Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company B agrees to pay Rs.91.5 crores, less a servicing charge of Rs.1.5 crores (net proceeds of Rs.90 crores), in exchange for 100% of the cash flows from short-term receivables.
The receivables have a face value of Rs.100 crores and carrying amount of Rs.95 crores. The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses upto Rs.5 crores, over and above the expected credit losses of Rs.5 crores and losses of up to Rs.15 crores are considered reasonably possible. Comment.



Question 77 –

Pass the necessary Journal Entry for above question.

4.3.2 DE-RECOGNITION OF FINANCIAL LIABILITY :

- Derecognition of FL (or part of FL) when and only when obligation is **discharged**, **cancelled** or **expires** or
- Exchanged with FL with substantially different terms or substantial modification of terms then derecognize old liability and recognize new.
- Gain/loss recognize in P&L
- If part derecognized (part repurchased) then allocate carrying amount on the basis of fair value.

4.3.2.1 EXCHANGE OF FINANCIAL LIABILITY INSTRUMENTS

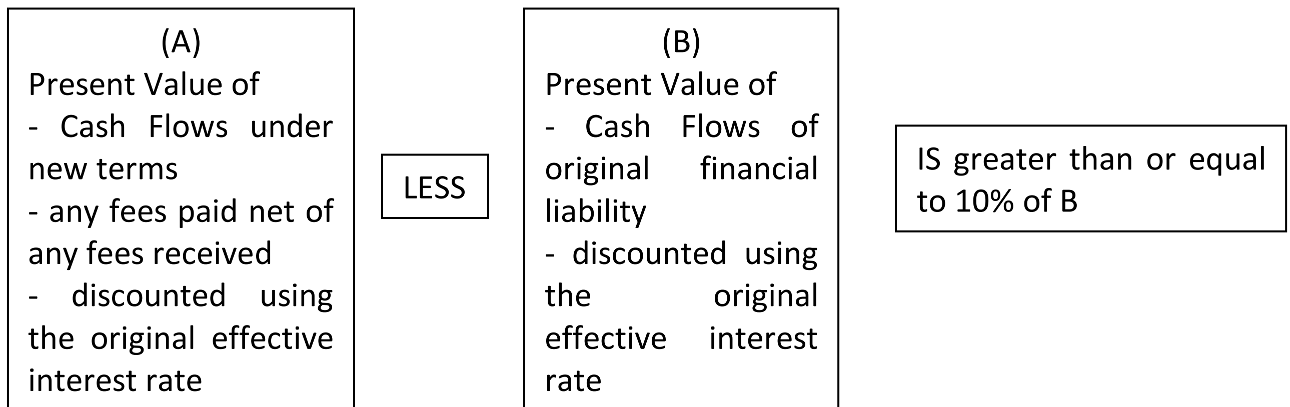
Many times entities re-negotiate terms of their existing debt with the lenders. In India, this is popularly known as "Strategic Debt Restructuring" or SDR. Sometimes, entities approach their lenders to renegotiate terms of their debt, when they want to take advantage of the falling interest rate regime.

In accounting terms, such situations need to be evaluated to determine whether the original debt is **extinguished**.

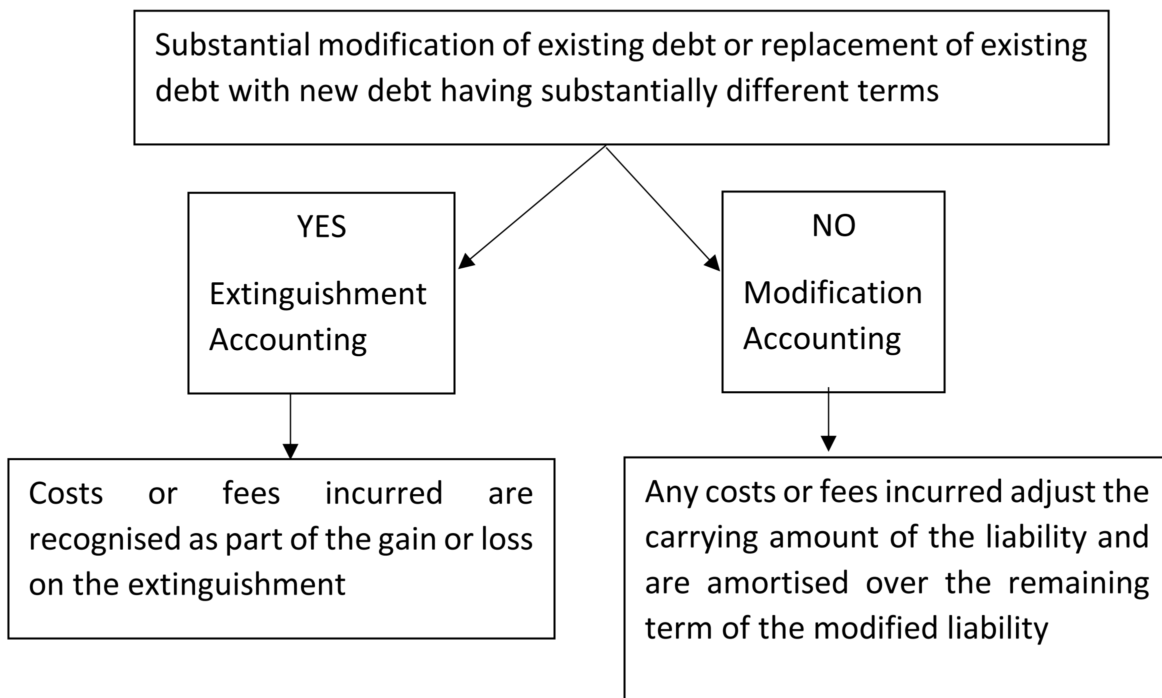
As per Ind AS 109, an exchange between an existing borrower and lender of debt instruments with **substantially different terms** shall be accounted for as:

- an extinguishment of the original financial liability, and
- the recognition of a new financial liability.

As per Ind AS 109, the **terms are substantially different if:**



If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment.
If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.



EXTINGUISHMENT ACCOUNTING :

If the 10% test is passed, principle of "extinguishment accounting" are applied, that is:

- De-recognition of the existing liability
- Recognition of the new or modified liability at its fair value (net of any fees incurred directly related to the new liability)
- Recognition of a gain or loss equal to the difference between the carrying value of the old liability and the fair value of the new one
- Recognizing any incremental costs or fees incurred for modification (and not for the new liability), and any consideration paid or received, in profit or loss
- Calculating a new effective interest rate for the modified liability, which is then used in future periods.

Fair value of the new or modified liability is estimated based on the expected future cash flows of the modified liability, discounted using the interest rate at which the entity could raise debt with similar terms and conditions in the market.

Questions :

Question 78 – XYZ Ltd.

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs.10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs.10,00,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

- the term is extended to 31 December 20Y1;
- interest payments are reduced to 5% p.a.;
- the bonds are redeemable on 31 December 20Y1 for Rs.15,00,000; and
- legal and other fees of Rs.1,00,000 are incurred.

XYZ Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%.

MODIFICATION ACCOUNTING :

Ind AS 109 is not clear as to the accounting treatment if the 10% test is failed. Two alternate approaches are therefore possible:

Approach 1: Recognition of gain or loss on date of modification

Under this approach, the difference between:

- discounted present value of the remaining cash flows of the original financial liability, and
- discounted present value of the remaining cash flows of the new financial liability
- both computed using original effective interest rate,
- is recognized in profit or loss. In addition, any fees or costs incurred will also be recognized in profit or loss.

Approach 2: Amortization of gain or loss on date of modification

- Under this approach,
- the fees or costs incurred are netted against the existing liability;
- the effective interest rate is recalculated. This is the rate which discounts the future cash flows as per modified contractual terms to the adjusted carrying amount mentioned above
- the adjusted effective interest rate is used to determine the amortised cost and interest expense in future periods

Questions :

Question 79 – XYZ Ltd.

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs.1,000,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs.1, 000,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

1. no further interest payments are made
2. the bonds are redeemed on the original due date (31 December 20X9) for Rs.1,600,000;
3. legal and other fees of Rs.50,000 are incurred.

DEBT FOR EQUITY SWAPS :

A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'.

The accounting principles are summarized below:

- An entity shall **remove a financial liability** (or part of a financial liability) from its balance sheet when, and only **when, it is extinguished** in accordance with derecognition principles mentioned above
- When **equity instruments issued to a creditor** to extinguish all or part of a financial liability are recognised initially, an entity shall **measure them at the fair value** of the equity instruments issued, unless that fair value cannot be reliably measured.
- **If the fair value of the equity instruments issued cannot be reliably measured** then the equity instruments shall be measured to reflect the **fair value of the financial liability** extinguished.
- **If only part of the financial liability is extinguished**, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid **does relate to a modification of the terms** of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding.

- The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. **If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability**.
- The **difference** between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be **recognised in profit or loss**

Questions :

Question 80 – JK Ltd.

JK Ltd. has an outstanding unsecured loan of Rs.90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, JK Ltd. is unable to service the debt and approaches the bank for a settlement.

The bank offers the following terms which are accepted by JK Ltd.:

- 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is Rs.80 crores.
- 1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is Rs.25 crores. The fair value of the cash flows as per these revised terms is Rs.28 crores.

Fair value of the consideration paid is Rs.56 crores (70% of Rs.80 crores) plus Rs.28 crores i.e. Rs.84 crores.

PART 5

• DERIVITIVES AND EMBEDDED DERIVATIVES

5.1 DERIVITIVES :

It is a Financial Instrument or any other contract which fulfills all the 3 conditions given below

1. The value changes to the underlying Asset
2. No Initial Investment or Very low Initial Investments
3. Settlement at a future date.

Examples of common derivative contracts and the identified underlying variable:

Interest rate swap	Interest Rates
Currency Swap	Currency Rates
Commodity Swap	Commodity prices
Equity Swap	Equity Prices
Credit Swap	Credit rating, credit index or credit price
Total Return Swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option	Interest rates
Purchased or written currency option (call or Put)	Currency rates
Purchased or written commodity option (Call or Put)	Commodity Prices
Purchased or written Stock option (Call or Put)	Equity Prices
Interest rate future linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity Forward	Equity prices

Questions :

Question 81 – Entity S

Entity S enters into a Rs.100 crores notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C.

- The interest rate of the variable part of the swap is reset on a quarterly basis to three-month Mumbai Interbank Offer Rate (MIBOR).
- The interest rate of the fixed part of the swap is 10% p.a.

- Entity S prepays its fixed obligation under the swap of Rs.50 crores (Rs.100 crores × 10% × 5 years) at inception, discounted using market interest rates
- Entity S retains the right to receive interest payments on the Rs.100 crores reset quarterly based on three-month MIBOR over the life of the swap.

Does the above contract fall under the definition of derivatives?

Question 82 – Entity XYZ

Entity XYZ enters into a forward contract to purchase 1 million ordinary shares of Entity T in one year

- The current market price of T is Rs.50 per share
- The one-year forward price of T is Rs.55 per share
- XYZ is required to prepay the forward contract at inception with a Rs.50 million payment.

Does the above contract fall under the definition of derivatives?

5.2 SPOT TRANSACTION :

- In a spot market, transactions are settled "on the spot".
- Once a trade is agreed upon, the settlement i.e. the actual exchange of money for goods - takes place with the minimum possible delay.
- **Ex.:** When a person selects a shirt in a shop and agrees on a price, the settlement (exchange of funds for goods) takes place immediately. That is a spot transaction.
- **Ex.:** 100 Equity shares of ACC purchased at BSE

5.3 FORWARD TRANSACTION :

- In a forward contract, two parties irrevocably agree to settle a trade at a future date, for a stated price and quantity.
- No money changes hands at the time the trade is agreed upon.
- Suppose a buyer L and a seller S agree today i.e. 1.7.2006 to do a trade in 1000 Shares of Wipro on 31 Dec. 2006 at Rs. 500/ a share. Here, Rs. 500/per share is the "forward price of 31 Dec. 2006 Wipro Share".
- The buyer L is said to be long and the seller S is said to be short.
- Once the contract has been entered into L is obligated to pay S Rs. 5,00,000 on 31 Dec. 2006, and take 1000 Shares of Wipro. Similarly, S is obligated to be ready to accept Rs. 5,00,000 on 31 Dec. 2006, and give 1000 Shares of Wipro.

Forward contracts will be valued at fair value and the difference arising on re-measurement shall be recognized in P&L a/c. Fair value of forward contract at inception will be always zero.

Questions :

Question 83 – An exporter

An exporter has $50,000 due in 6 months. Rate on the date of sale 1st January is Rs.47 per $. The forward rate offered is Rs.47.50. Year ends on 31st March when the exchange rate was 47.20. On settlement date i.e. 30th June rate was 47.60. Show the accounting including for forward contract. Forward rate on 31st March for 30th June due date is Rs.47.55. (it is a forward contract to sell the foreign currency).

Question 84 – A party

A party enters into forward contract for trading or speculation. Contract is to sell $1,00,000 due on 30.6 @Rs.47.50. Today (1st January) spot rate is Rs.47. On 31st March (i.e. at year-end) the forward contract for 3 month (i.e. remaining maturity period upto 30.6) to sell $ is available at Rs.47.55 Rate on 30.6 is Rs.47.60. Account for the transactions.

Question 85 – A party

On February 1, 2009, Future Ltd. entered into a contract with Son Ltd. to receive the fair value of 1000 Future Ltd's own equity shares outstanding as on 31-01-2010 in exchange for payment of Rs.1,04,000 in cash i.e. Rs.104 per share. The contract will be settled in net cash on 31.01.2010.

The fair value of this forward contract on the different dates were:

(i) Fair value of forward on 01-02-2009 Nil

(ii) Fair value of forward on 31-12-2009 Rs.6,300

(iii) Fair value of forward on 31-01-2010 Rs.2,000

Presuming that Future Ltd. closes its books on 31st December each year, pass entries:

If net settled is in cash

If net is settled by Son Ltd. by delivering shares of Future Ltd.

5.4 FUTURES :

Futures contract is a derivative instrument under which buyer and seller have

- a future obligation to buy or sell the underlying asset
- at a given price
- at a given date in future
- for a given quantity

Questions :

Question 86 – Mr.A

- Mr.A enters into a future contract on 28.3.2018. Initial margin is Rs.30,000.
- Initial margin on subsequent days were as follows
- 29.3.18 - Rs.35,000
- 30.3.18 - Rs.25,000
- 31.3.18 - Rs.27,000
- Pass Journal Entries.

Question 87 – Mr.A

- Mr.A enters into a future contract (long) for 100 shares @ 300 each. He paid Rs.5000 initial margin. Date of contract is 27.7.2018. settlement date is 29.9.18
- Price of share on subsequent days were as follows
- 27.7.18 - Rs.315
- 12.8.18 - Rs.350
- 16.8.18 - Rs.340
- 31.8.18 - Rs.290
- 29.9.18 - Rs.310
- Pass Journal Entries.

Question 88 – RM buys

RM buys and XYZ sells Nifty Index Future.

Date	Trade Price per Unit	No. of Lots	Lot Size	Expiry Date	Initial Margin
29.3.2012	Rs.5,330	2	50	26.4.2012	10%
30.3.2012	Rs.5,340	3	50	26.4.2012	10%

Closing Nifty Index Prices were as follows:

Date	29.03.2012	30.03.2012	31.03.2012	1 to 25 April, 2012	26.4.2012
Closing Nifty Index Future Price	Rs.5,350	Rs.5,320	Rs.5,330	Rs.5,340	Rs.5,400

On 01.04.2012, two lots were squared up at Rs.5350.

Required: Pass Journal Entries in the books of Buyer

Question 89 – Mr.A

Suppose Mr. A purchases the following units of Equity Index Futures (EIF):

Date of purchase	Name of future	Expiry date/ series	Contract price per unit (Rs.)	Contract Multiplier (no. of units)
28th March, 2012	EFI	May, 2012	1420	200
29th March, 2012	EF2	June, 2012	4280	50

Daily settlement price of the above units of equity index futures were as follows:

Date	EFI May Series (Rs.)	EF2 June Series (Rs.)
28.3.2012	1410	-
29.3.2012	1428	4300
30.03.2012	1435	4270
31.3.2012	1407	4290
1.4.2012	1415	4250
2.4.2012	1430	-
3.4.2012	1442	-

For the sake of convenience, it has been assumed that the above contracts were settled on the following dates:

- EF2 June Series on 1st April, 2012
- The other contract of EFI May series on 3rd April, 2012.

5.5 SWAP :

- Swap is contract for exchanging one type of Cash flows or obligation with other type.
- We have Interest rate Swap & Currency Swap in the financial market to hedge/ speculate.
- There are no Accounting Standards or Guidance Note as yet on Swap accounting,
- Hence the accounting explained below is on the basis of Generally Accepted Accounting Principles & Frame work for preparation & Presentation of Financial Statements.

Interest Rate Swap :

- When two parties have different interest rate borrowing option(choices) one prefers fixed interest rate and the other prefers fluctuating rate.
- Due to different credit rating of the parties they may be offered rates lower to one than to other.(also known as Quality spread/ differential).
- Such parties with opposite preferences and different credit rating and needing same amount of funds will know each other through a facilitator or bank who may work as a middleman and also offer credit assurances.
- In return part of the gain will be shared with such middleman.
- When both parties have same preferences or both the rates offered to one party are higher than to other by same rate differential or both types of offers to both are same or rates of their preference is already cheap, in such situations there will be no scope for Swap.

Questions :

Question 90 –

Parties	A	B
Credit rating Parties preference	Lower Fixed rate	Higher Fluctuating rate
Rates offered by the lenders Fixed rate Fluctuating rate	 12% Prime rate + 0.5%	 10.5% Prime rate

There is difference in the two types of rate offered to the two parties but difference in fixed rate is 1.5% whereas that in fluctuating rate is only 0.5%. This gives rise to scope for interest rate swap which will result into benefit of 1% which can be shared by both by making interest swap as explained below - Prime rate is assumed at 9%.

Currency Swap :

- When the party say X in one country say in India needs the borrowing in the currency of other country say USA.
- And some other party in USA say Y needs the borrowing in Rupees.
- If 'X' and 'Y' borrows in their own country in foreign currency the cost will be higher than the cost if they borrow in their home currency.
- In such case they may borrow in their home currency equivalent amount and enter into financial contract of currency swap to exchange their cash flows together with interest burden.
- The gain will accrue to both of them.
- But the point is, how such parties will come in contact of each other.
- Here some facilitator / swap Bank will come into picture & the currency swap can be made through them.
- This will also give assurance to both the parties about the compliance of swap terms by the other.
- In return part of the gain will be shared by swap Bank.

Questions :

Question 91 –

	X (from India)	Y (from USA)
Exchange rate assumed 1$ = Rs.40		
Funds needed	$1,00,000	Rs. 40,00,000
Interest rate on Rupee Loan	13%	14%
Interest rate on $ loan	9%	8%

Suggest the Swap scheme.

5.6 OPTIONS :

- **An option** is the right, but not the obligation, to buy or sell something at a stated date at a stated price.
- A **"call option"** gives one the right to buy, but he is not under obligation to do so.
- A **"put option"** gives one the right to sell, but he is not under obligation to do so.
- The person who gets such right is called **'Buyer' or 'Holder'**.
- The person against whom the buyer/ holder can exercise his right is called **'Seller' or 'Writer'**.
- Unlike buyer (holder), the seller (writer) of an option has no right, but an obligation to sell or buy the underlying asset as and when the buyer (holder) exercises his right.
- For this right buyer pays a price to seller known as **option premium**. In a futures contract, there is no payment (other than initial margin). Option premium is the price (value) of option.
- Options come in two varieties - European and American.
- In a **European option**, the holder of the option can only exercise his right (if he so desires) on the expiration date.
- In an **American option**, he can exercise this right anytime between purchase date and the expiration date.
- Options can be on foreign currency, shares, index etc. Option can be used for hedging, speculation or for arbitrage.
- On the maturity date if it is favorable buyer will exercise the option and the option seller will be bound to perform it. If it is unfavorable the buyer will not exercise the option instead can do the transaction at spot rate.
- In market terminology, an option contract can be **'at the money', 'in the money' or 'out of the money'**.
- **'At the money'** means that the current market value of the underlying asset is the same as the exercise price of the option.
- **In the money** is a profit position for the option buyer. A call option is said to be 'in the money' if the current market value of the underlying asset is above the exercise price of the option. A put option is said to be 'in the money' if the current market value of the underlying asset is below the exercise price of the option.
- **Out of the money** is a loss position for the option buyer. A call option is said to be 'out of the money' if the current market value of the underlying asset is below the exercise price of the option. A put option is said to be 'out of the money' if the current market value of the underlying asset is above the exercise price of the option.
- **From the view point of buyer**
  - At the money→ No profit no loss situation
  - In the money → profit position. He will exercise the option.
  - Out of the money → loss position. He will not exercise the option.
- Trading in the options reflects the views of the parties to the contract about the movement in the index and prices of stock. For instance, when two persons enter into an equity index call option contract of one month's maturity at a strike price of Rs.1,100 per unit, it implies that the buyer/holder expects that the price of the equity index at the time of maturity of

the contract would be higher than Rs.1,100 while the seller/writer expects it to be less than Rs.1,100.

Questions :

Question 92 – Light Limited

A buyer buys a stock option of Light Limited on 30th August, 2006 with a strike price of Rs.150 per unit to be expired on September 30, 2006. The premium is Rs.10 per unit and the market lot is of 100. The margin to be paid is Rs.60 per unit.
Show, how the transactions will appear in the books of the seller, when:

1. The option is settled by delivery of the Asset, and
2. The option is settled in cash and the Index price is Rs.160 per unit.

Question 93 – New Light Company Limited

A buyer buys a stock option of New Light Company Limited on 31st October, 2011 with a strike price of Rs.150 per unit to be exercised on February 28, 2012. The premium is Rs.10 per unit and the market lot is of 100. The margin to be paid is Rs.30 per unit. Show, how the transactions will appear in the books of the buyer (X) & seller (Y), if it is a call & if it is a put option when: The option is settled by delivery of the Asset, and if the option is settled in cash and the Share price on maturity is (i) Rs.140 or (ii) Rs.155 or (iii) Rs.170 per unit.

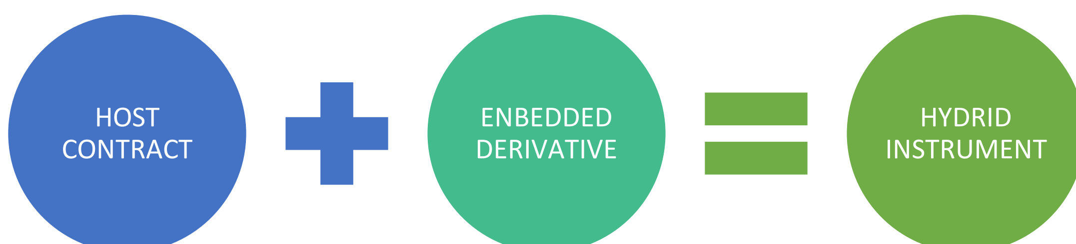
Question 94 –

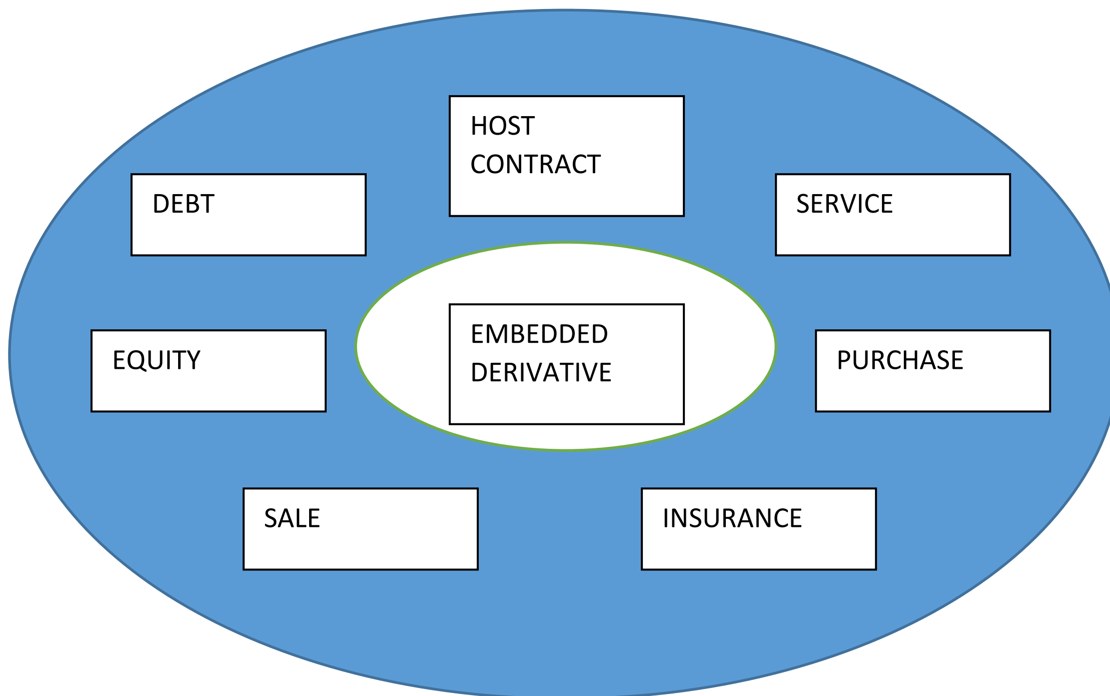
Show also accounting in above case, if the accounting year ends on 31.12.2011 when the same option price/premium is (i) Rs.6 or (i) Rs.15

5.7 EMBEDDED DERIVATIVE :

"An embedded derivative is:

- a **<u>component</u>** of a hybrid contract
- that also includes a **<u>non-derivative host</u>**
- with the effect that **<u>some</u>** of the **<u>cash flows</u>** of the combined instrument **<u>vary</u>** in a way **<u>similar to a stand-alone derivative</u>**.





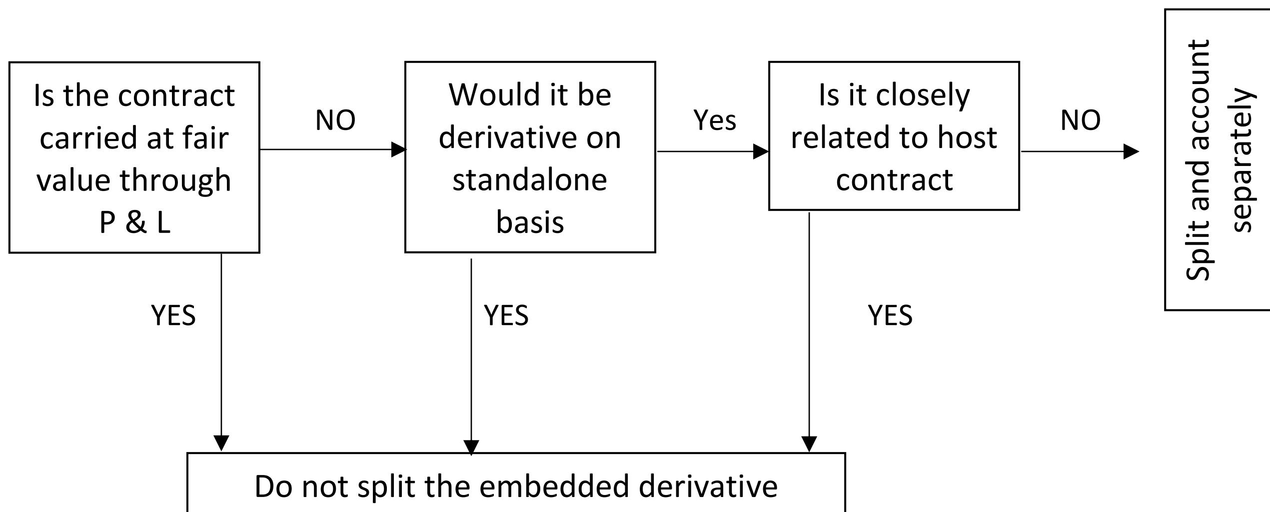
SEPARATION OF EMBEDDED DERIVATIVES FROM HOST CONTRACT :

In certain circumstances, an embedded derivative is required to be separated from the host contract and accounted for separately as a financial instrument.

For this purpose it's important to understand

1. if the host contract is a Financial Asset (Equity / Debt) or
2. if the host contract is not a Financial Asset (Sale / Insurance / Purchase / Service)

1. If a hybrid contract contains a host that is an asset within the scope of this standard then requirement of classification and measurement be applied to entire hybrid contract. (No need to separate embedded derivative)
2. If a hybrid contract contains a host that is not an asset within the scope of this standard, then an embedded derivative should be separated from the host contract and accounted for as a derivative under this Standard if, and only if:
   (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;(Factor affecting risk and return of the host contract is different from the factors affecting the derivative)
   (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (if the embedded derivative can be meet the definition of standalone basis)
   (c) the hybrid (combined) instrument is not measured at fair value through profit or loss (i.e., a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).



Questions :

Question 95 – (Embedded Derivative)

A Lease contract between 2 Indian companies of an Asset in India includes contingent lease rentals that are depended upon US inflation index. Can the entity inflation linked feature as closely related.

Question 96 –

Embedded in a lease contract is a provision requiring lease payment to increase by 1 million if profit after tax is over 100 million. Can the entity treat this feature as closely related.

Question 97 –

What is the Accounting treatment of an investment in a Bond(FA) that is convertible into shares of the issuing entity or another entity before maturity.

Question 98 – The Indian company

The Indian company should be entered into a contract to purchase steel from a local Indian supplier, in 6 months in USD. USD is not the functional currency of either party to the transaction. The steel will be delivered and used over reasonable period in the normal course of business. Contract is entered into 1st Jan 2005. The contract is over a specified amount of steel for USD 1,00,000. The 6 month Forward Rate is Rs/$ 65. The 3 month forward rate on 31/3/2005 is Rs/$ 63 and spot rate on 30/6/2005, the delivery date is Rs/$ 63.5. How the transaction should be accounted.

Question 99 – ABG Pvt. Ltd.

On 1 January 20X1, ABG Pvt. Ltd., a company incorporated in India enters into a contract to buy solar panels from A&A Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30 June 20X1

The purchase price for solar panels is US$ 50 million.

The functional currency of ABG is Indian Rupees (INR) and of A&A is Dirhams.

The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.

Exchange rates:

1. Spot rate on 1 January 20X1: USD 1 = INR 60
2. Six-month forward rate on 1 January 20X1: USD 1 = INR 65

Spot rate on 30 June 20X1: USD 1 = INR 66.

PART 6

• HEDGE ACCOUNTING

HEDGE ACCOUNTING IS AT THE OPTION AT THE MANAGEMENT

HEDGING :

- Hedge refer to actions designed to reduce future uncertainty of cash flows or value of Assets, liabilities etc
- A forward exchange contract to buy foreign currency for future payments in foreign currency is an example of hedge
- The hedge accounting refers to recognition of changes in values of hedged item and financial instrument used for hedging in the same period.

Example :
ABC Ltd. an Indian Company enters into a contract to acquire new machinery from AI, an American company. The cost of the machinery is $ 50,000 and payable in 1 years time. ABC Ltd. functional currency is INR and the current exchange rate is Rs/$ 50.
ABC Ltd. faces the exchange risk associated with this contract. To eliminate this risk, ABC Ltd enters into a forward contract to acquire $ 50,000 in 1 year at the current exchange rate.
In 1 years time when ABC Ltd. has to pay $ 50,000 to AI, pay Rs. 25,00,000 for the machinery irrespective of whether the exchange rate has moved up or down.
This is known as hedging.

HEDGED ITEM :

- Hedged item is an
  - Asset
  - Liability or
  - Transaction
- That exposes an entity to risk of changes in fair value or future cash flows and is designated as being hedged.
- Hedged items
  - Recognised Asset
  - Recognised Liability
  - Unrecognised firm commitment
  - Highly probable forecast transaction
  - Net investment in a foreign operations

HEDGING INSTRUMENT :

A hedging instrument is a Financial instrument, mostly a derivative, designated for hedging a specific item of asset, liability etc.

Note : Derivatives not regarded as hedge instruments are treated as held for trading instruments.

HEDGE ACCOUNTING :

The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income, in the case of investments in equity instruments at FVTOCI).

Hedge accounting recognises the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item.

Hedging relationships are of three types:

(a) **fair value hedge:** a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion thereof, that is attributable to a particular risk and could affect profit or loss.

(b) **cash flow hedge:** a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss.

(c) **hedge of a net investment** in a foreign operation as defined in IndAS 21.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

Items and their hedging :

Item being Hedged	Fair Value Hedge	Cash Flow Hedge
1. Recognised Asset	Yes	Yes
2. Recognised Liability	Yes	Yes
3. Unrecognized firm commitment	Yes	No
4. Foreign currency risk of a unrecognized firm commitment	Yes	Yes
5. Highly probable forecast transaction	No	Yes

Hedging: Fair value Hedge or Cash flow hedge

Risk Types	Example	Reason
Fluctuation in Fair value :	Investment in Fixed Rate Bond	With change in Market interest rate Bonds interest will not change but its market value will change
Fluctuation in cash flows :	Investment in Variable Rate Bond	With change in Market interest rate Bond interest (i.e. cash flow) will change & not the value of bond.

A hedging relationship qualifies for hedge accounting if, and only if, all of the following conditions are met.

(a) **Hedging relationship** consist of eligible hedging instrument and eligible hedging item. At the inception of the hedge there is **formal designation and documentation** of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge.

(b) **the hedging relationship meets all of the following hedge effectiveness requirements:**

(i) there is an economic relationship between the hedged item and the hedging instrument;

(ii) the effect of credit risk does not dominate the value changes that result from that economic relationship; and

(iii) the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting.

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again (this is referred to as 'rebalancing').

Fair Value Hedges :

(i) A fair value hedge **should be accounted for as follows:**

(a) the gain or loss from remeasuring the hedging instrument at fair value should be recognised in the statement of profit and loss; and

(b) the gain or loss on the hedged item attributable to the hedged risk should adjust the carrying amount of the hedged item and be recognised in the statement of profit and loss.

Recognition of the gain or loss attributable to the hedged risk in the statement of profit and loss applies even if the hedged item is a FA at FVTOCI. But if hedged item is an investment in equity instrument elected as at FVTOCI then gain/loss both on hedged item and hedging instrument be recognized in OCI.

(ii) An entity should **discontinue prospectively the hedge accounting** only when the hedging relationship ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable). This includes:

(a) the hedging instrument expires or is sold, terminated or exercised;or

(b) the entity revokes the designation.

(iii) **Amortization of the adjustment to the value of hedged item measured at amortized cost:**
Any adjustment arising as above to the carrying amount of a hedged financial instrument measured at amortized cost, should be amortised to the statement of profit and loss.
Amortisation may begin as soon as an adjustment exists and should begin no later than when the hedged item ceases to be adjusted for changes in its fair value.
The **adjustment is based on a recalculated effective interest rate at the date amortization begins.**
In the case of a financial asset that is a hedged item and that is measured at FVTOCI, amortization applies in the same manner but to the amount that represents the cumulative gain or loss previously recognised in OCI, instead of by adjusting the carrying amount.

(iv) When an **unrecognized firm commitment is designated as a hedged item**, the subsequent cumulative change in the fair value of the firm commitment is recognised as an asset or liability with a corresponding gain or loss recognised in the statement of profit and loss. The changes in the fair value of the hedging instrument are also recognised in the statement of profit and loss.

When an entity enters into a **firm commitment to acquire an asset or assume a liability that is a hedged** item in a fair value hedge, the initial carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the firm commitment that was recognised in the balance sheet.

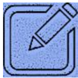
Questions :

Question 100 – RM Ltd.

RM Ltd has Rs. as its functional currency. It has chosen to treat all hedges of foreign currency risk associated with firm commitment as fair value hedges. In Jan 2017, it contracts which the US supplier to purchase a machinery. The machine will be delivered in July 2017 and the contracted price is $ 1000. RM Ltd contracts with the bank to purchase $ 1000 in July at a fwd rate of Rs/$ 60. If the Fair value of fwd contract at the end 31st March 2017, is Rs.3000 positive to RM, on delivery Rs.5000 positive to RM. Spot exchange rate in July is Rs/$ 65. Pass journal Entries.

Question 101 – RM Ltd.

RM Ltd maintains an inventory of COCOA that it used in production of Chocolate. RM was to hedge the risk of the price changes in the COCOA inventory. On 1/7/2005 it enters into a Fwd derivative instrument at is indexed to COCOA. The FV of COCOA inventory has decreased by Rs.50,000 and the FV of Derivative has increased by Rs. 50,000. Pass journal entry for FV Hedge.



Question 102 – Entity A

Entity A has originated a 5% fixed rate loan asset that is measured at amortized cost ($100,000). Because Entity A is considering whether to securitize the loan asset (i.e., to sell it in a securitization transaction), it wants to eliminate the risk of changes in the fair value of the loan asset. Thus on January 1, 2006, Entity A enters into a pay-fixed, receive-floating interest rate swap to convert the fixed interest receipts into floating interest receipts and thereby offset the exposure to changes in a fair value. Entity A designates the swap as a hedging instrument in a fair value hedge of the loan asset. Market interest rates increase. At the end of the year, Entity A receives $5,000 in interest income on the loan and $200 in net interest payments on the swap. The change in the fair value of the interest rate swap is an increase of $1,300. At the same time, the fair value of the loan asset decreases by $1,300.

Required

- Prepare the appropriate journal entries at the end of the year.
- Assume that all conditions for hedge accounting are met.

Question 103 – A Ltd.

- A Ltd has given a 10% fixed loan to S Ltd. A Ltd measures this loan at an amortised cost of Rs.250,000. A Ltd plans to hive-off the receivable at a later stage and as a measure to safeguard against fall in value of its dues enters into pay-fixed, receive floating interest rate swap to convert the fixed interest receipts into floating interest receipts. A Ltd designates the swap as a hedging instrument in a fair value hedge of the loan asset.
- Over the following months, market interest rates increase and A Ltd earns interest income of Rs.25,000 on the loan and Rs.1,000 as net interest payment on the swap. The fair value of Loan asset decrease by Rs.5,000 while that of interest rate swap increases by Rs.5,000. All conditions required for hedge accounting are satisfied. Pass journal entries in the books of A Ltd.

Question 104 – A Ltd.

- On April 1, 2007. A Ltd. borrowed Rs.10 lakh at annual fixed interest rate of 7% payable half-yearly. The life of the loan is 4 years with no pre-payment permitted. The company expected the interest rate to fall and on the same day, it entered into an interest rate swap arrangement, whereby the company would pay 6 months LIBOR and would receive annual fixed interest of 7% every half year. The swap effectively converted the company's fixed rate obligation to floating rate obligation.
- The following value of swap and debt are available

	Value of swap	Value of debt

	(Rs. in lakhs)	(Rs. in lakhs)
Sept 30, 2007	+0.2	10.2
March 31, 2008	-0.1	9.9

Six month LIBOR on April 1, 2007 was 6% and that on October 1, 2007 was 8%. Show important accounting entries in respect of the swap arrangement.

Question 105 –

During year 1 an investor purchases a fixed rate debt security for Rs.10 million. Based on IND AS 109 Principle it is classified as FVTOCI. At the end of Year 1, the FV of the asset is Rs.11 million. To Protect this value the investor enters into a Hedge by acquiring a Derivative with FV of NIL. At the end of Year 2, the derivative has a fair value 0.5 million and the debt security has a corresponding decline in Fair Value. Pass journal Entries for the FV Hedge.

Question 106 –

Taking data from question no 106, assume that we have purchased a debt instrument which is measured at OCI. Pass journal entries.

Cash Flow Hedges :

(I) If a cash flow hedge meets the qualifying criteria it **should be accounted for as follows:**

(a) the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):

(i) the cumulative gain or loss on the hedging instrument from inception of the hedge; and

(ii) the cumulative change in fair value (present value) of the hedged item (ie the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.

(b) the portion of the **gain or loss on** the hedging instrument that is determined to be an **effective hedge** as per (a) above should be recognised directly in OCI**;** and

(c) the portion of the **gain or loss** on the hedging instrument that is determined to be an **ineffective hedge** should be recognised in the **statement of profit and loss**.

(II) If a hedge of a **forecast transaction** subsequently results in the recognition of a **non-financial asset or a non-financial liability**, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity should:

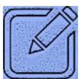
Removes the associated gains and losses from cash flow hedge reserves a/c, and includes them in the initial cost or other carrying amount of the asset or liability. It is not a re-classification hence does not affect OCI.

For other cash flow hedges gain or losses in cash flow hedge reserve be recognised in, the statement of profit and loss in the same period or periods during which the hedged

forecast transaction affects profit or loss (for example, when a forecast sale occurs). It is a re-classification adjustment.
However, all or a portion of a loss in Hedging Reserve account which is expected not to be recovered in one or more future periods, should be recognised immediately in the statement of profit and loss as a re-classification adjustment.

(III) In case the qualifying criteria for hedge accounting no longer meets, entity **should discontinue prospectively the hedge accounting**:
The cumulative gain or loss on the hedging instrument that was recognised cash flow hedge reserve a/c should remain as it is until the future cash flow occurs. When the future cash flow occurs, above treatment applies.
When the forecast transaction is no longer expected to occur the same should be recognised in the statement of profit and loss.

Questions :



Question 107 – R Ltd.

On 4th Jan, 2012, R Ltd. has forecasted sale of 1 million of chemical on 15th Dec, 2012 to M Ltd. in UK. On 4th Jan 2012, R Ltd designates, the cash flow of forecast sale as the Hedged Item and inters into Forward exchange contract to sale 4 million pound based in the forecast receipt (1 million x pound 4 per Kg). Forward contract locks the value of the pound to be received @ Rs/Pound 80. At the inception at the FV of the derivative is Nil.
On 30th June, 2012 the FV of Forward contract is Rs. -1,00,000. On 15st Dec, 2012, the transaction occurred as expected. The FV of Forward contract is -1,50,000 as Rs continued to weaken against pound. Pass journal Entries

Question 108 – Entity A

On 30/9/2017, Entity A Hedges the anticipated sales 24 tons of PULP on 1/3/2018 by entering into a Forward contract. The contract requires net settlement in cash, determined as the difference between the future spot price of PULP on a specified commodity exchange and Rs.1000.
Entity A expects to sale the PULP in the different local market. Entity A determines that the Forward contract is the effective Hedge.
On 31st Dec, the spot price of PULP has increased both in the local market and the exchange. The increase in local market exceeds the increase in commodity exchange as a result the present value of Expected cash inflow from the sale on the local market is Rs.1100. The FV of forward contract is – Rs.80. Pass journal Entry.

Question 109 –

Assume above data, consider on 31/12 the spot price of pulp increase in both the local market and the exchange. The increase in commodity exchange exceeds the local market. The price is expected to be 1080 in the local market and the Forward contract the FV is 100. Pass journal entries.

Question 110 – Entity A

- Entity A is a producer of widgets. To hedge the risk of declines in the price of 100 widgets that it expects to sell on December 31, 2008, Entity A on January 1, 2007, enters into a net–settled forward contract on 100 widgets for delivery on December 31, 2008. During 2007, the change in the fair value of the forward contract is a decrease of $8000. During 2008, the change in the fair value of the forward contract is an increase of $2000. On December 31 2008, Entity A settles the forward contract by paying $6000. At the same time, it sells 100 widgets to customers for $93,000.
- ***Required***
  Prepare the appropriate journal entries on January 1, 2007, December 31, 2008. Assume that all conditions for hedge accounting are met and that the hedging relationship is fully effective (100%).

Question 111 – RM Ltd.

RM Ltd planned to purchase goods amounting to $10,000 in 9 months' time.

Date	Closing exchange rate	Forward rate	Terms of Forward
1.1.15	62.20	62.40	9 Months
31.3.15	62.40	62.55	6 Months
30.6.15	63.67	63.75	3 Months
30.9.15	64.10	-	-

Appropriate risk free rate is 8%. The best estimate for the projected exchange rate on 30.9.15 is forward rate of the appropriate term. Pass journal entries.

Question 112 – RM Ltd.

RM Ltd uses INR as functional currency, RM wants to limit the effects of currency fluctuation in its firm. Statements by hedging highly probable Forecasted USD denominated sales for the month of July 2019. RM expects to sell $1,35,00,000 during the month of July 2019 on 1.1.2019, RM enters into 6 months forward Contract to sell $13500000 @ RS.47.50/$

Date	Spot Rate	Forward rate for June 2019
1.1.19	47.80	47.50
31.3.19	48.10	47.90
30.6.19	48.50	-

"Assume hedge is fully effective and there is no ineffective portion"
Appropriate Risk Free Rate is 6%

Hedges of a Net Investment :

Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see Ind AS 21), should be **accounted for similarly to cash flow hedges** :

(a) the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge should be recognised directly in the OCI as Foreign currency translation reserve account (It should be recognised in the statement of profit and loss on disposal of the foreign operation); and

(b) the portion of the gain or loss on the hedging instrument that is determined to be an ineffective hedge should be recognised in the statement of profit and loss.

Thanks ....

CHAPTER

4

IND AS 102 – SHARE BASED PAYMENT

CONCEPTS COVERED

1. SHARE-BASED PAYMENT
2. EQUITY-SETTLED SHARE-BASED PAYMENTS
3. CASH-SETTLED SHARE-BASED PAYMENTS
4. OTHER ISSUES
5. SELF PRACTICE QUESTIONS

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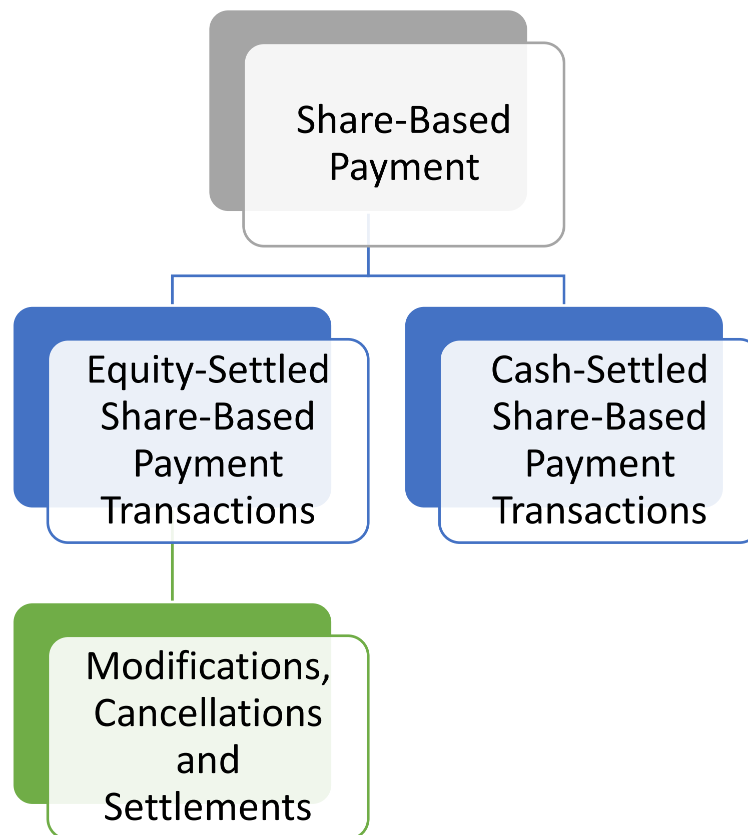


1. SHARE-BASED PAYMENT :

Introduction :

Share-based payment has become increasingly common. Share-based payment occurs when an entity buys goods or services from other parties (such as employees or suppliers) and:

- settles the amounts payable by issuing shares or share options, or
- incurs liabilities for cash payments based on its share price.

Types of transaction :

IND As 102 applies to all share-based payment transactions. There are two main types.

- **Equity-settled share-based payments:** the entity acquires goods or services in exchange for equity instruments of the entity (e.g. shares or share options)
- **Cash-settled share-based payments:** the entity acquires goods or services in exchange for amounts of cash measured by reference to the entity's share price.

The most common type of share-based payment transaction is where share options are granted to employees or directors as part of their remuneration.

2. EQUITY-SETTLED SHARE-BASED PAYMENTS :

Accounting treatment :

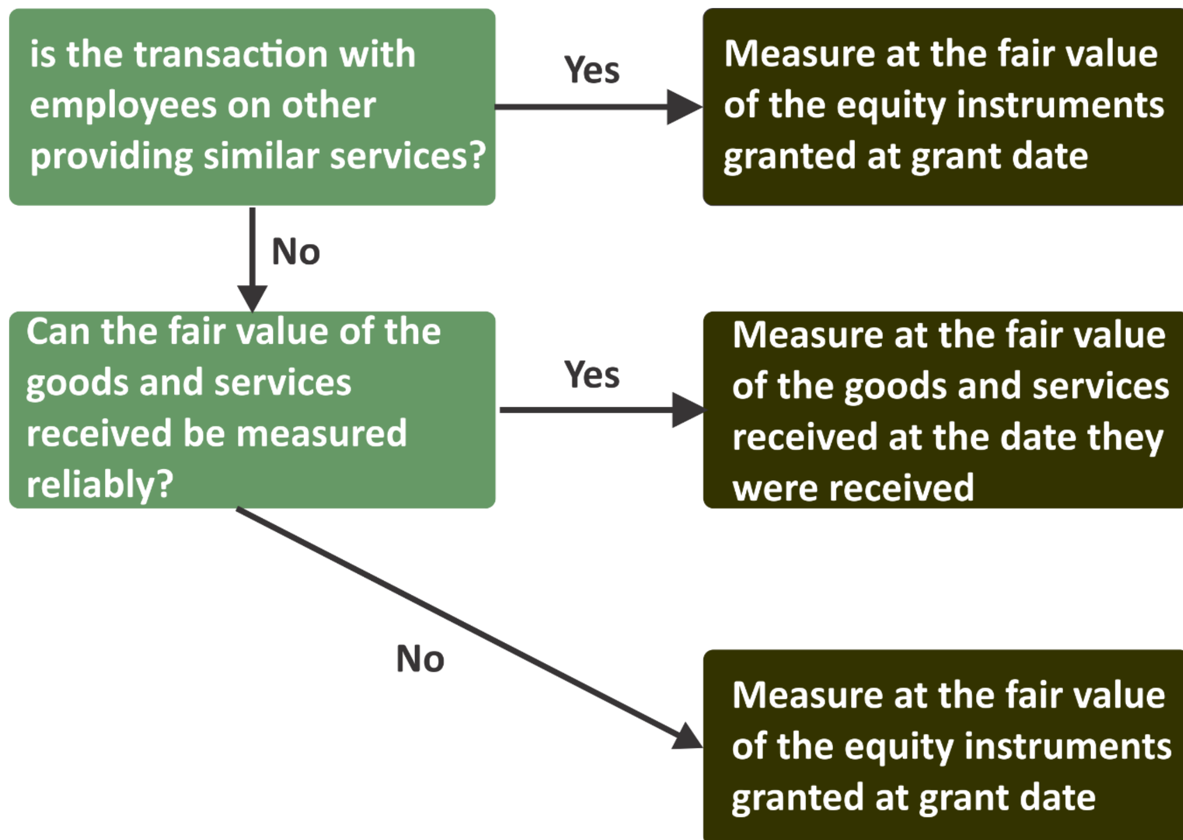
When an entity receives goods or services as a result of an equity-settled share-based payment transaction, it posts the following double entry:

Dr Expense/asset
Cr Equity

The entry to equity is normally reported in 'other components of equity'. Share capital is not affected until the share-based payment has 'vested' (covered later in the chapter).

Measurement :

The basic principle is that all transactions are measured at fair value:



The grant date is the date at which the entity and another party agree to the arrangement.

Allocating the expense to reporting periods :

Some equity instruments vest immediately. In other words, the holder is unconditionally entitled to the instruments. In this case, the transaction should be accounted for in full on the grant date. However, when share options are granted to employees, there are normally conditions attached. For example, a service condition may exist requires employees to complete a specified period of service.

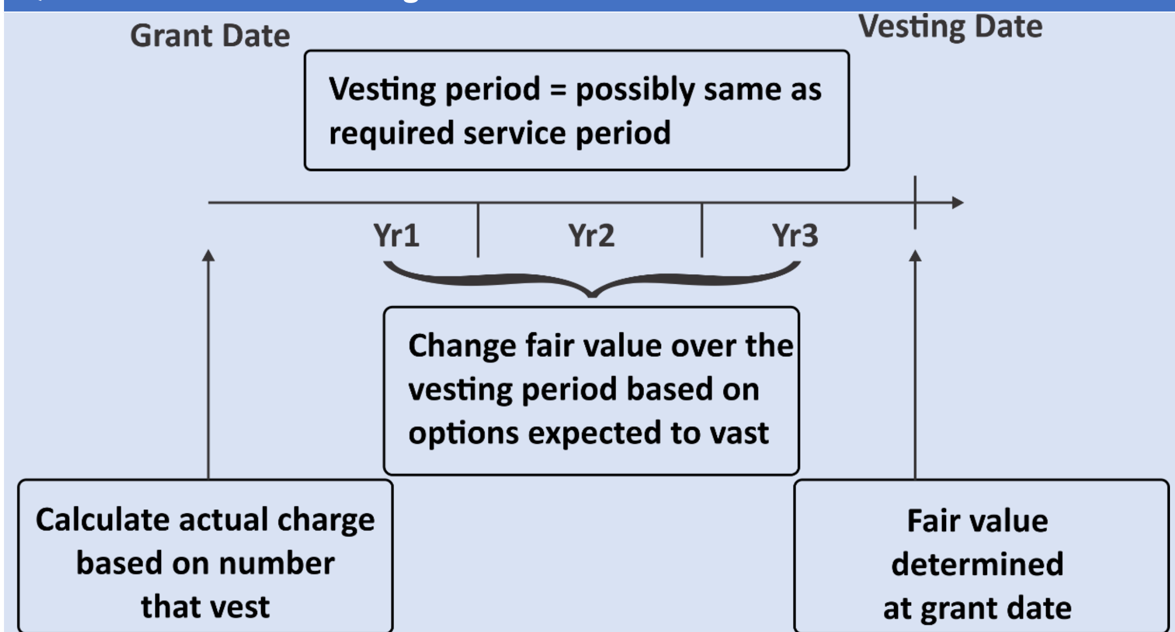
IND As 102 states that an entity should account for services as they are rendered during the vesting period (the period between the grant the vesting date).

The **vesting date** is the date on which the counterparty (e.g. the employee) becomes entitled to receive the cash or equity instruments under the arrangement.

The expense recognised at each reporting date should be based on the best estimate of the number of equity instruments expected to vest.

On the vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vest.

Question 1 – When to recognise the transaction



Test your understanding 1 – Equity-settled share-based

An entity has a reporting date of 31 December.

On 1 January 20X1 it grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee working for the entity until 31 December 20X3. At the grant date the fair value of each share option is $15.

During 20X1, 20 employees leave and the entity estimates that a total of 20% of the 500 employees will leave during the three-year period.

During 20X2, a further 20 employees leave and the entity now estimates that only 15% of the original 500 employees will leave during the three- year period.

During 20X3, a further 10 employees leave.

Required:

Calculate the remuneration expense that will be recognised in each of the three years of the share-based payment scheme.

Performance conditions :

In addition to service conditions, some share based payment schemes have performance conditions that must be satisfied before they vest, such as:

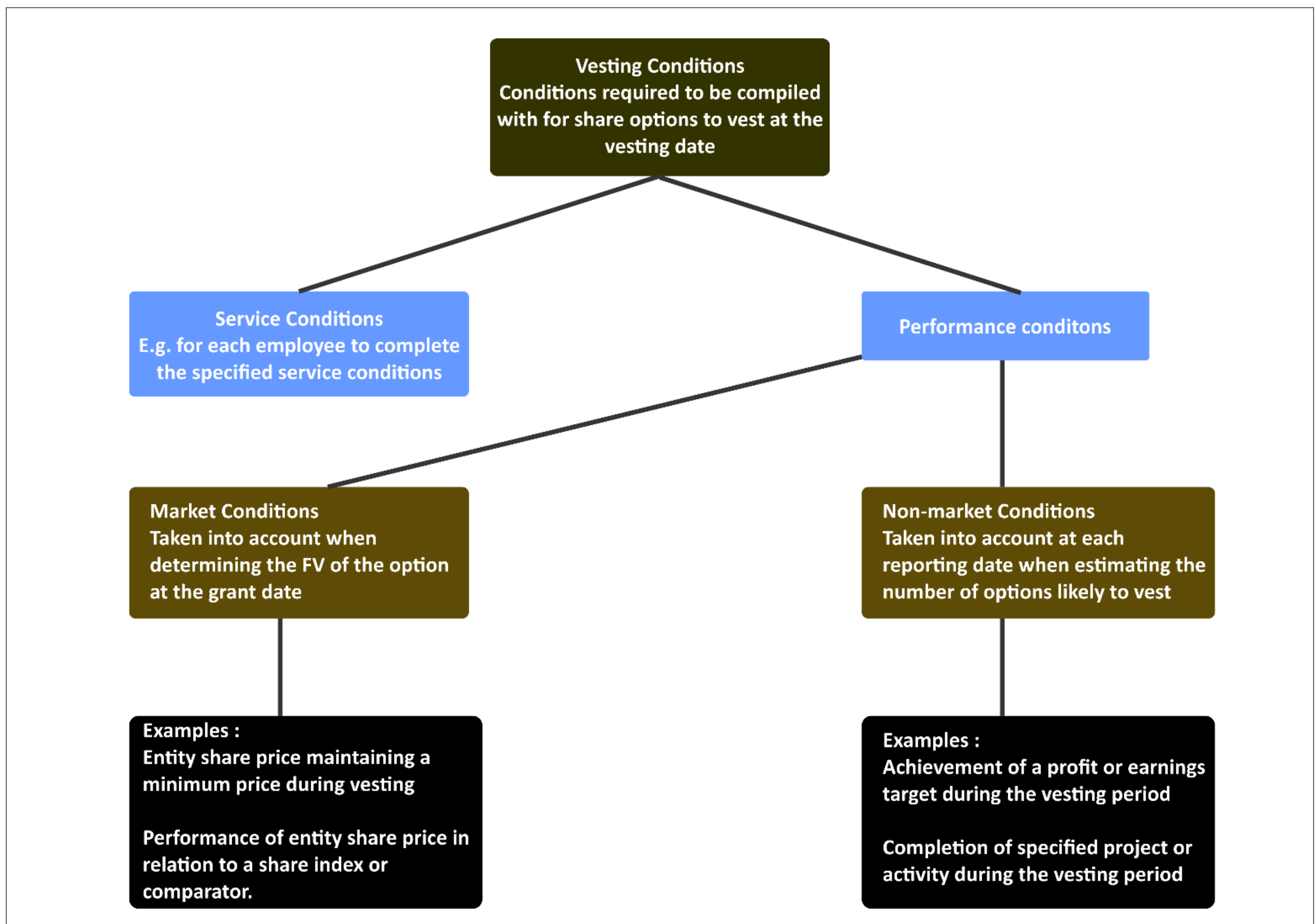
- achieving a specified increase in the entity's profit
- the completion of a research project
- achieving a specified increase in the entity's share price.

Performance conditions can be classified as either market conditions or non- market conditions.

- A **market condition** is defined by IND As 102 as one that is related to the market price of the entity's equity instruments. An example of a market condition is that the entity must attain a minimum share price by the vesting date for scheme members to be eligible to participate in the share- based payment scheme.

- **Non-market performance conditions** are not related to the market price of the entity's equity instruments. Examples of non-market performance conditions include EPS or profit targets.

Conditions attaching to share-based payment transactions : a summary



The impact of performance conditions :

- **Market-based conditions** have already been factored into the fair value of the equity instrument at the grant date. Therefore, an expense is recognised irrespective of whether market conditions are satisfied.
- **Non-market based conditions** must be taken into account in determining whether an expense should be recognised in a reporting period.

Test your understanding 2 - Market based conditions
On 1 January 20X1, one hundred employees were given 50 share options each. These will vest if the employees still work for the entity on 31 December 20X2 and if the share price on that date is more than $5. On 1 January 20X1, the fair value of the options was $1. The share price on 31 December 20X1 was $3 and it was considered unlikely that the share price would rise to $5 by 31 December 20X2. Ten employees left during the year ended 31 December 20X1 and a further ten are expected to leave in the following year.

Required:
How should the above transaction be accounted for in the year ended 31 December 20X1?

Modifications to the terms on which equity instruments are granted :

An entity may alter the terms and conditions of share option schemes during the vesting period. For example:

- it might increase or reduce the exercise price of the options (the price that the holder of the options has to pay for shares when the options are exercised). This makes the scheme less favourable or more favourable to employees.
- it might change the vesting conditions, to make it more likely or less likely that the options will vest.

If a modification to an equity-settled share-based payment scheme occurs, the entity must continue to recognise the grant date fair value of the equity instruments in profit or loss, unless the instruments do not vest because of a failure to meet a non-market based vesting condition.

If the modification increases the fair value of the equity instruments, then an extra expense must be recognised:

- The difference between the fair value of the new arrangement and the fair value of the original arrangement (the incremental fair value) at the date of the modification must be recognised as a charge to profit or loss.
- The extra expense is spread over the period from the date of the change to the vesting date.

Test your understanding 3 - Modifications

An entity grants 100 share options to each of its 500 employees, provided that they remain in service over the next three years. The fair value of each option is $20.

During year one, 50 employees leave. The entity estimates that a further 60 employees will leave during years two and three.

At the end of year one the entity reprices its share options because the share price has fallen. The other vesting conditions remain unchanged. At the date of repricing, the fair value of each of the original share options granted (before taking the repricing into account) was $10. The fair value of each repriced share option is $15.

During year two, a further 30 employees leave. The entity estimates that a further 30 employees will leave during year three.

During year three, a further 30 employees leave.

Required:

Calculate the amounts to be recognised in the financial statements for each of the three years of the scheme.

Cancellations and settlements :

- An entity may cancel or settle a share option scheme before the vesting date.
- If the cancellation or settlement occurs during the vesting period, the entity immediately recognises the amount that would otherwise have been recognised for services received over the vesting period ('an acceleration of vesting' (IND AS 102, para 28a)).
- Any payment made to employees up to the fair value of the equity instruments granted at cancellation or settlement date is accounted for as a deduction from equity.
- Any payment made to employees in excess of the fair value of the equity instruments granted at the cancellation or settlement date is accounted for as an expense in profit or loss.

Test your understanding 4 – Cancellations and settlements
An entity introduced an equity-settled share-based payment scheme on 1 January 20X0 for its 5 directors. Under the terms of the scheme, the entity will grant 1,000 options to each director if they remain in employment for the next three years. All five directors are expected to stay for the full three years. The fair value of each option at the grant date was $8. On 30 June 20X1, the entity decided to base its share-based payment schemes on profit targets instead. If therefore cancelled the existing scheme. On 30 June 20X1, it pair compensations of $10 per option to each of the 5 directors. The fair value of the options at 30 June 20X1 was $9. **Required:** **Explain, with calculations, how the cancellation and settlement of the share-based payment scheme should be accounted for in the year ended 31 December 20X1.**

3. CASH-SETTLED SHARE-BASED PAYMENTS :

Examples of cash-settled share-based payment transactions include:

- share appreciation rights (SARs), where employees become entitled to a future cash payment based on the increase in the entity's share price from a specified level over a specified period of time
- the right to shares that are redeemable, thus entitling the holder to a future payment of cash.

Accounting treatment :

The double entry for a cash-settled share-based payment transaction is: Dr Profit or loss/Asset Cr Liabilities

Measurement :

The entity remeasures the fair value of the liability arising under a cash-settled scheme at each reporting date.

This is different from accounting for equity-settled share-based payments, where the fair value is fixed at the grant date.

Allocating the expense to reporting periods :

Where services are received in exchange for cash-settled share-based payments, the expense is recognised over the period that the services are rendered (the vesting period).
This is the same principle as for equity-settled transactions.

Question 2 – Cash-settled share-based payment transactions

An entity has a reporting date of 31 December.
On 1 January 20X1 the entity grants 100 share appreciation rights (SARs) to each of its 300 employees, on the condition that they continue to work for the entity until 31 December 20X3.
During 20X1, 20 employees leave. The entity estimates that a further 40 will leave during 20X2 and 20X3.
During 20X2, 10 employees leave. The entity estimates that a further 20 will leave during 20X3.
During 20X3, 10 employees leave.
The fair value of a SAR at each reporting date is shown below:

	$
20X1	10.00
20X2	12.00
20X3	15.00

Required:
Calculate the expense for each of the three years of the scheme, and the liability to be recognised in the statement of financial position as at 31 December for each of the three years.

The value of share appreciation rights (SARs) :

SARs may be exercisable over a period of time. The fair value of each SAR comprises the intrinsic value (the cash amount payable based upon the share price at that date) together with its time value (based upon the fact that the share price will vary over time).
When SARs are exercised, they are accounted for at their intrinsic value at e exercise date. The fair value of a SAR could exceed its intrinsic value at this date. This is because SAR holders who do not exercise their rights at that time have the ability to benefit from future share price rises. At the end of the exercise period, the intrinsic value of a SAR will equal its fair value. The liability will be cleared and any remaining balance taken to profit or loss.

Test your understanding 5 - Growler

On 1 January 20X4 Growler granted 200 share appreciation rights (SARs) to each of its 500 employees on the condition that they continue to work for the entity for two years. At 1 January 20X4, the entity expects that 25 of those employees will leave each year.
During 20X4, 20 employees leave Growler. The entity expects that the same number will leave in the second year.
During 20X5, 24 employees leave.

The SARs vest on 31 December 20X5 and can be exercised during 20X6 and 20X7. On 31 December 20X6, 257 of the eligible employees exercised their SARs in full. The remaining eligible employees exercised their SARs in full on 31 December 20X7.

The fair value and intrinsic value of each SAR was as follows:

Reporting date	FV per SAR	Intrinsic value per SAR
31 December 20X4	$5	
31 December 20X5	$7	
51 December 20X6	$8	$7
H December 20X7	$10	$10

Required:

(a) Calculate the amount to be recognised as a remuneration expense in the statement of profit or loss, together with the liability to be recognised in the statement of financial position for each of the two years to the vesting date.

(b) Calculate the amount to be recognised as a remuneration expense and reported as a liability in the financial statements for each of the two years ended 31 December 20X6 and 20X7.

Reporting a cash-settled scheme with an equity-settled scheme :

An entity may modify the terms of a cash-settled share-based payment scheme so that it becomes classified as an equity-settled scheme. If this is the case, IND As 102 requires the entity to.

- Measure the transaction by reference to the modification fair value of the equity instruments granted
- Derecognise the liability and recognise equity to the extent of the services rendered by the modification date
- Recognise a profit or loss for the difference between the liability derecognised and the equity recognised.

4. OTHER ISSUES :

Hybrid transactions :

If a share-based payment transaction gives the entity a choice over whether to settle in cash or by issuing equity instruments, IND As 102 states that:

- The scheme should be accounted for as a cash-settled share-based payment transaction if the entity has an obligation to settle in cash.
- If no obligation exists to settle in cash, then the entity accounts for the transaction as an equity-settled share-based payment scheme.

Some entities enter into share-based payment transactions that give the counterparty the choice of settling in cash or in equity instruments. In this case, the entity has granted a compound instrument that must be split accounted (part is recorded as debt and part is recorded as equity).

Group share-based payments :

A subsidiary might receive goods or services from employees or suppliers but the parent (or another entity in the group) might issue equity or cash settled share-based payments as consideration.

In accordance with IND As 102, the entity that receives goods or services in a share based payment arrangement must account for those goods or services irrespective of which entity in the group settles the transaction, or whether the transaction is settled in shares or cash.

Disclosures :

The main disclosures required by IND As 102 are as follows:

- a description of share-based payment arrangements
- the number of share options granted or exercised during the year
- the total share-based payment expense.

IND As 102 requires disclosures that enable users to understand how fair values have been determined.

5. SELF PRACTICE QUESTIONS :

Question 3 – Equity Settled Shared Based Payment- Service conditions

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

Question 4 – Cash Settled Shared Based Payment-Service conditions

1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is Rs. 95. SAR can be exercised any time upto 31st March, 20X3. At the end of period on 31st March, 20X1 it is expected that 95% of total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% were exercised at the end of the 3rd year. Fair Values at the end of each period have been given below:

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

Pass the Journal entries?

Question 5 – Share-based payment with cash alternative

On 1st January, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

Fair values of the shares are as follows:	Rs.
Share alternative fair value (with restrictions)	102
Grant date fair value on 1st January, 20X1	113
Fair value on 31st December, 20X1	120
Fair Value on 31st December, 20X2	132

The employees exercise their cash option at the end of 20X2. Pass the journal entries.

Question 6 – Share-based payment - Purchase of goods

Indian Inc. issued 995 shares in exchange for purchase of an office building. The title was transferred in the name of Indian Inc. on February, 20X1 and shares were issued. Fair value of the office building was Rs. 2,00,000 and face value of each share of Indian Inc was Rs. 100.

Pass the journal entries?

Question 7 – Share-based payment - Services

Reliance limited hired a maintenance company for its oil fields. The services will be settled by issuing 1,000 shares of Reliance. Period for which the service is to be provided is 1st April, 20X1 to 1st July, 20X1 and fair value of the service was estimated using market value of similar contracts for Rs. 1,00,000. Nominal value per share is Rs. 10.

Record the transactions?

Question 8 – Share-based payment - Cash & equity alternatives

Tata Industries issued share-based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

Option I	**Period**	**Rs.**
No of cash settled shares		74,000
Service condition	3 years	
Option II		
No of equity settled shares of face value of Rs. 100 each		90,000
Conditions:		

Service	3 years	
Restriction to sell	2 years	
Fair values		
Equity price with a restriction of sale for 2 years		115
Fair value at grant date		135
Fair value		
20X0		138
20X1		140
20X2		147

Pass the Journal entries?

Question 9 – Equity Settled – Non market conditions

Ankita Holding Inc. grants 100 shares to each of its 500 employees on 1st January, 20X1. The employees should remain in service during the vesting period. The shares will vest at the end of the

First year if the company's earnings increase by 12%;

Second year if the company's earnings increase by more than 20% over the two-year period;

Third year if the entity's earnings increase by more than 22% over the three-year period.

The fair value per share at the grant date is Rs. 122. In 20X1, earnings increased by 10%, and 29 employees left the organisation. The company expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation in end of 20X2, company's earnings increased by 18%. Therefore, the shares did not vest. Only 29 employees left the organization during 20X2. Company believes that additional 23 employees will leave in 20X3 and earnings will further increase so that the performance target will be achieved in 20X3. At the end of the year 20X3, only 21 employees have left the organization. Assume that the company's earnings increased to desired level and the performance target has been met.

Determine the expense for each year and pass appropriate journal entries?

Question 10 – Equity Settled – Non market conditions (Reversals)

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

Fair value of the option at grant date was	Rs. 95	
Cost reduction achieved-		
Year 1	12%	Achieved
Year 2	8%	Not expected to vest in future

Year 3	10%	Achieved

How the expenses would be recorded?

Question 11 – Equity Settled – Market based conditions

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

The share price has moved as per below details –

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

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

How should we recognize the transaction?

Question 12 – Modifications – Equity-settled share based payment

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

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

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

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

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

Year 3: 39 employees left

How the modification/ re-pricing will be accounted?

Question 13 – Cancellation- Equity Settled Share based payment

Anara Fertilisers Limited issued 2000 share options to its 10 directors for an exercise price of Rs. 100.The directors are required to stay with the company for next 3 years.

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

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

Fair value of option at the time of cancellation was	Rs. 90
Market price of the share at the cancellation date was	Rs. 99

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

How the cancellation would be recorded?

Question 14 –

A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is Rs. 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options.

Pass the necessary journal entries for giving effect to the above arrangement.

Thanks ….

CHAPTER

5

IND AS 111 – JOINT ARRANGEMENTS

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. ASSESSMENT OF JOINT ARRANGEMENT
4. TYPES OF JOINT ARRANGEMENT
5. ACCOUNTING OF JOINT OPERATIONS
6. ACCOUNTING OF JOINT VENTURES
7. ACCOUNTING FOR ACQUISITIONS OF INTERESTS IN JOINT OPERATIONS IN SEPARATE AND CONSOLIDATED FINANCIAL STATEMENT OF JOINT OPERATOR

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1. OBJECTIVE :

Joint arrangement is an arrangement of which two or more parties have joint control. Joint arrangements are established for a variety of purposes (e.g. as a way for parties to share costs and risks, or as a way to provide the parties with access to new technology or new markets) and can be established using different structures and legal forms.

The objective of Ind AS 111 is to establish principles for financial reporting by entities that have an interest in a joint arrangement.

This Ind AS defines various terms related to joint arrangements. It requires an entity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved i.e. whether it is a joint operation or a joint venture by assessing its rights and obligations. Based on the type of the arrangement, the accounting treatment for that arrangement will be decided.

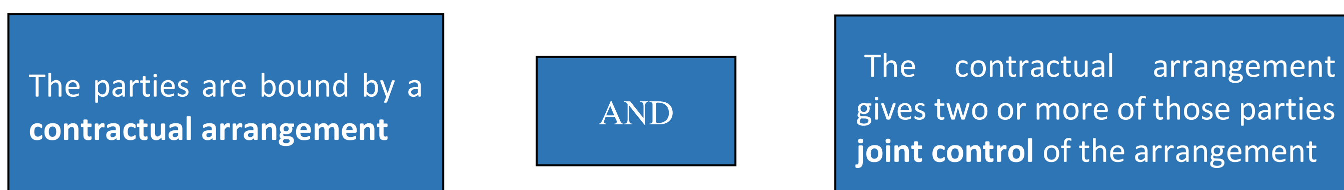
2. SCOPE :

Ind AS 111 shall be applied by all entities that are a **party to a joint arrangement**.

3. ASSESSMENT OF JOINT ARRANGEMENT :

As mentioned above, a joint arrangement is an arrangement of which two or more parties have joint control.

A joint arrangement has the following characteristics:



Contractual arrangement :

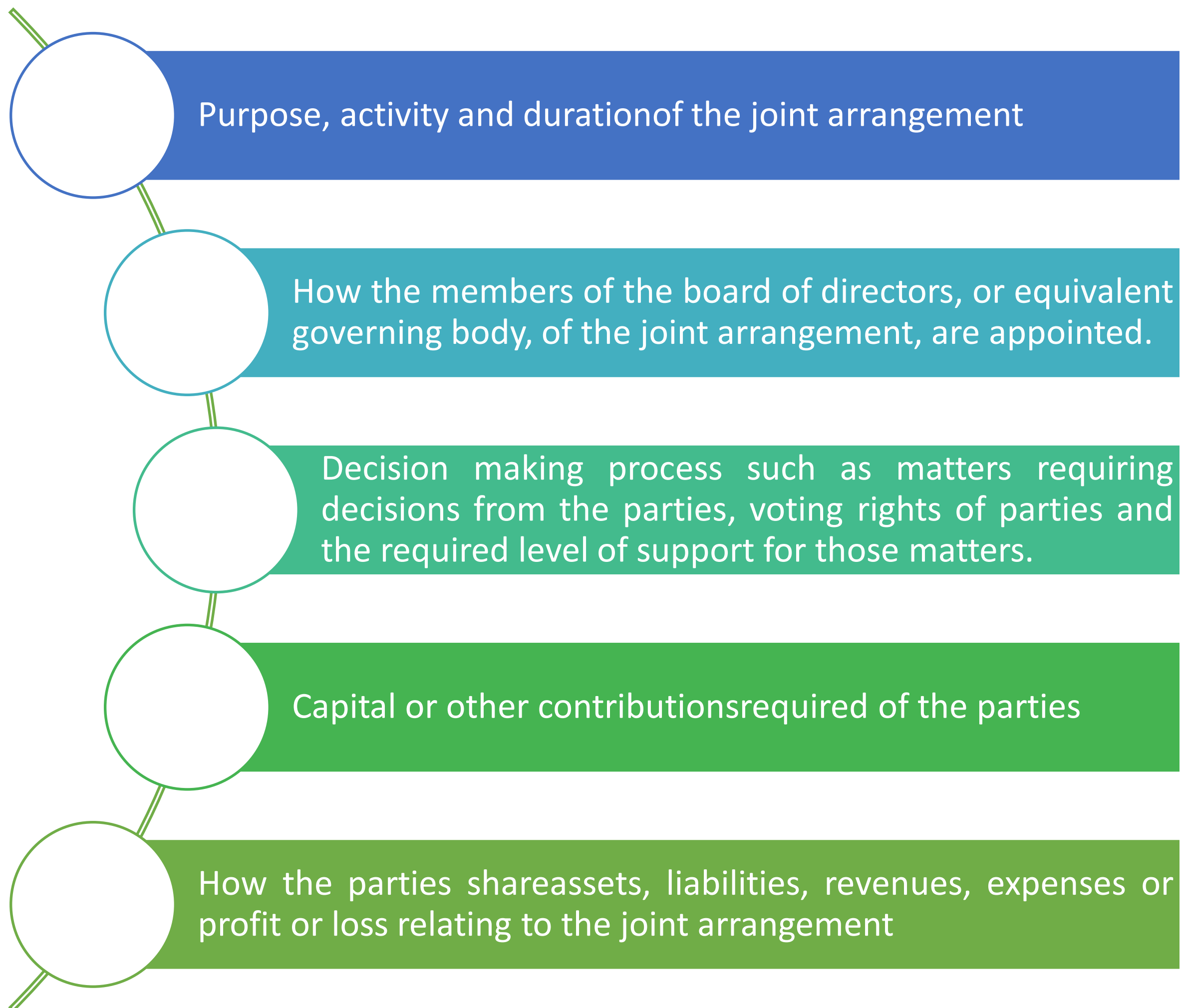
One of the essential elements of a joint arrangement is that there has to be a contractual arrangement between the parties to the arrangement. A contractual arrangement is usually in writing, however, it can be evidenced in several other ways as well.

A joint arrangement can be structured through a separate vehicle. In most of such case, the contractual arrangement is incorporated in the articles, charter or by-laws of the separate vehicle.

Example 1 :

A Ltd. and B Ltd. incorporated a new entity AB Ltd. The articles of association of AB Ltd. defines the terms of contractual arrangements between A Ltd. and B Ltd.

The contractual arrangement describes the terms of arrangement between the two or more parties that are involved in the activity that is subject of the arrangement. The contractual arrangement generally deals with such matters as:



Joint control :

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when **decisions about the relevant activities** require the **unanimous consent** of the parties sharing control.

Hence, in a joint arrangement, all the parties to an arrangement must act collectively in order to take decisions about the relevant activities of the arrangement and there is no single party who can control the arrangement individually. In a joint arrangement, any party sharing the control can prevent the other party / parties from controlling the arrangement.

In order to assess the joint control, an entity that is a party to an arrangement should **first assess** that whether the contractual arrangement gives all the parties or a group of the parties **control over the arrangement**. Control assessment will be done based on the guidance given in Ind AS 110 (which is discussed in Unit 3). Accordingly, all the principles of control assessment, some of which are summarised below, would be relevant while doing the assessment of joint control by the parties:

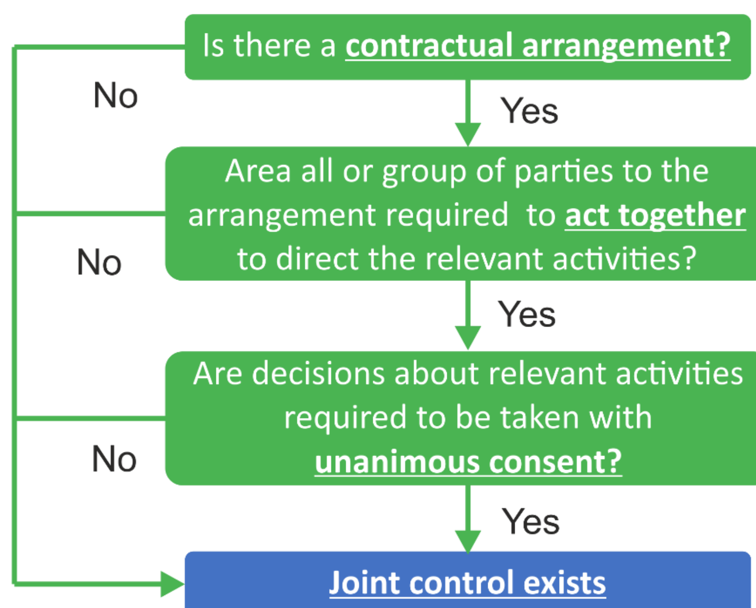
- Power over the relevant activities of the investee
  - Power with and without voting rights
  - Potential voting rights
  - Rights to appoint Key Managerial Personnel
  - De-facto control

- Purpose and design of the investee
- Contractual arrangements
- Special relationship with investor and investee

- Exposure to returns
- Ability to use the power to affect the returns of the investee

Hence, if all the parties or a group of parties to a contractual arrangement (**considered collectively**) have power, exposure to returns and ability to use that power to affect the returns of the arrangement then the parties have control over the arrangement collectively.

The flowchart below can be used as a visual aid to remember the aforementioned concepts in brief :



Please remember: In a joint arrangement, no single party controls the arrangement on its own. That is because, by definition, a party with joint control can prevent other parties from controlling the arrangement.

Following are some of the illustrations for doing assessment of joint control.

(One should keep in mind that the illustrations on control assessment discussed in Unit 3 would also be equally relevant for doing assessment of joint control).

Question 1 – ABC Ltd.

ABC Ltd. and DEF Ltd. have entered into a contractual arrangement to manufacture a product and sell that in retail market. As per the terms of the arrangement, decisions about the relevant activities require consent of both the parties. The parties share the returns of the arrangement equally amongst them. Whether the arrangement can be treated as joint arrangement?

Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement **implicitly leads to joint control**. This is explained in below illustrations:

Question 2 – PQR Ltd. And XYZ Ltd.

PQR Ltd. and XYZ Ltd. established an arrangement in which each has 50% of the voting rights and the contractual arrangement between them specifies that at least 51% of the voting rights are required to make decisions about the relevant activities. Whether the arrangement can be treated as joint arrangement?

Question 3 – A Ltd., B Ltd., C Ltd.

A Ltd., B Ltd. and C Ltd. established an arrangement whereby A Ltd. has 50% of the voting rights in the arrangement, B Ltd. has 30% and C has 20%. The contractual arrangement between A Ltd., B Ltd. and C Ltd. specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Apart from the above mentioned situations of implicit joint control, there can be other circumstances where the contractual arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the **contractual arrangement specifies** which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement. This is explained in below illustrations:

Question 4 – X Ltd.

An arrangement has three parties: X Ltd. has 50% of the voting rights in the arrangement and Y Ltd. and Z Ltd. each have 25%. The contractual arrangement between them specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Question 5 – A Ltd. and B Ltd.

An arrangement has A Ltd. and B Ltd. each having 35% of the voting rights in the arrangement with the remaining 30% being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. Whether the arrangement can be treated as joint arrangement?

The above illustrations also highlight that it is **not necessary** that all the parties in an arrangement should have joint control to form a joint arrangement. Some party or parties may be participating in the joint arrangement but may not be having joint control of that joint arrangement. That is the reason the word “or” has been used between the words “all” and “group of parties” in the flowchart given earlier.

Following are some further illustrations on assessment of whether a joint arrangement exists or not:

Question 6 – Electronics Ltd.

Electronics Ltd. is established by two investors R Ltd. and S Ltd. The investors are holding 60% and 40% of the voting power of the investee respectively.

As per the articles of association of Electronics Ltd., both the investors have right to appoint 2 directors each on the board of Electronics Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether Electronics Ltd. is controlled by a single investor or is jointly controlled by both the investors.

Question 7 – MN Software Ltd.

MN Software Ltd. is established by two investors M Ltd. and N Ltd. Both the investors are holding 50% of the voting power each of the investee.

As per the articles of association of MN Software Ltd., both the investors have right to appoint 2 directors each on the board of the company. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. The decision about relevant activities of the entity will be taken by board of directors through simple majority. Articles of association also provides that M Ltd. has right to appoint the chairman of the board who will have right of a casting vote in case of a deadlock situation.

Determine whether MN Software Ltd. is jointly controlled by both the investors.

Question 8 – ABC Ltd.

ABC Ltd. is established by two investors AB Ltd. and BC Ltd. Each investor is holding 50% of the voting power of the investee.

As per the articles of association of ABC Ltd., AB Ltd. and BC Ltd. have right to appoint 3 directors and 2 directors respectively on the board of ABC Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether ABC Ltd. is jointly controlled by both the investors.

Question 9 – X Ltd. and Y Ltd.

X Ltd. and Y Ltd. entered into a contractual arrangement to buy a piece of land to construct residential units on the said land and sell to customers.

As per the arrangement, the land will be further divided into three equal parts. Out of the three parts, both the parties will be responsible to construct residential units on one part each by taking decision about relevant activities independently and they will entitled for the returns generated from their own part of land. The third part of the land will be jointing managed by both the parties requiring unanimous consent of both the parties for all the decision making.

Determine whether the arrangement is a joint arrangement or not.

Question 10 – Entity R and entity S

Entity R and entity S established a new entity RS Ltd. to construct a national highway and operate the same for a period of 30 years as per the contract given by government authorities.

As per the articles of association of RS Ltd, the construction of the highway will be done by entity R and all the decisions related to construction will be taken by entity R independently. After the construction is over, entity S will operate the highway for the period of 30 years and all the decisions related to operating of highway will be taken by entity S independently. However, decisions related to funding and capital structure of RS Ltd. will be taken by both the parties with unanimous consent.

Determine whether RS Ltd. is a joint arrangement between entity R and entity S?

Question 11 – Investors A, B, C and D

An entity has four investors A, B, C and D holding 10%, 20%, 30% and 40% voting power respectively. The articles of association requires decisions about relevant activities to be taken by majority voting rights. However, investor A, B and C have informally agreed to vote together. This informal agreement has been effective in recent meetings of the investors to take decisions about relevant activities. Whether A, B and C have joint control over the entity?

It should be noted that if the requirement for unanimous consent relates only to decisions that give a party **protective rights** and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement. This is explained in below illustration:

Question 12 – D Ltd., E Ltd. and F Ltd.

D Ltd., E Ltd. and F Ltd. have established a new entity DEF Ltd. As per the arrangement, unanimous consent of all three parties is required only with respect to decisions related to change of name of the entity, amendment to constitutional documents of the entity to enter into a new business, change in the registered office of the entity,

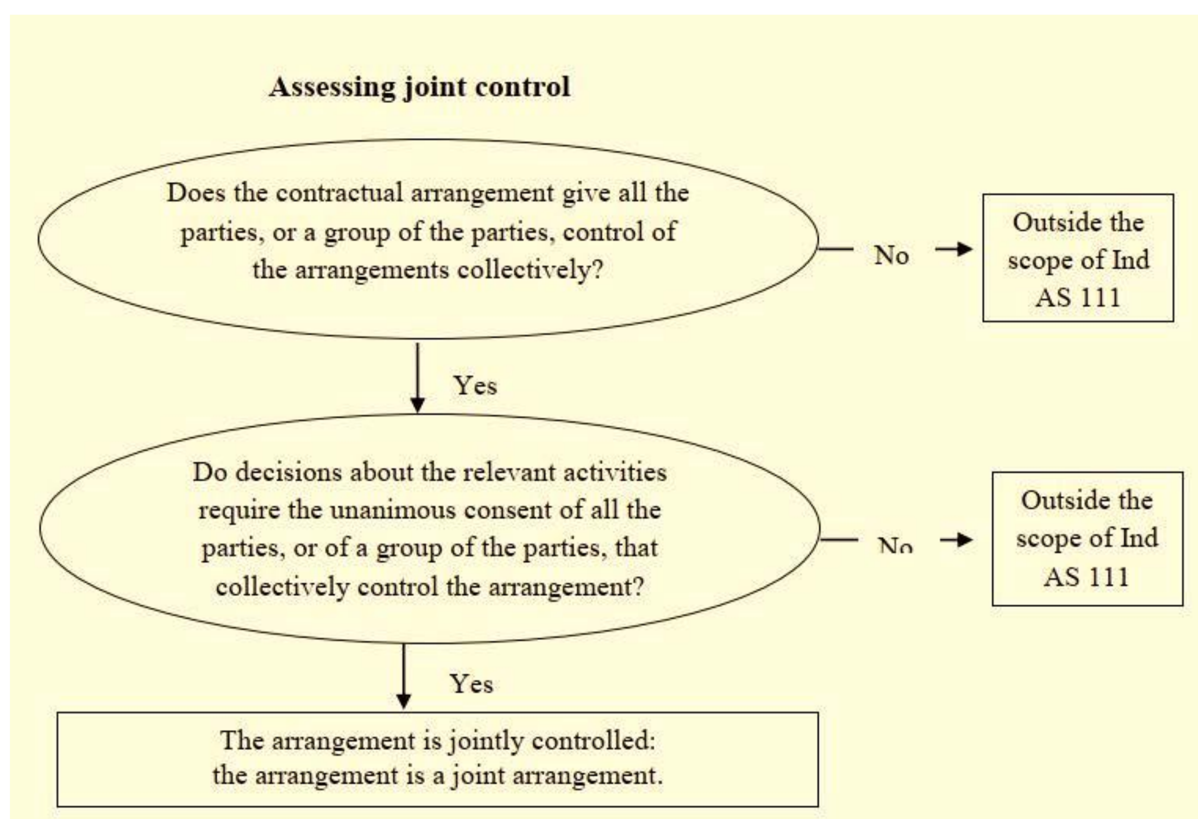
etc. Decisions about other relevant activities require consent of only D Ltd. and E Ltd. Whether F Ltd. is a party with joint control of the arrangement?

A contractual arrangement might include clauses on the **resolution of disputes**, such as arbitration. These provisions may allow for decisions to be made **without unanimous consent** among the parties that have joint control. The existence of such provisions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement. This is explained in below illustration:

Question 13 – Entity A and Entity B

Entity A and Entity B established a contractual arrangement whereby the decision related to relevant activities are required to be taken by unanimous consent of both the parties. However, in case of any dispute with any vendor or customer of the arrangement, entity A has right to take necessary decisions for the resolution of disputes including decisions of going for the arbitration or filing a suit in court of law. Whether the arrangement is a joint arrangement?

The following flow chart summarises the requirements of assessing joint control:



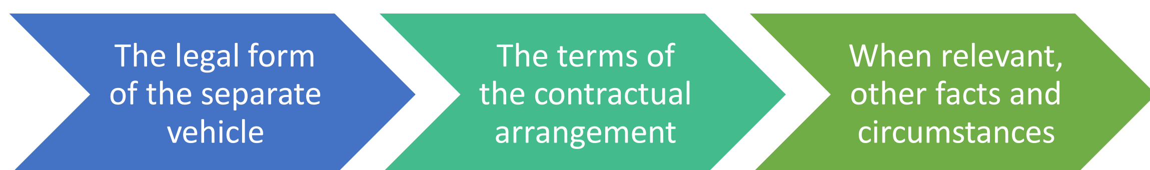
When an arrangement is outside the scope of Ind AS 111, an entity accounts for its interest in the arrangement in accordance with relevant Ind AS, such as Ind AS 110, Ind AS 28 or Ind AS 109. If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.

4. TYPES OF JOINT ARRANGEMENT:

Once it is determined that an arrangement is a joint arrangement, the entity needs to determine whether the joint arrangement is a joint operation or a joint venture depending upon the rights and obligations of the parties to the arrangement. This determination is relevant because the way the joint arrangement is accounted for i.e. whether it is a consolidation of assets, liabilities, income and expenses or use of equity method specified under Ind AS 28. Joint operation and joint venture are defined below:

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.	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.

As mentioned above, for classification of a joint arrangement between joint operation and joint venture, the parties shall assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the **structure of the joint arrangement**. Further, if the joint arrangement is **structured through a separate** vehicle then the entity shall consider the following.



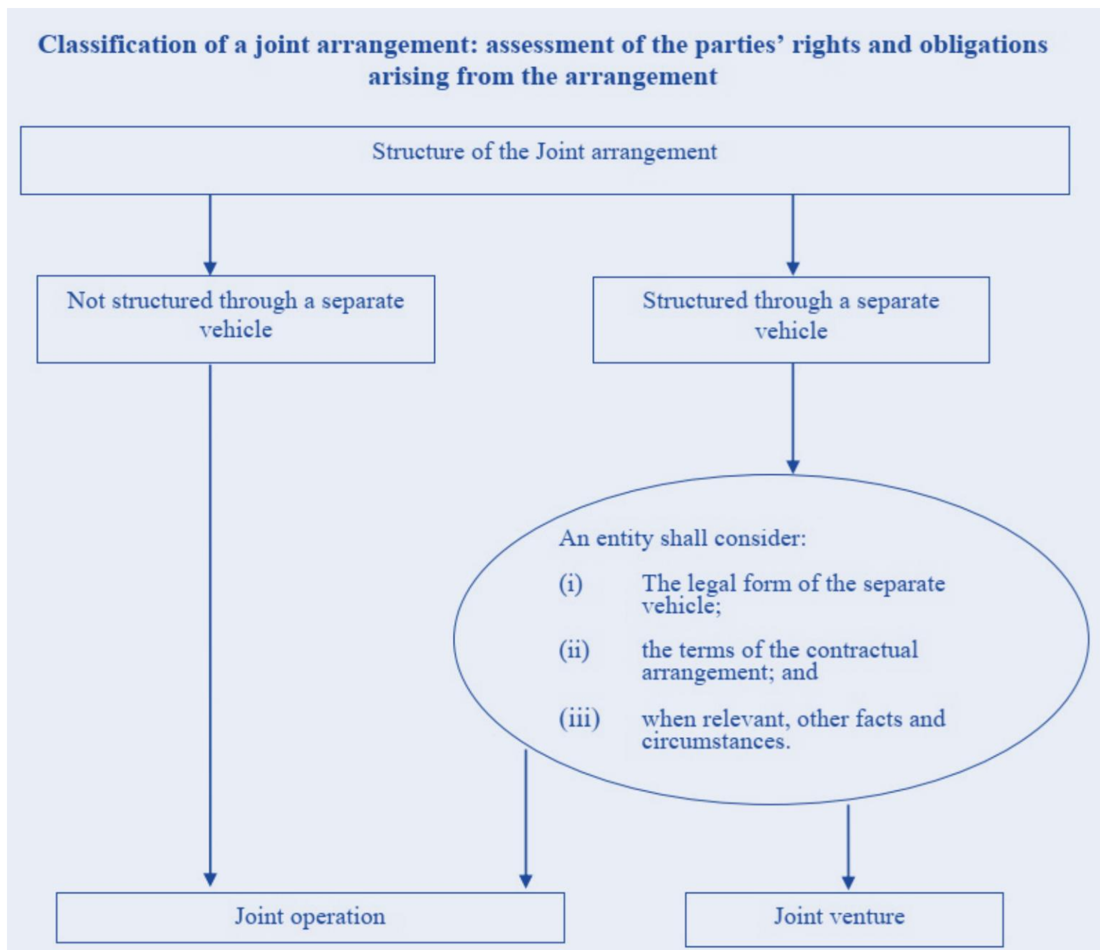
Each of the above factors are discussed below in detail. If facts and circumstances change, an entity shall reassess whether its earlier conclusion on the type of joint arrangement has changed.

Assessment of whether a joint arrangement is a joint operation or a joint venture :

When assessing whether a joint arrangement is a joint operation or a joint venture, an entity should first determine whether the joint arrangement is structured through a separate vehicle or not. Some joint arrangements are not structured through a separate vehicle and some joint arrangements are structured through a separate vehicle.

A separate vehicle is defined in Ind AS 111 as a **separately identifiable financial structure**, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality. **Examples** of a separate vehicle include partnership, company, trust, association of persons, government authority, etc.

Below chart summarise the classification of a joint arrangement based on the structure of the arrangement.



Joint arrangements not structured through a separate vehicle :

A joint arrangement that is not structured through a separate vehicle is a **joint operation**.

In such case, the contractual arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together. The contractual arrangement also establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement. The contractual arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them.

This is explained in below illustration:

Question 14 – P Ltd. and Q Ltd.

P Ltd. and Q Ltd. are two construction entities and they have entered into a contractual arrangement to jointly construct a metro rail project.

The construction of metro rail project involves various activities such as construction of infrastructure (like metro station, control room, pillars at the centre of the road, etc.) for the metro, laying of the tracks, acquiring of the coaches of the metro, etc. The total length of the metro line to be constructed is 50 kms. As per the arrangement, both the parties are responsible to construct 25 kms each. Each party is required to

incur its own cost, use its own assets, incur the liability and has right to the revenue from their own part of the work.
Determine whether the arrangement is a joint operation or not?

In some cases, the parties to a joint arrangement might agree, for example, to share and operate an asset together. However, such arrangements are still a joint operation since they are not structured through a separate vehicle.
In such a case, the contractual arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. This is explained in below illustration:

Question 15 – RS Ltd. and MN Ltd.

RS Ltd. and MN Ltd. entered into a contractual arrangement to run a business of providing cars of hire. The cars will be owned by both the parties jointly. The expenses to run the car (like driver salary, petrol, maintenance, insurance, etc.) and revenues from the business will be shared between both the parties as agreed in the contractual arrangement. Determine whether the arrangement is a joint operation or not?

Joint arrangements structured through a separate vehicle :

A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either **a joint venture or a joint operation**.
As mentioned earlier, when the joint arrangement is structured through a separate vehicle, an entity should consider i) legal form of the separate vehicle, ii) the terms of the contractual arrangement and, when relevant, iii) any other facts and circumstances to assess whether the arrangement is a joint venture or a joint operation. Each of these factors are further explained below.

The legal form of the separate vehicle :

The legal form of the separate vehicle is relevant when assessing the type of joint arrangement.
For example, there may be a situation where the legal form of a separate vehicle causes the separate vehicle to be **considered in its own right** (i.e. the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such case, the legal form of the separate vehicle indicates that the arrangement is a joint venture.
If the legal form of the separate vehicle indicates that the arrangement is a joint venture then the entity should further evaluate the terms of contractual arrangements and any other relevant facts and circumstance to see whether those factors indicate that the arrangement is a joint operation or not. However, if the legal form indicates that the arrangement is a joint operation (i.e. in a situation where the legal form does not confer separation between the parties and the separate vehicle) then there is no need to evaluate any other factor and the arrangement is concluded to be a joint operation.

Question 16 – Entity X and Entity Y

Entity X and Entity Y are engaged in the business of Engineering, Procurement and Construction (EPC) for its customers. Both the parties have jointly won a contract from a customer for executing an EPC contract and for that the parties have established a new entity XY Ltd. The contract will be executed through XY Ltd.

All the assets required for the execution of the contract will be acquired and liabilities relating to the execution will be incurred by XY Ltd. in its own name. Entity X and entity Y will have share in the net profits of XY Ltd. in the ratio of their shareholding i.e. 50% each. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Question 17 –

Two entities have established a partnership firm with each party having 50% share in the net profits of the firm. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Assessing the terms of the contractual arrangement :

Generally, the rights and obligations conferred through contractual arrangement are consistent with the rights and obligations conferred by the legal form of the separate vehicle. However, in some case the contractual arrangement alters the rights and obligations conferred by the legal form of the separate vehicle.

If the contractual arrangement indicates that the arrangement is a joint operation then there is no need to evaluate any other facts and circumstances and the arrangement is concluded to be a joint operation.

Question 18 – Entity X and Entity Y

Continuing with the illustration 16 above, assume that Entity X and Entity Y have entered into a separate agreement whereby they have agreed that each party has an interest in the assets of the XY Ltd. and each party is liable for the liabilities of XY Ltd. in a specified proportion. Determine whether the joint arrangement is a joint operation or a joint venture?

The following table provides some examples (not an exhaustive list) of some common terms present in contractual arrangements of parties to a joint operation and a joint venture:

Assessing the terms of the contractual arrangement		
	Joint operation	**Joint venture**
The terms of the contractual arrangement	The terms provide the parties with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The terms provide the parties with rights to the net assets of the arrangement.

Rights to assets	The parties share all interests (e.g. rights, title or ownership) in the assets relating to the arrangement in a specified proportion.	The assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (i.e. no rights, title or ownership) in the assets of the arrangement.
Obligations for liabilities	The parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion.	The joint arrangement is liable for the debts and obligations of the arrangement.
	The parties to the joint arrangement are liable for claims raised by third parties.	The parties are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement.
		Creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.
Revenues, expenses, profit or loss	Revenues and expenses are allocated on the basis of the relative performance of each party to the joint arrangement.	Each party has share in the profit or loss relating to the activities of the arrangement.
	However, the parties might have agreed to share the profit or loss relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	
Guarantees	The parties to joint arrangements might provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the classification of joint arrangement is whether the parties have obligations for the liabilities relating to the arrangement (whether they are guaranteed by the parties or not is irrelevant).	

Assessing other facts and circumstances :

When the legal form of the separate vehicle and the terms of the contractual arrangement indicate that the arrangement is a joint venture, the parties should evaluate other relevant facts and circumstance to assess whether the arrangement is a joint operation or not. If the other relevant facts and circumstances also do not have evidence of the arrangement being a joint operation then the arrangement is concluded to be a joint venture.

The other relevant facts and circumstances that should be evaluated which might indicate that the arrangement is a joint operation are as follows. If both the following conditions are satisfied then the arrangement is a joint operation.

- The arrangement's activities primarily aim to **provide the parties with an output** (i.e. the parties have rights to substantially all the economic benefits of the assets held in the separate vehicle); and
- The parties are substantially the **only source of cash flows** contributing to the continuity of the operations of the arrangement. Hence, the arrangement depends on the parties on a continuous basis for settling the liabilities relating to the activity conducted through the arrangement.

Question 19 – Entity X and Entity Y

Two parties structure a joint arrangement in an incorporated entity i.e. Entity A in which each party has a 50% ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of Entity A (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in Entity A are the assets and liabilities of Entity A. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of Entity A. There are following other relevant facts and circumstances applicable in this case:

- The parties agreed to purchase all the output produced by Entity A in a ratio of 50:50. Entity A cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by Entity A. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

Based on the above fact pattern, determine whether the arrangement is a joint operation or a joint venture?

The following flow chart summarises the above principles an entity should follow to classify an arrangement when the joint arrangement is **structured through a separate vehicle**:

Classification of a joint arrangement structured through a separate vehicle

Factor	Question	If Yes
Legal form of the separate vehicle	Does the legal form of the separate vehicle give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement?	Yes → Joint operation
	No ↓	
Terms of the contractual arrangement	Do the terms of the contractual arrangement specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement?	Yes → Joint operation
	No ↓	
Other facts and circumstances	Have the parties designed the arrangement so that (a) its activities primarily aim to provide the parties with an output (ie the parties have rights to substantially all the economic benefits of the assets held in the separate vehicle) and (b) it depends on the parties on a continuous basis for settling the liabilities relating to the activity conducted through the arrangement?	Yes → Joint operation
	No ↓	
	Joint venture	

Multiple joint arrangements under single framework agreement :

Sometimes the parties may be bound by a framework agreement that sets up the general contractual terms for undertaking one or more activities. Under a single framework agreement, the parties might establish different joint arrangements for different activities to be performed under the framework agreement. Even though all such joint arrangements are related to the same framework agreement, their type might be different i.e. one joint arrangement can be a joint operation and another joint arrangement can be a joint venture. This is explained in below illustration:

Question 20 – AB Ltd. and CD Ltd.

AB Ltd. and CD Ltd. have entered into a framework agreement to manufacture and distribute a new product i.e. Product X. The two activities to be performed as per the framework agreement are i) Manufacture of Product X and ii) Distribution of Product X. The manufacturing of the product will not be done through a separate vehicle. The

parties will purchase the necessary machinery in their joint name. For the distribution of the product, the parties have established a new entity ABCD Ltd. All the goods manufactured will be sold to ABCD Ltd. as per price mutually agreed by the parties. Then ABCD Ltd. will do the marketing and distribution of the product. Both the parties will have joint control over ABCD Ltd.

The legal form of ABCD Ltd. causes it to be considered in its own right (ie the assets and liabilities held in ACD Ltd. are the assets and liabilities of ABC Ltd. and not the assets and liabilities of the parties). Further, the contractual arrangement and other relevant facts and circumstances also do not indicate otherwise.

Determine whether various arrangements under the framework agreement are joint operation or joint venture?

5. ACCOUNTING OF JOINT OPERATIONS :

In this section, we will discuss following concepts related to accounting of joint operations:

- Accounting of interest in joint operations in separate and consolidated financial statement of joint operator
- Accounting for sales or contributions of assets to a joint operation in separate and consolidated financial statement of joint operator
- Accounting for purchases of assets from a joint operation in separate and consolidated financial statement of joint operator
- Accounting by an entity that is a party to the joint operation but does not have joint control

Accounting of interest in joint operations in separate and consolidated financial statement of joint operator

A joint operator shall recognise in its **separate and consolidated financial statements** in relation to its interest in a joint operation:

a) its assets, including its share of any assets held jointly;
b) its liabilities, including its share of any liabilities incurred jointly;
c) its revenue from the sale of its share of the output arising from the joint operation;
d) its share of the revenue from the sale of the output by the joint operation; and
e) its expenses, including its share of any expenses incurred jointly.

A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Ind ASs applicable to the particular assets, liabilities, revenues and expenses.

Question 21 – P and Q

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the capital of PQ. However, the contractual terms of the joint arrangement states that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ and obligations for all other liabilities in PQ in proportion to their share of capital (i.e. 50% each).

PQ's balance sheet is as follows :

Balance Sheet

Liabilities	Rs.	Assets	Rs.

Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		**3,00,000**

How should P record in its financial statements its rights and obligations in PQ?

Question 22 – P and Q

AB Ltd. and BC Ltd. have established a joint arrangement through a separate vehicle PQR. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Ltd. has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owned by PQR to a lender XYZ. AB Ltd. and BC Ltd. have rights to all other assets of PQR and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each)

PQR's balance sheet is as follows:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Debt owed to XYZ	240	Cash	40
Employee benefit plan obligation	100	Building 1	240
Equity	140	Building 2	200
	480		**480**

How should AB Ltd. record in its financial statements its rights and obligations in PQR?

Accounting for sales or contributions of assets to a joint operation in separate and consolidated financial statement of joint operator

When a joint operator sells or contributes any asset to the joint operation, it is in effect transacting with the other parties to the joint operation and hence the joint operator shall **recognise gains and losses** resulting from such transactions **only to the extent of the other parties' interest** in the joint operation.

Question 23 – A Ltd.

A Ltd. is one of the parties to a joint operation holding 60% interest in a joint operation and the balance 40% interest is held by another joint operator. A Ltd. has contributed an asset held by it to the joint operation for the activities to be conducted in joint operation. The carrying value of the asset sold was Rs. 100 and the asset was actually sold for Rs. 80 i.e. at a loss of Rs. 20. How should A Ltd. account for the sale of asset to joint operation in its books?

When above transactions provide evidence of a **reduction in the net realisable value** of the assets to be sold or contributed to the joint operation, or of an **impairment loss** of those assets, those losses shall be **recognised fully** by the joint operator.

Accounting for purchases of assets from a joint operation in separate and consolidated financial statement of joint operator

When a joint operator purchases any asset from the joint operation, it **shall not recognise its share** of the gains and losses until it resells those assets to a third party.

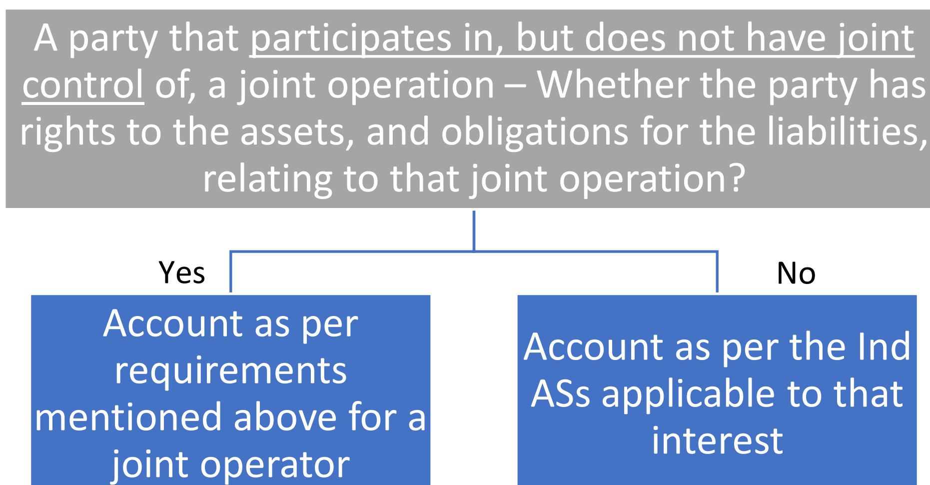
Question 24 – A Ltd.

A Ltd. is one of the parties to a joint operation holding 60% interest in the joint operation and the balance 40% interest is held by another joint operator. A Ltd. has purchased an asset from the joint operation. The carrying value of the asset in the books of joint operation was Rs. 100 and the asset was actually purchased for Rs. 80 i.e. at a loss of Rs. 20. How should A Ltd. account for the purchase of asset from joint operation in its books?

When above transactions provide evidence of a **reduction in the net realisable value** of the assets to be purchased or of an **impairment loss** of those assets, a joint operator shall **recognise its share of those losses**.

Accounting by an entity that is a party to the joint operation but does not have joint control

A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in its separate and consolidated financial statements as follows:



6. ACCOUNTING OF JOINT VENTURES :

Accounting in the consolidated financial statements :

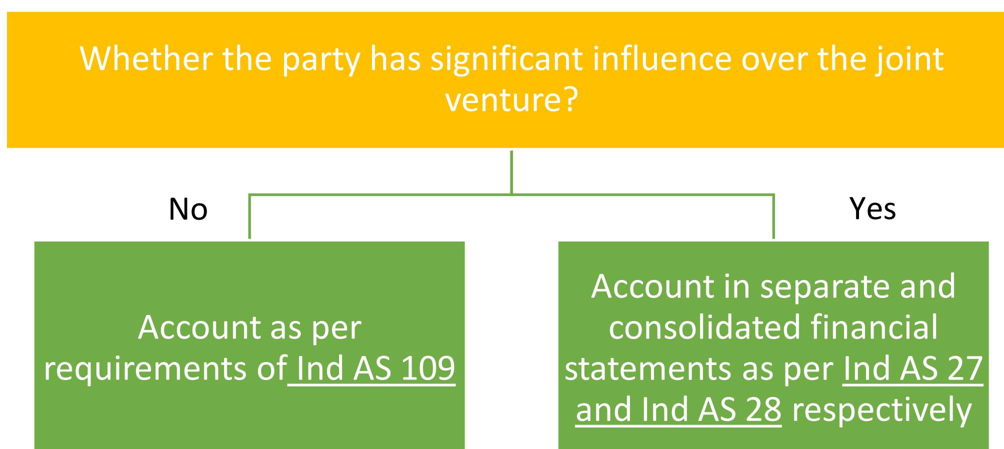
A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the **equity method** in accordance with **Ind AS 28**, unless the entity is exempted from applying the equity method as specified in that standard. These requirements are discussed in detail in unit 6.

Accounting in the separate financial statements

In its separate financial statements, a joint venturer shall account for its interest in a joint venture in accordance **Ind AS 27**. These requirements are discussed in detail in unit 7.

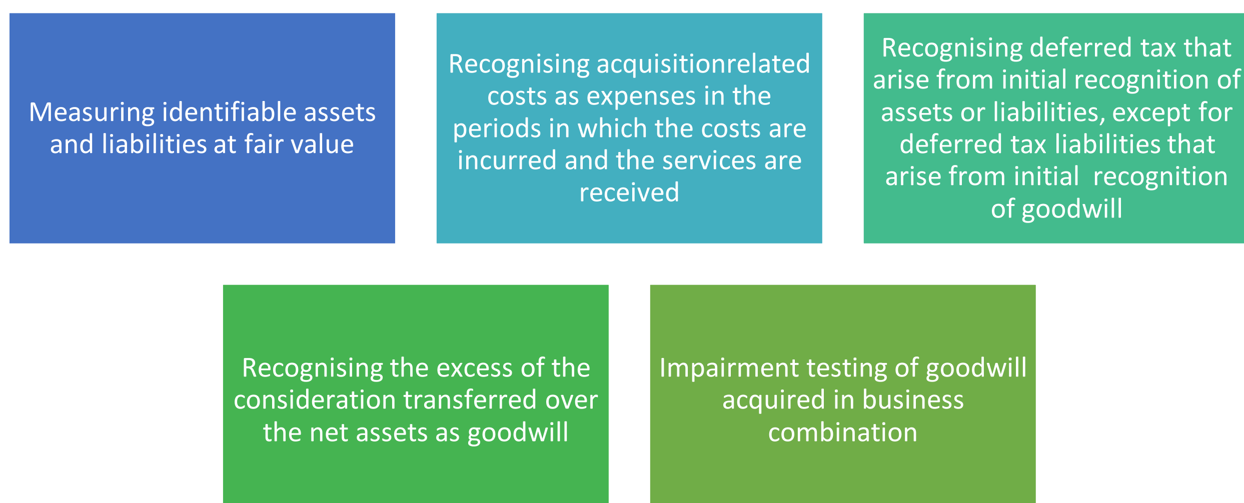
Accounting by an entity that is a party to the joint venture but does not have joint control

A party that participates in, but does not have joint control of, a joint venture shall also account for its interest in the arrangement in its **separate and consolidated financial statements** as follows:



7. ACCOUNTING FOR ACQUISITONS OF INTEREST IN JOINT OPERATIONS IN SEPARATE AND CONSOLIDIATED FINANCIAL STATEMENT OF JOINT OPERATOR:

When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes **a business, as defined in Ind AS 103**, it shall apply, to the extent of its share in the joint operation, all the requirements of business combinations accounting as per Ind AS 103, and other Ind ASs, that do not conflict with the guidance in Ind AS 111. Necessary disclosure shall also be made as required by those Ind ASs in relation to business combinations. The principles on business combinations accounting that do not conflict with the guidance in Ind AS 111 include but are not limited to following:



The above requirements also apply to the **formation of a joint operation** if, and only **if, an existing business**, as defined in Ind AS 103, is contributed to the joint operation on its formation by one of the parties that participate in the joint operation. However, these requirements **do not apply** to the formation of a joint operation if all of the parties that participate in the joint operation **only contribute assets or groups of assets that do not constitute businesses** to the joint operation.

A joint operator might **increase its interest in a joint operation** in which the activity of the joint operation constitutes a business, as defined in Ind AS 103, by acquiring an additional interest in the joint operation. In such cases, **previously held interests in the joint operation are not remeasured** if the joint operator retains joint control.

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in Ind AS 103. In such cases, previously held interests in the joint operation are not remeasured.

If the transaction of acquisition of interest in the joint operation is a **common control transaction** as defined in Ind AS 103 then an entity should not apply the requirements mentioned above. In such case, the entity shall apply the accounting specified in **Appendix C of Ind AS 103**.

Thanks ....

CHAPTER

6

IND AS 28 – INVESTMENTS IN ASSOCIATES & JOINT VENTURES

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. SIGNIFICANT INFLUENCE
4. EQUITY METHOD
5. IMPAIRMENT LOSSES
6. DISCONTINUING THE USE OF THE EQUITY METHOD
7. CLASSIFICATION OF INVESTMENT IN ASSOCIATE OR JOINT VENTURE AS HELD FOT SALE
8. MAJOR CHANGES IN IND AS 28 FROM IAS 28

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1. OBJECTIVE :

Ind AS 28 prescribes following:

- guidance on accounting of investments in associates and
- the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

2. SCOPE :

Ind AS 28 shall be applied by all entities that are

- investors with **joint control** of an investee (i.e. the investee is a joint venture of the investor), or
- **significant influence** over an investee (i.e. the investee is an associate of the investor).

3. SIGNIFICANT INFLUENCE :

An associate is an entity over which the investor has significant influence. Hence, to assess whether an investee is an associate or not, an entity needs to understand the term 'significant influence'.

Significant influence is the power to **participate in the financial and operating policy decisions** of the investee but is not control or joint control of those policies.

In this section, we will discuss following concepts related to assessment of significant influence:

- Presumption of significant influence
- Judgement required in assessment of significant influence
- Consideration of potential voting rights when assessing significant influence
- Loss of significant influence

Each of the above concepts are discussed in detail below.

Presumption of significant influence :

Presumption of significant influence:

- If an entity holds (directly or indirectly through a subsidiary) **20% or more of the voting rights** of an investee then it is **presumed that the entity has significant influence**, unless it can be clearly demonstrated that it is not the case.
- Conversely, if the entity holds, (directly or indirectly through a subsidiary), less **than 20% of the voting power** of the investee, it is **presumed that the entity does not have significant influence**, unless such influence can be clearly demonstrated.

It should be noted that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

Question 1 – E Ltd.

E Ltd. holds 25% of the voting power of an investee. The balance 75% of the voting power is held by three other investors each holding 25%.

The decisions about the financing and operating policies of the investee are taken by investors holding majority of the voting power. Since, the other three investors together hold majority voting power, they generally take the decisions without taking the consent of E Ltd. Even if E Ltd. proposes any changes to the financing and operating policies of the investee, the other three investors do not vote in favour of those

changes. So, in effect the suggestions of E Ltd. are not considered while taking decisions related to financing and operating policies.
Determine whether E Ltd. has significant influence over the investee?

Judgement required in assessment of significant influence :

The assessment of whether the investor has significant influence over the investee requires application of judgement. In making such judgement, the investor shall consider following factors which generally demonstrate the existence of significant influence:

a) representation on the board of directors or equivalent governing body of the investee

Question 2 – Kuku Ltd.

Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd.'s board comprise of eight members and two of these members are appointed by Kuku Ltd. Each board member has one vote at meeting. is Boho Ltd an associate of Kuku Ltd?

b) participation in policy-making processes, including participation in decisions about dividends or other distributions

Question 3 – M Ltd.

M Ltd. holds 10% of the voting power an investee. The balance 90% voting power is held by nine other investors each holding 10%.
The decisions about the relevant activities (except decision about taking borrowings) of the investee are taken by the members holding majority of the voting power. The decisions about taking borrowings are required to be taken by unanimous consent of all the investors. Further, decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee.
Determine whether M Ltd. has significant influence over the investee?

c) material transactions between the entity and its investee

Question 4 – RS Ltd.

RS Ltd. is an entity engaged in the business of pharmaceuticals. It has invested in the share capital of an investee XY Ltd. and is holding 15% of XY Ltd.’s total voting power. XY Ltd. is engaged in the business of producing packing materials for pharmaceutical entities. One of the incentives for RS Ltd. to invest in XY Ltd. was the fact that XY Ltd. is engaged in the business of producing packing materials which is also useful for RS Ltd. Since last many years, XY Ltd.’s almost 90% of the output is procured by RS Ltd.
Determine whether RS Ltd. has significant influence over XY Ltd.?

d) interchange of managerial personnel

Question 5– Entity X and Entity Y

Entity X and entity Y operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provide for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board and as well as to entity X. Analyse.

e) provision of essential technical information

Question 6 – R Ltd.

R Ltd. is a tyre manufacturing entity. The entity has entered into a technology transfer agreement with another entity Y Ltd. which is also involved in the business of tyre manufacturing. R Ltd. is an established entity in this business whereas Y Ltd. is a relatively new entity.

As per the agreement, R Ltd. has granted to Y Ltd. a license to use its the technical information and know-how which are related to the processes for the manufacture of tyres. Y Ltd. is dependent on the technical information and know-how supplied by R Ltd. because of its lack of expertise and experience in this business. Further, R Ltd. has also invested in 10% of the equity share capital of Y Ltd.

Determine whether R Ltd. has significant influence over Y Ltd.?

Consideration of potential voting rights when assessing significant influence :

An entity may own potential voting rights such as share warrants, share call options, convertible instruments, or other similar instruments that can give the entity additional voting power or reduce another party's voting power over the investee.

Potential voting rights that are **currently exercisable are considered** when assessing whether an entity has significant influence. Potential voting rights that are currently not exercisable are not considered for the assessment. This can be the case when the rights cannot be exercised until a future date or until the occurrence of a future event.

In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances except (a) the intentions of management and (b) the financial ability to exercise those potential rights.

Question 7 – An entity

An entity which is currently holding 10% of the voting power of an entity has an option of purchase additional 15% voting power of the investee from other investors. However, the entity currently does not have financial ability to purchase additional 15% voting power of the investee. Determine whether the entity has significant influence over the investee?

Loss of significant influence :

An entity loses significant influence over an investee **when it loses the power to participate in the financial and operating policy decisions** of that investee.

The loss of significant influence can occur with or without a change in ownership levels. For example, loss of significant influence can occur when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual arrangement.

4. EQUITY METHOD :

The **equity method** is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income. In this section, we will discuss following principles related to equity method of accounting:

- Application of the equity method
- Exemptions from applying the equity method
- Equity method procedure

The above principles are explained below.

Application of the equity method :

An investor is required to account its investments in associates and joint ventures as per equity method.

It should be noted that equity method is **not applied** for accounting of investments in associates and joint ventures **in the separate financial statements** of the investor. In separate financial statements, an investor shall apply the guidance given in Ind AS 27 which is discussed in detail in unit 7.

Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

1) Initial entry to record investment done in associate or joint venture at cost
2) Recording of investor's share in the profit / loss of the associate or joint venture after the date of acquisition
3) Recording of investor's share in the other comprehensive income of the associate or joint venture after the date of acquisition
4) Distributions received from an investee

Above entries are explained by way of an illustration below:

Question 8 – A Ltd.

On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of Rs. 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of Rs. 10,000 and other comprehensive income of Rs. 2,000. In that year, B Ltd. also declared dividend to the extent of Rs. 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate.

It should be noted that Ind AS 28 not only requires to record the income distributed by the associate or joint venture but it also requires an investor to record its share in the profit / loss of the associate or joint venture (which may not be yet distributed). This provides more informative reporting of the investor's net assets and profit or loss.

Potential voting rights :

Generally, an entity accounts for its interest in an associate or joint venture on the basis of existing ownership interests and the possible effect of exercise or conversion of any **potential voting rights are not considered for applying equity method**. Instruments with such potential voting rights are accounted for as per Ind AS 109.

For example, if potential voting rights are contained in Compulsorily Convertible Preference Shares (CCPS) of the investee and such CCPS do not give present access to returns associated with ownership interests (refer below), then such CCPS shall be accounted for as per Ind AS 109 (refer chapter 12) i.e. either at fair value through profit or loss or at fair value through other comprehensive income.

However, there can be some cases where the potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture. In such cases, the investor shall account for instruments with such potential voting rights as per equity method and not as per Ind AS 109. This can be the situation where, **for example**, an investor has a purchase option to acquire additional voting power in an investee and the terms of the contract provides that the investor will also get the share in the profit / loss of the investee even for the period prior to the date of actual exercise of the option.

Exemptions from applying the equity method :

An entity need not apply the equity method to its investment in an associate or a joint venture in following cases:

Exemption 1 :

As per paragraph 17 of Ind AS 28, an entity need not apply equity method if the entity is a parent that is **exempt from preparing consolidated financial statements** by the scope exception in paragraph 4(a) of Ind AS 110 **or if all the following** apply:

Owners of the entity	
The entity is a wholly owned or partly owned subsidiary of another entity and all the owners of the entity are informed and they do not object to the entity not applying the equity method.	The entity's ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.
Public trading of instruments of the entity	
The debt or equity instruments of the entity are not traded in a public market (whether domestic or foreign stock exchange or an	The entity has not filed nor is it in the process of filing its financial statements with a securities commission or other regulatory

over-the-counter market, including local and regional markets).	organisation for the purpose of issuing any class of instruments in a public market.

The above conditions are similar to the conditions given in paragraph 4(a) of Ind AS 110. To see illustration of above conditions, refer to the scope exemption illustrations give in unit 3 on Ind AS 110.

Exemption 2 :

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a **venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds**, the entity may elect to measure investments in those associates and joint ventures at **fair value through profit or loss** in accordance with Ind AS 109. Such election shall be made separately for each associate or joint venture at time of its initial recognition.

Example 1

A mutual fund has invested in the equity share capital of certain companies in excess of 20% of the total equity share of those entities. Hence, those investees are presumed to be an associate of the mutual fund. In this case, the mutual fund can decide not to apply equity method to account for those investments and instead measure them at fair value through profit or loss as per Ind AS 109.

Exemption 3 :

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109.
This is regardless of whether the venture capital organisation has significant influence over that portion of the investment.
If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation.
This exemption is explained in below illustration:

Question 9 – MNO Ltd.

MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15% held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

Equity method procedure :

Many of the concepts used in applying the equity method of accounting are similar to the concepts used for consolidation procedure for subsidiaries. Following is the summary of various concepts used in applying the equity method of accounting:

- Calculation of goodwill / capital reserve on acquisition of investment in associate or joint venture and calculation of share in profit / loss of associate or joint venture
- Determination group's share in an associate or a joint venture shall be determined
- Accounting of upstream and down stream transactions between the entity and its associate or joint venture
- Accounting of contribution of non-monetary asset by an entity to its associate or joint venture
- How to deal with different reporting periods of the entity and its associate or joint venture?
- Requirement to have uniform accounting policies
- What are the long-term interests in associate or joint venture apart from equity investment?
- How to account for share in losses of loss making associate or joint venture in excess of value interest in the associate or joint venture?

Each of the above concepts are explained below.

Calculation of goodwill / capital reserve and calculation of share in profit / loss of associate or joint venture :

An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture.

On acquisition of the investment, an entity shall identify the goodwill or capital reserve.

Goodwill

Any excess of the cost of the investment over the entity's share of the net fair value of the investee's identifiable assets and liabilities is treated as goodwill. Goodwill is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

Capital reserve

Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is treated as capital reserve. It is recorded directly in equity.

While recording the entity's share in the profit / loss of the investee, the entity needs to make certain adjustment to that share of profit / loss. For example, adjustment shall be made for:

- depreciation of the depreciable assets based on their fair values at the acquisition date.
- impairment losses such as for goodwill or property, plant and equipment.

Question 10 – Blue Ltd.

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for Rs. 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was Rs. 3,00,000 and the fair value was Rs. 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of Rs. 40,000 and other comprehensive income of Rs. 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

Question 11 – KL Ltd.

KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares to other investors worth Rs. 10,00,000. During the year, MN Ltd. earned profit of Rs. 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

Group's share in an associate or a joint venture :

For applying the equity method, an entity shall consider the share held by it **directly or indirectly (through a subsidiary)** in an associate or a joint venture. The holding by the entity's associate or joint venture in another associate or joint venture of the entity is ignored for this purpose.

Example 2

A Ltd., its subsidiary B Ltd. and its joint venture C Ltd. holds 15%, 10% and 10% respectively of the share capital of an associate X Ltd. Hence, to apply equity method, A Ltd. shall consider the interest held by it and by its subsidiary B Ltd. i.e. total interest of 25%. It shall not consider the interest held by C Ltd. which is a joint venture.

When an **associate or a joint venture has subsidiaries, associates or joint ventures**, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's **financial statements which include** the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures.

Example 3

X Ltd. has an associate P Ltd. P Ltd. has further invested in a subsidiary Q Ltd. and a joint venture R Ltd. Hence, for the purpose of applying the equity method, X Ltd. shall consider the consolidated financial statements of P Ltd.

Question 12 – Entity A

Entity A holds a 20% equity interest in Entity B (as associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of Rs. 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for Rs. 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of Rs. 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	**Rs.**	**Liabilities**	**Rs.**
Investment in B	200	Equity	200
Total	**200**	**Total**	**200**

B's consolidated financial statements

Assets	**Rs.**	**Liabilities**	**Rs.**
Assets (from C)	1,000	Equity	1,000
Total	**1,000**	**Total**	**1,000**

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements

Assets	**Rs.**	**Liabilities**		**Rs.**
Assets (from C)	1,000	Equity	1,000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1,100
		Non-controlling interest		200
Total	**1,300**	**Total**		**1,300**

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now Rs. 220 (20% of Rs. 1,100) i.e. Rs. 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

Upstream and downstream transactions between the entity and its associate or joint venture:

An entity (or a subsidiary of the entity) may enter into upstream or downstream transactions with its associate or joint venture.

- Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the investor.
- 'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

There may be some gain / loss resulting from such transactions. The entity shall record such gain / loss in its financial statements only to the extent of the unrelated investors' interests in the associate or joint venture.

Question 13 – M Ltd.

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of Rs. 10,00,000. This included profit of 10% on the transaction price i.e. profit of Rs. 1,00,000. Out the above inventory, M Ltd. sold inventory of Rs. 6,00,000 to outside customers. Hence, the inventory of Rs. 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

When downstream transactions provide evidence of a **reduction in the net realisable value** of the assets to be sold or contributed, or of an **impairment loss** of those assets, those losses shall be **recognised in full** by the investor.

When upstream transactions provide evidence of a reduction in the **net realisable value** of the assets to be purchased or of an **impairment loss** of those assets, the investor shall **recognise its share** in those losses.

Question 14 – X Ltd.

Scenario A :

X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of Rs. 8,00,000. The asset's carrying value in X Ltd.'s books was Rs. 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Scenario B :

Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

Contribution of non-monetary asset by an entity to its associate or joint venture :

An entity might contribute a non-monetary asset to an associate or a joint venture in exchange of an equity interest in that associate or joint venture. Such contribution of asset shall be accounted in accordance with the **guidance for downstream transactions** discussed above.

However, if such contribution of non-monetary asset **lacks commercial substance**, then the gain / loss involved in such transaction is treated as unrealised and such **gain / loss is eliminated against the investment value**. In other words, the carrying amount of the investment in associate or joint venture in such a situation will be equal to the carrying amount of non-monetary asset contributed in exchange. The term 'commercial substance' has the same meaning as defined in Ind AS 16 *'Property, Plant and Equipment'* and discussed in unit 2 of chapter 7.

If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity **recognises in full** in profit or loss the portion of the **gain or loss** on the non-monetary contribution **relating to the monetary or non-monetary assets received**.

Different reporting periods of the entity and its associate or joint venture :

To apply equity method of accounting, an entity shall use the **most recent** available financial statements of the associate or joint venture.

When the end date of the reporting period of the entity and that of the associate or joint venture is different (e.g. entity's financial year ends on 31 March 20X1 but the associate's financial year ends on 31 December 20X0) then associate or joint venture shall prepare financial statements as of the period end date of the entity **for the purpose of doing equity method accounting** by the entity.

In above situation, if it is impracticable for the associate or joint venture to prepare financial statements as of the period end date of the entity then the entity can use the financial statements of associate or joint venture ending on different date subject to **giving effect of significant transactions or events** occurring between the end date of the associate's or joint venture's financial statements and end date of the entity's financial statements.

In no case, the difference between the end date of the reporting period of associate or joint venture and end date of reporting period of the entity **can exceed 3 months**.

The length of the reporting periods and any difference between the ends of the reporting periods shall be the same from period to period. This means that if the financial statements of an associate or a joint venture used for equity accounting in previous periods were ending on different dates than that of the entity whereas the financial statements used for current period end on the same date as that of the entity then the comparatives for previous period should be restated to have comparison of equivalent periods.

Uniform accounting policies :

When using the financial statements of an associate or joint venture for doing equity method accounting, the **accounting policies** (for like transaction and events in similar circumstances) as used by associate or joint venture in preparing their financial statements **should be same as the policies used by the entity** in preparing its financial statements.

If the accounting policies are not same then **adjustments should be made to align** the accounting policies of associate or joint venture to those of the entity.

Example 4

A Ltd. (a company incorporated and registered in India) holds 25% voting power of B Inc. (a company incorporated and registered in United States). B Inc. is an associate for A Ltd. A Ltd. Follows Ind AS for the preparation of o its financial statements. However, B Inc. follows generally accepted accounting principles in United States (US GAAP). Hence, while using B Inc.'s financial statements for the purpose of doing equity method accounting, A Ltd. Shall do necessary adjustment to covert US GAAP financial statements to Ind AS financial statements and then do equity method accounting.

There are two exceptions to above rule:

Exception 1 :

In case of an **associate**, the adjustment for uniformity of accounting policies with those of the entity will not be done **if it is impracticable to do so**.

It is to be noted that this exemption is available in case of an associate only and not available for joint venture. This is because for an investor with just significant influence over an investee, it may be difficult to obtain necessary information to do adjustment for aligning accounting policies. However, in case of a joint venture, it would be relatively easy to obtain such information as the investor has joint control over the joint venture.

Exception 2 :

An entity may have interest in **an associate or a joint venture that is an investment entity**. Such an associate or a joint venture may also have interest in one or more subsidiaries. When this is the case, such associate or joint venture, being an investment entity, would **account for its interest in subsidiaries at fair value**. Hence, in such case, the **entity can elect to retain** the fair value measurement used by the associate or joint venture.

Such election can be made by the entity **separately for each associate or joint venture** at the later of the date on which:

a) the associate or joint venture is initially recognised

b) the associate or joint venture becomes an investment entity

c) the associate or joint venture first becomes a parent

Long-term interests in associate or joint venture apart from equity investment :

An entity might hold financial instruments in an associate or joint venture other than the investments accounted for using the equity method. These includes long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture.

For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture.

- Such items may include
  - preference shares and
  - long-term receivables or loans,

- but do not include o trade receivables,
  - o trade payables or
  - o any long-term receivables for which adequate collateral exists, such as secured loans.

An entity shall account such long-term interest in accordance with Ind AS 109. It is to be noted that certain requirements of Ind AS 28 also apply to such long-term interests (like allocating share in loss of associate or joint venture to such interests and testing for impairment and recording of impairment loss on the net investment in associate or joint venture – these are explained in subsequent paragraphs). However, an entity should first apply Ind AS 109 to those interests and then apply Ind AS 28 to the balance remaining after applying Ind AS 109.

Loss making associate or joint venture :

In case of a loss making associate or joint venture, an entity's share of losses of such associate or joint venture may equal or exceed its **interest in the associate or joint venture**. In such case, the entity discontinues recognized its share of further losses.

It should be noted that the interest in the associate or joint venture not only includes the carrying amount of the investment in the associate or joint venture determined using the equity method but also includes any **long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture**. The examples of such long-term interests are discussed in 6.4.5.8 above. It should be noted that an entity should **first apply Ind AS 109** to such long-term interests and then apply the above requirement of allocating to such long-term interest any share in loss of associate or joint venture. Further, while applying Ind AS 109, an entity shall not take account of any adjustments to the carrying value of long-term interests that arise from applying Ind AS 28.

Losses recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).

After the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred **legal or constructive obligations or made payments** on behalf of the associate or joint venture.

If the associate or joint venture **subsequently reports profits**, the entity resumes recognized its share of those profits **only after** its share of the profits equals the share of losses not recognized.

Question 15 – X Ltd.

An entity has following three type interests in an associate:

- Equity shares: 25% of the equity shares to which equity method of accounting is applied
- Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.

- Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.

At the start of year 1, the carrying value of each of the above interests is as follows:

- Equity shares – Rs. 10,00,000
- Preference shares – Rs. 5,00,000
- Long-term loan – Rs. 3,00,000

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5.

End of Year	Increase / (Decrease) in fair value of preference shares as per Ind AS 109	Impairment loss / (reversal) on long-term loan as per Ind AS 109	Entity's share in profit / (loss) of associate
1	(50,000)	(50,000)	(16,00,000)
2	(50,000)	-	(2,00,000)
3	1,00,000	50,000	-
4	50,000	-	10,00,000
5	30,000	-	10,00,000

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

5. IMPAIRMENT OF LOSSES :

After doing accounting as per equity method explained above, an entity shall determine whether there is **an objective evidence** that the entity's net investment in an associate or a joint venture is impaired.

The objective evidence of impairment can arise as a result of:

- one or more events that occurred after the initial recognition of the net investment (a **'loss event'**) and
- that loss event (or events) has an **impact on the estimated future cash flows** from the net investment that can be reliably estimated.

It is not necessary to identify a single event that caused impairment. Rather, impairment can be a combined effect of several individual events.

Losses expected as a result of future events, no matter how likely, are not recognized.

Objective evidence that the net investment is impaired includes **observable data** about the following loss events:

Significant **financial difficulty** of the associate or joint venture

Breach of contract, such as a default in payments by the associate or joint venture

The entity **granting a concession** to associate or joint venture (because of its financial difficulties)

It becoming probable that the associate or joint venture will enter **bankruptcy or other financial reorganisation**

Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture

Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates

Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost

It should be noted that the disappearance of an active market because the associate's or joint venture's equity or financial instruments are **no longer publicly traded is not evidence of impairment**.

A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

Impairment of goodwill included in carrying value of associate or joint venture

As discussed earlier in this unit, the goodwill on acquisition of associate or joint venture is recognized as part of the carrying amount of the net investment in associate or joint venture. Such goodwill is **not tested separately** for impairment, rather the entire carrying amount of the investment is **tested for impairment as a single asset** when there is objective evidence of impairment as mentioned above.

Any impairment loss recognized is **not allocated** to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture.

Reversal of impairment loss

Any reversal of impairment loss is recognized in accordance with Ind AS 36 *'Impairment of Assets'* to the extent that the recoverable amount of the net investment subsequently increases.

Determining value in use

Impairment loss is provided by comparing the recoverable amount (higher of value in use and fair value less **costs of disposal**) with the carrying amount of the investment.

For above purpose, an entity can determine the value in use in **either** of the following ways:

a) Method 1: Values in use shall include entity's share in the present value of estimated future cash flows expected to be generated by the associate or joint venture, including:

   i. cash flows from the operations of the associate or joint venture and

ii. proceeds from the ultimate disposal of the investment

b) Method 2: Value in use shall include the present value of estimated future cash flows expected to arise from:
   i. dividends to be received and
   ii. proceeds from the ultimate disposal of the investment.

If appropriate assumptions are used then both the above methods will give the same results. The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture separately, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

6. DISCONTINUING THE USE OF THE EQUITY METHOD :

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture
The accounting consequences when an investment ceases to be an associate or a joint venture are explained below.

Investment becomes a subsidiary :

If the investment becomes a subsidiary, the entity shall account for its investment in accordance with Ind AS 103 and Ind AS 110. Ind AS 103 requires revaluation of the previously held interest in the equity accounted investment at its acquisition date fair value, with recognition of any gain or loss in profit or loss.

Retained interest in the former associate or joint venture is a financial asset :

Retained interest in the former associate or joint venture that is a financial asset shall be measured at fair value. The entity shall recognise in profit or loss any difference between:

- the fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and
- the carrying amount of the investment at the date the equity method was discontinued.

Following illustration explains how an entity shall record in profit or loss any gain / loss on discontinuation of equity method in such case.

Question 16 – CD Ltd.

CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is Rs. 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of Rs. 80,000. The fair value of the retained 30% interest is Rs. 1,20,000. Determine how much gain / loss should be recorded in profit or loss of CD Ltd.

Reclassification of items recorded in other comprehensive income :

On discontinuation of equity method, any share in the other comprehensive income of associate or joint venture that was previously recognized by the entity shall be reclassified to profit or loss

on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.

Example 5

An investor has recognised in past in its other comprehensive income its share of Rs. 10,000 in the cumulative exchange differences relating to a foreign operation of its associate. Now, the investment in that associate is sold and equity method of accounting is stopped. So, the investor shall reclassify the cumulative exchange differences of Rs. 10,000 recorded in its other comprehensive income to profit or loss.

The above principle also applies in case there is a reduction in the ownership interest in an associate or joint venture but the investee still continues to be an associate or joint venture. In that case, the reclassification should be done in proportion to the reduction in the ownership interest.

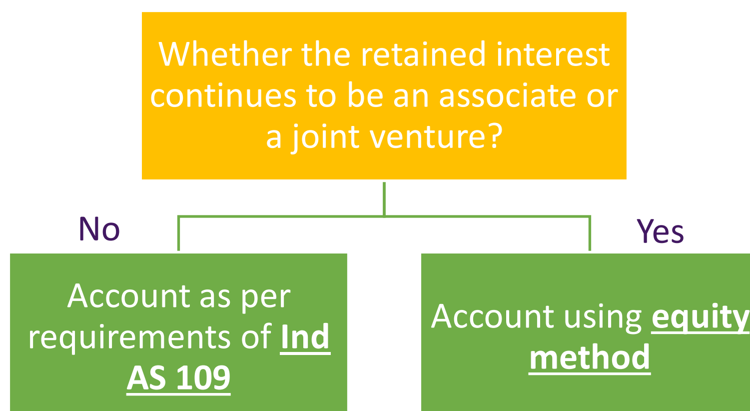
It may be noted that while it is not explicitly stated in Ind AS 28, it can be inferred that in case there is a reduction in the ownership interest in an associate or joint venture but the investee still continues to be an associate or joint venture, the entity should recognize gain or loss. This accounting treatment is different from the accounting for changes in ownership interest interests in a subsidiary, without losing control. **An associate becomes a joint venture and vice versa** If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.

7. CLASSIFICATION OF INVESTMENT IN ASSOCIATE OR JOINT VENTURE AS HELD FOR SALE :

An entity shall apply Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale.

Any **retained portion of an investment** in an associate or a joint venture that has not been classified as held for sale shall be accounted as follows:

- Till the time disposal of the portion that is classified as held for sale takes place:
  - Accounted using equity method
- After the disposal of the portion that is classified as held for sale takes place
  - Accounted as follows:



The above requirements are explained in below illustration:

Question 17 – Ram Ltd.

Ram Ltd. holds 50% of the equity share capital of Shyam Ltd. The balance 50% equity share capital is held by another investor. Ram Ltd. has joint control over Shyam Ltd. and it is a joint venture of Ram Ltd., accounted using equity method. Now Ram Ltd. is planning to sell 10% of the equity share capital of Shyam Ltd. to a third party. Such 10% investment meets the criteria of an asset held for sale and has been measured and disclosed accordingly. Now determine how should Ram Ltd. account 40% interest retained in Shyam Ltd.

When an investment, or a portion of investment, in associate or a joint venture previously classified as held for sale **no longer meets the criteria** to be so classified, it shall be accounted for using the **equity method retrospectively** as from the date of its classification as held for sale. Financial statements for the prior periods shall be amended accordingly.

8. MAJOR CHANGES IN IND AS 28 FROM IAS 28 :

Ind AS 28, like other Ind ASs, has been converged from the global standards, i.e., IFRSs, which has been made applicable to the Indian entities (based on the net worth criteria) in a phased manner via Ministry of Corporate Affairs Roadmap. While converging from IAS 28, following are the carve outs given under Appendix 1 to Ind AS 28, keeping in mind, the requirements of other converged Ind ASs and the economic environment in India:

- With respect to the requirement of uniform accounting policies to be followed by associates and joint ventures, Ind AS 28 gives an exemption in case of an associate where it is impracticable to do so. However, there is no such exemption given under IAS 28. Ind AS 28 provides such exemption because the investor does not have 'control' over the associate and it may not be able to influence the associate to prepare additional financial statements or to follow the accounting policies that are followed by the investor.
- On acquisition of an associate or joint venture, Ind AS 28 requires to transfer the excess of the investor's share of the net fair value of the investee's identified assets and liabilities over the cost of investment in capital reserve. However, IAS 28 requires it to be recognised in profit or loss.

Thanks ….

CHAPTER

7

IND AS 27 – SEPARATE FINANCIAL STATEMENTS

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. WHAT ARE SEPARATE FINANCIAL STATEMENTS AND HOW THEY ARE PRESENTED
4. PREPARATION OF SEPARATE FINANCIAL STATEMENTS
5. MAJOR CHANGES IN IND AS 27 FROM IAS 27

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1. OBJECTIVE :

The objective of Ind AS 27 is to prescribe the accounting and disclosure requirements for **investments in subsidiaries, joint ventures and associates** when an entity prepares separate financial statements.

2. SCOPE :

Ind AS 27 shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity

- elects, or
- is required by law,

to present separate financial statements.

It is to be noted that **Ind AS 27 does not mandate which entities produce separate financial statements**. It applies when an entity prepares separate financial statements that comply with Ind AS. However, it may be noted that as per the Companies Act, 2013, all companies covered under that Act are required to prepare financial statements.

3. WHAT ARE SEPARATE FINANCIAL STATEMENTS AND HOW THEY ARE PRESENTED?:

What are separate financial statements?

Separate financial statements are those presented by:

- a parent (i.e. an investor with control of a subsidiary) or
- an investor with investment in an associate or a joint venture,

in which the investments are accounted for at **cost or in accordance with Ind AS 109** 'Financial Instruments'.

How separate financial statements are presented?

Separate financial statements are presented:

- **in addition** to consolidated financial statements or
- **in addition** to financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures in which investments in associates or joint ventures are accounted for using the equity method.

There are two more scenarios in which separate financial statements are prepared:

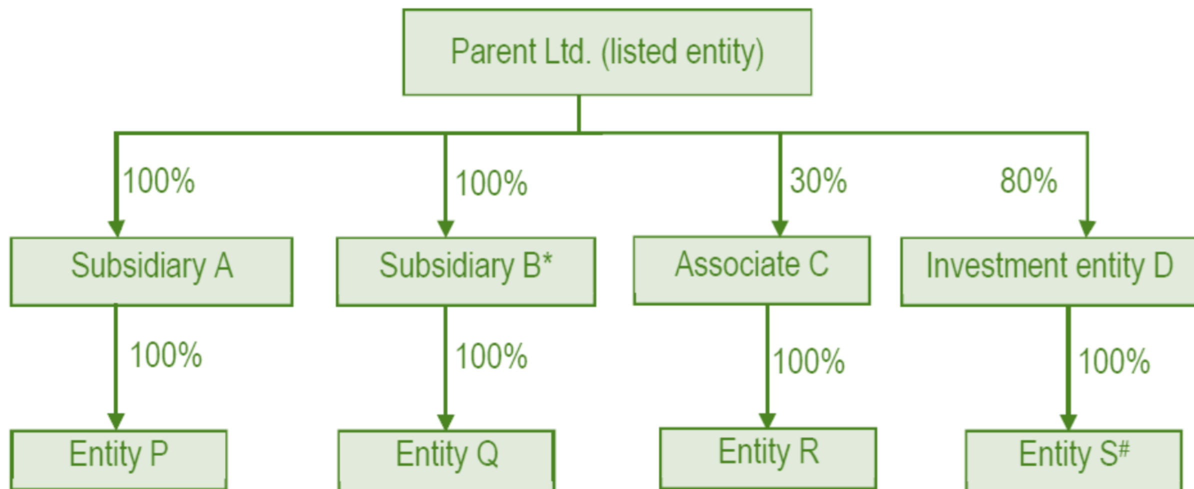
Scenario 1 :

An entity that is exempted from: preparation of consolidated financial statements in accordance with paragraph 4(a) of Ind AS 110 (explained in detail in unit 3) or applying equity method as per paragraph 17 of Ind AS 28 (explained in detail in unit 6) may present separate financial statements as its only financial statements.

Scenario 2 :

As per para 31 of Ind AS 110, an investment entity that has one or more subsidiaries and the purpose and activities of all those subsidiaries is not to provide services that relate to the investment entity's investment activities then such investment entity shall not prepare consolidated financial statements. Instead, such investments in subsidiaries are to be accounted at fair value through profit or loss as per Ind AS 109. In such case, investment entity presents separate financial statements as its only financial statements.

Example: Following chart represents the group structure of Parent Ltd. and table below it explains the above requirements related to separate financial statements



* Subsidiary B has availed the exemption from preparation of consolidated financial statements as per paragraph 4(a) of Ind AS 110

\# Entity S does not provide services that relate to the Investment entity D's investment activities

All the above entities are incorporated as per Companies Act, 2013.

Name of the entity	Whether entity prepares consolidated financial statements?	Status for separate financial statements
Parent Ltd.	Yes	Will be prepared as it is required by Companies Act, 2013
Subsidiary A	Yes	Will be prepared as it is required by Companies Act, 2013
Subsidiary B	No	Will be prepared as it is required by Companies Act, 2013 (in this case, entity will present separate financial statements as its only financial statements)
Associate C	Yes	Will be prepared as it is required by Companies Act, 2013
Investment entity D	No	Will be prepared as it is required by Companies Act, 2013. Entity will present separate financial statements as its only financial statements
Entity P	No	These entities will prepare their financial statements as required by Companies Act 2013, however, they will not be termed as separate financial statements since these entities do not have subsidiary, associate or joint venture.
Entity Q	No	
Entity R	No	
Entity S	No	

4. PREPARATION OF SEPARATE FINANCIAL STATEMENTS :

In this section, we will discuss about following concepts relating to accounting in separate financial statements:

- Accounting of investments in subsidiaries, associates and joint ventures
- Accounting when a parent ceases to be an investment entity or becomes an investment entity
- Accounting of dividend from subsidiary, associate or joint venture
- Reorganisation of the group structure

Accounting of investments in subsidiaries, associates and joint ventures :

An entity shall prepare its separate financial statements in accordance with all the applicable Ind ASs except that it shall account for investments in subsidiaries, associates and joint ventures
in one of the following ways:

- At cost, or
- In accordance with Ind AS 109 (i.e. either at fair value through profit or loss or at fair value through other comprehensive income)

The entity shall apply the same accounting for each category of investments.

Investments accounted for at cost shall be accounted for in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' when they are classified as held for sale. The measurement of investments accounted for in accordance with Ind AS 109 is not changed in such circumstances.

Example 1

An entity has invested in a subsidiary and a joint venture. Entity has elected to measure investment in subsidiary at cost and measure investment in joint venture at fair value through profit or loss in accordance with Ind AS 109. Now, at the end of the year, both these investments are held for sale. In such case, the investment in subsidiary will be measured as per Ind AS 105 i.e. at lower of its carrying amount and fair value less costs to sell. However, investment in joint venture is continued to be accounted at fair value through profit or loss as per Ind AS 109.

Investments held by investment entities and similar entities

Ind AS 110 requires an investment entity to measure its investment in subsidiaries at fair value through profit or loss as per Ind AS 109. Then the investment entity shall account for those investments **in the same i.e. at fair value through profit or loss** in the separate financial statements.

Further, Ind AS 28 provides that an when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. Hence, if an entity makes such election, then it shall also account for those investments **in the same way i.e. at fair value through profit or loss** in its separate financial statements.

Accounting when a parent ceases to be an investment entity or becomes an investment entity

When a parent ceases to be an investment entity, or becomes an investment entity, it shall account for the change **from the date when the change in status occurred**, as follows:

When an entity ceases to be an investment entity

In such case, the entity shall account for an **investment in a subsidiary** in either of the following ways:

Account at cost. The fair value of the subsidiary at the date of the change of status shall be used as the **deemed cost**at that date	OR	Continue to account in accordance with **Ind AS 109**

Example 2

A Ltd. was an investment entity and was measuring its investment in subsidiary X Ltd. at fair value. On 1 April 20X1, A Ltd. ceased to be an investment entity. On that date, the fair value of investment in X Ltd. recorded in its books was Rs. 1,00,000. Now, when A Ltd. ceased to be an investment entity, it can measure the investment in X Ltd. either:

- at cost (in such case, the carrying value of Rs. 1,00,000 will be its deemed cost at the date of change in status), or
- continue to measure in accordance with Ind AS 109

When an entity becomes an investment entity

In such case, the entity shall account for an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

In that case, the difference between the previous carrying amount of the subsidiary and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in profit or loss. The cumulative amount of any fair value adjustment previously recognized in other comprehensive income in respect of those subsidiaries shall be reclassified to profit or loss as if the investment entity had disposed of those subsidiaries at the date of change in status.

Example 3

A Ltd. holds investment in a subsidiary X Ltd. and it measures its investment in subsidiary at cost. On 1 April 20X1, A Ltd. becomes an investment entity. On that date, the carrying value of investment in X Ltd. recorded in its books was Rs. 1,00,000. However, the fair value of that investment on the date of change in status was Rs. 1,50,000. Hence, A Ltd. should record a gain of Rs. 50,000 (1,50,000 – 50,000) in the profit of loss.

In this case, assume that A Ltd. was measuring the above investment at fair value through other comprehensive income in accordance with Ind AS 109 prior to change in status. The cumulative gain recorded in other comprehensive income was Rs. 50,000 and the carrying value of investment was Rs. 1,50,000. Hence, on the date of change in status, A Ltd. shall reclassify the gain of Rs. 50,000 from other comprehensive income to profit or loss as if the investment has been disposed by A Ltd. on that date.

Accounting of dividend from subsidiary, associate or joint venture :

An entity shall recognise a dividend from a subsidiary, an associate or a joint venture in profit or loss in its separate financial statements when its right to receive the dividend is established. Generally, the right to receive the dividend is established when the dividend is approved by the shareholders in their general meeting.

Reorganisation of the group structure :

A parent reorganises the structure of its group by establishing a new entity as its parent. Ind AS 27 provides guidance on how to calculate the cost of investment when a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

a) the new parent obtains control of the original parent by **issuing equity instruments** in exchange for existing equity instruments of the original parent;

b) the **assets and liabilities** of the new group and the original group are the **same** immediately before and after the reorganisation; and

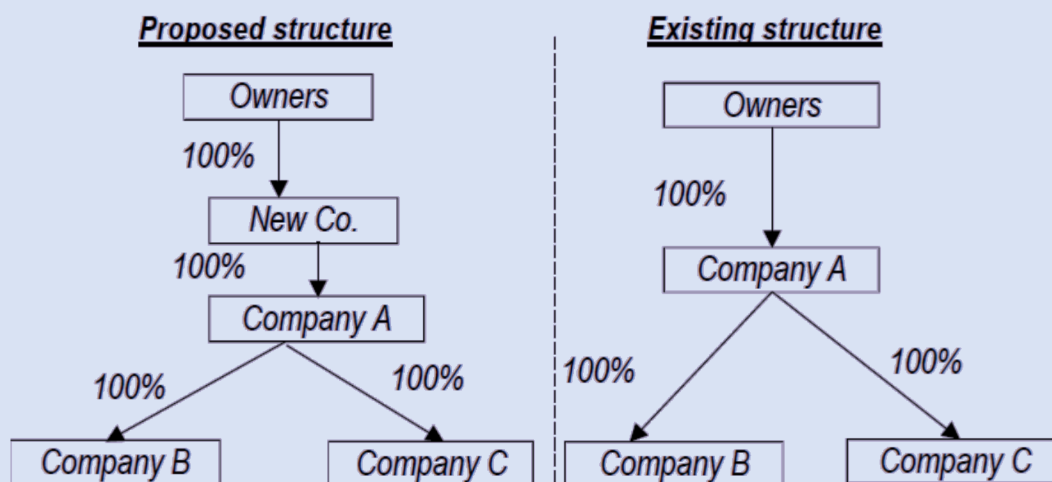
c) the owners of the original parent before the reorganisation have the **same absolute and relative interests** in the net assets of the original group and the new group immediately before and after the reorganisation,

If above conditions are fulfilled and the new parent elects to account for its investment in the original parent at cost then the new parent shall measure cost at the **carrying amount of its share of the equity** items shown in the separate financial statements of the original parent at the date of the reorganisation.

This is explained in following illustration:

Question 1 – A Ltd.

Following is the existing and proposed group structure of an original parent A Ltd.



As per the above structure, the Owners of Company A will transfer all their shareholding in Company A to New Co. In exchange of such shares, New Co. will issue its equity shares to the Owners. New Co. will issue the shares to the owners in the same ratio of their existing holding in Company A so that they have same absolute and relative interests in the net assets of the groupimmediately before and after the

reorganisation. The assets and liabilities of the group immediately before the and after the proposed restructuring will also be the same.
The cost of the investment in Company A in the books of the Owners is Rs. 10 lakh. Total equity of Company A (i.e. equity share capital and other equity attributable to the owners) as per its separate financial statements on the date of proposed restructuring is Rs. 15 lakh.
After the proposed restructuring, New Co. wants to record its investment in Company A at cost. Determine how it should measure the cost of investment in Company A?

A entity that is not a parent establishes a new entity as its parent

The requirements of measuring cost of investment by a new parent as discussed above will equally apply in case where an entity that is not a parent (i.e. it does not have a subsidiary) establishes a new parent between itself and its owners.
Hence, in illustration 1 above, the same accounting treatment will have to be followed by New Co. even if Company A does not have any subsidiary.

5. MAJOR CHANGES IN IND AS 27 FROM IAS 27 :

Ind AS 27, like other Ind ASs, has been converged from the global standards, i.e., IFRSs, which has been made applicable to the Indian entities (based on the net worth criteria) in a phased manner via Ministry of Corporate Affairs Roadmap. While converging from IAS 27, following are the carve outs given under Appendix 1 to lnd AS 27, keeping in mind, the requirements of other converged lnd ASs and the economic environment in India:

- IAS 27 allows the entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their Separate Financial Statements (SFS). Such option is not given in Ind AS 27, as the equity method is not a measurement basis like cost and fair value but is a manner of consolidation and therefore would lead to inconsistent accounting conceptually.

Thanks ….

CHAPTER

8

IND AS 19 – EMPLOYEES BENEFITS

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. EMPLOYEE BENEFIT
4. DEFINITIONS
5. SHORT-TERM EMPLOYEE BENEFITS
6. POST-EMPLOYMENT BENEFITS
7. ACCOUNTING FOR DEFINED CONTRIBUTION PLANS
8. ACCOUNTING FOR DEFINED BENEFIT PLANS
9. RECOGNITION AND MEASUREMENT: PRESENT VALUE OF DEFINED BENEFIT OBLIGATIONS AND CURRENT SERVICE COST
10. RECOGNITION AND MEASUREMENT: PLAN ASSETS
11. COMPONENTS OF DEFINED BENEFIT COST
12. PRESENTATION
13. OTHER LONG-TERM EMPLOYEE BENEFITS
14. TERMINATION BENEFITS
15. SELF PRACTICE QUESTIONS

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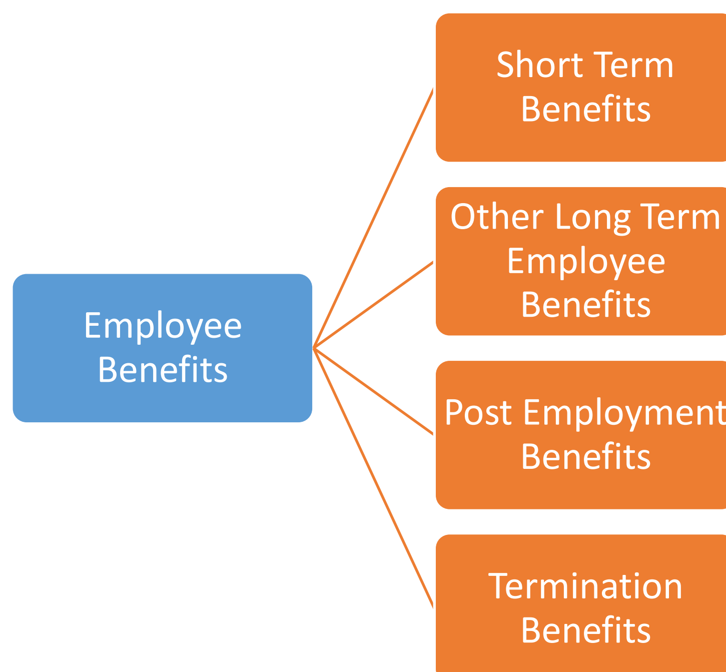
1. OBJECTIVE :

- The objective of this standard is to prescribe the accounting and disclosure for employee benefits.
- Ind AS 19 requires an entity to recognise:
  (a) a liability for advance services received from an employee; and
  (b) an expense for consumption of economic benefits raised from the service provided by an employee in exchange for employee benefits.

2. SCOPE :

- This Standard shall be applied by an employer in accounting for all employee benefits other than benefits to which Ind AS 102, Share-based Payment, is applicable.
- This Standard does not deal with reporting by employee benefit plans.
- Employee benefits are required to be paid.
- under formal plans/agreements between an entity and its individual employees/group of employees/their representatives,
  - as required by law or as required by any type of industry arrangements an entity is required to contribute to any nation/state/industry or other multi-employer plans; or
  - where due to some change in informal practice entity is required to pay due to constructive obligation.

3. EMPLOYEE BENEFITS :



4. DEFINITIONS ;

1. **Employee Benefits :** All forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

2. **Short-term Employee Benefits:** Employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.
   Example : Wages, salaries, paid annual leave.

3. **Post-employment Benefits:** Employee benefits (other than termination benefits benefits and short-term employee benefits) that are payable after the completion of employment.
   Example : Pensions, lumpsum payments on retirement.

4. **Other long-term employee benefits** are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.
   Example : Long-term paid absences such as long-service leave or sabbatical leave, jubilee or other long-service benefits.

5. **Termination benefits** are employee benefits provided in exchange for the termination of an employee's employment as a result of either:
   (a) an entity's decision to terminate an employee's employment before the normal retirement date; or
   (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment.

6. **Post-employment Benefit Plans**: These plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
   Under these plans the benefits given to employees are after employment like gratuity, pension, provident fund etc.
   Note : Defined contribution plans and Defined Benefit Plans are two categories of postemployment benefits plans.

7. **Defined Contribution Plans** : They are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
   In such kind of plans the contribution is defined which means it is fixed and known to the entity.
   Example : Provident Fund contribution by the employer.

8. **Defined Benefit Plans**: Post-employment benefit plans other than defined contribution plans.
   Example: Gratuity.

9. **Multi-employer Plans** : Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:
   (a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees.

10. **Net defined benefit liability (asset) :** The deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

11. **Deficit or surplus:**
    (a) the present value of the defined benefit obligation less
    (b) the fair value of plan assets (if any).

12. **Asset ceiling**: The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

13. **Present Value of a Defined Benefit Obligation**: Present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods. Plan assets comprise:
    (a) assets held by a long-term employee benefit fund; and
    (b) qualifying insurance policies.

14. **Assets Held by a Long-term Employee Benefit Fund**: Assets (other than non-transferable financial instruments issued by the reporting entity) that:
    (a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and
    (b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:
        (i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or
        (ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

15. **Qualifying Insurance Policy**: Insurance policy issued by an insurer that is not a related party (as defined in Ind AS 24, Related Party Disclosures) of the reporting entity, if the proceeds of the policy:
    (a) can be used only to pay or fund employee benefits under a defined benefit plan; and
    (b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:
        (i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or
        (ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

16. **Fair Value :** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Ind AS 113, Fair Value Measurement.)

17. **Service cost** comprises:
    (a) Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
    (b) Past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and
    (c) any gain or loss on settlement.

18. **Net interest on the net defined benefit liability (asset)**: The change during the period in the net defined benefit liability (asset) that arises from the passage of time.

19. **Remeasurements of the net defined benefit liability** (asset) comprise:
    (a) actuarial gains and losses;
    (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
    (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

20. **Actuarial gains and losses** are changes in the present value of the defined benefit obligation resulting from:
    (a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
    (b) the effects of changes in actuarial assumptions.

21. **Return on plan assets**: Interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:
    (a) any costs of managing plan assets; and
    (b) any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.

22. **Settlement**: A transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

5. SHORT-TERM EMPLOYEE BENEFITS :

- Short-term employee benefits include items expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services.

- It includes
  (a) wages, salaries and social security contributions;
  (b) paid annual leave and paid sick leave;
  (c) profit-sharing and bonuses; and
  (d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Recognition and Measurement of Short-term Benefits :

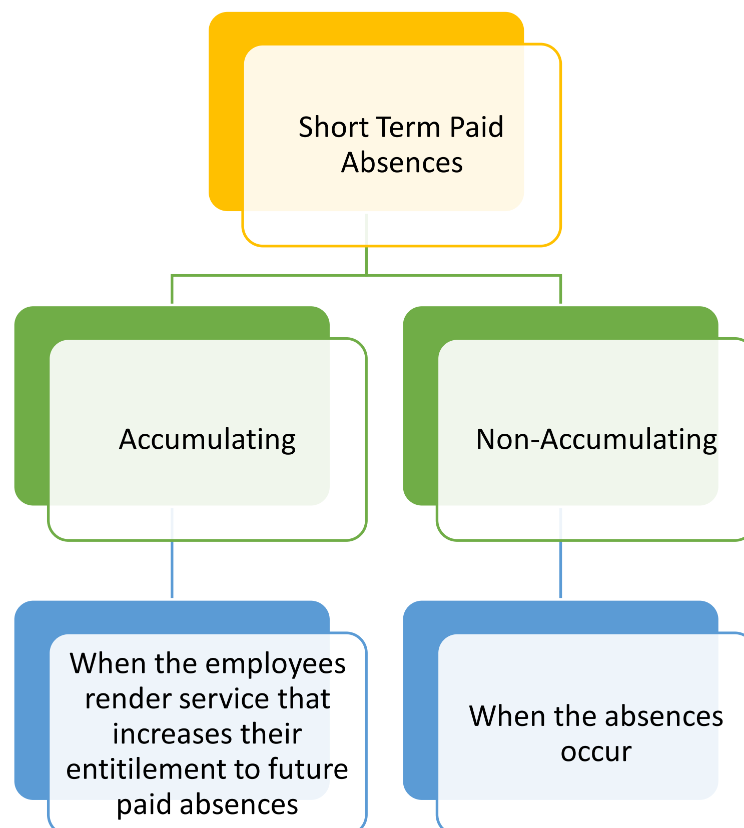
Accounting for short term benefits has two characteristics:

(a) measurement of short term benefits are measured on an undiscounted basis; and

(b) it involves no actuarial assumptions to be made, hence there is no accounting required for any actuarial gain/loss.

Note: Recognition of short term employee benefit is in the form of either paid expenses or profit sharing or bonus plans

Short -term paid absences :



Accumulating Paid Absences :

These are the absences that are carried forward and can be used in future periods if the employee is not able to use them in current reporting period of the employer. They can be either:

(i) **Vesting :** In this case, employees are entitled to a cash-payment for the unutilised entitlement at the time of leaving the entity.

(ii) **Non-vesting :** In this case, employees are not entitled to a cash payment for unused entitlement on leaving.

Question 1 – Sunderam Pvt.

Sunderam Pvt. Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled for 30 annual leaves out of which 10 may be carried forward to the next current year, 10 sick leaves out of which 2 may be carried forward as paid leave. At March 31, 20X1, the average unused entitlement is 5 days per employee for privilege leave and 1 for sick leave. On an average, it is found that the number of such employees who would be claiming annual leaves would be 30 and 10 employees who would claim sick leaves. Compute the liability to be recognised as sick pay and privilege leave by the entity in 20X0-20X1.

Non-accumulating Paid Absences :

- These are the absences that do not carry forward and they will lapse if the current period's entitlement is not used in full by the employee and
- This also do not entitle employees to a cash payment for unused entitlement on leaving the entity.

  Example : Sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and compensated absences for jury service or military service.
- An entity shall recognise no liability or expense as the employee service does not increase the amount of the benefit.

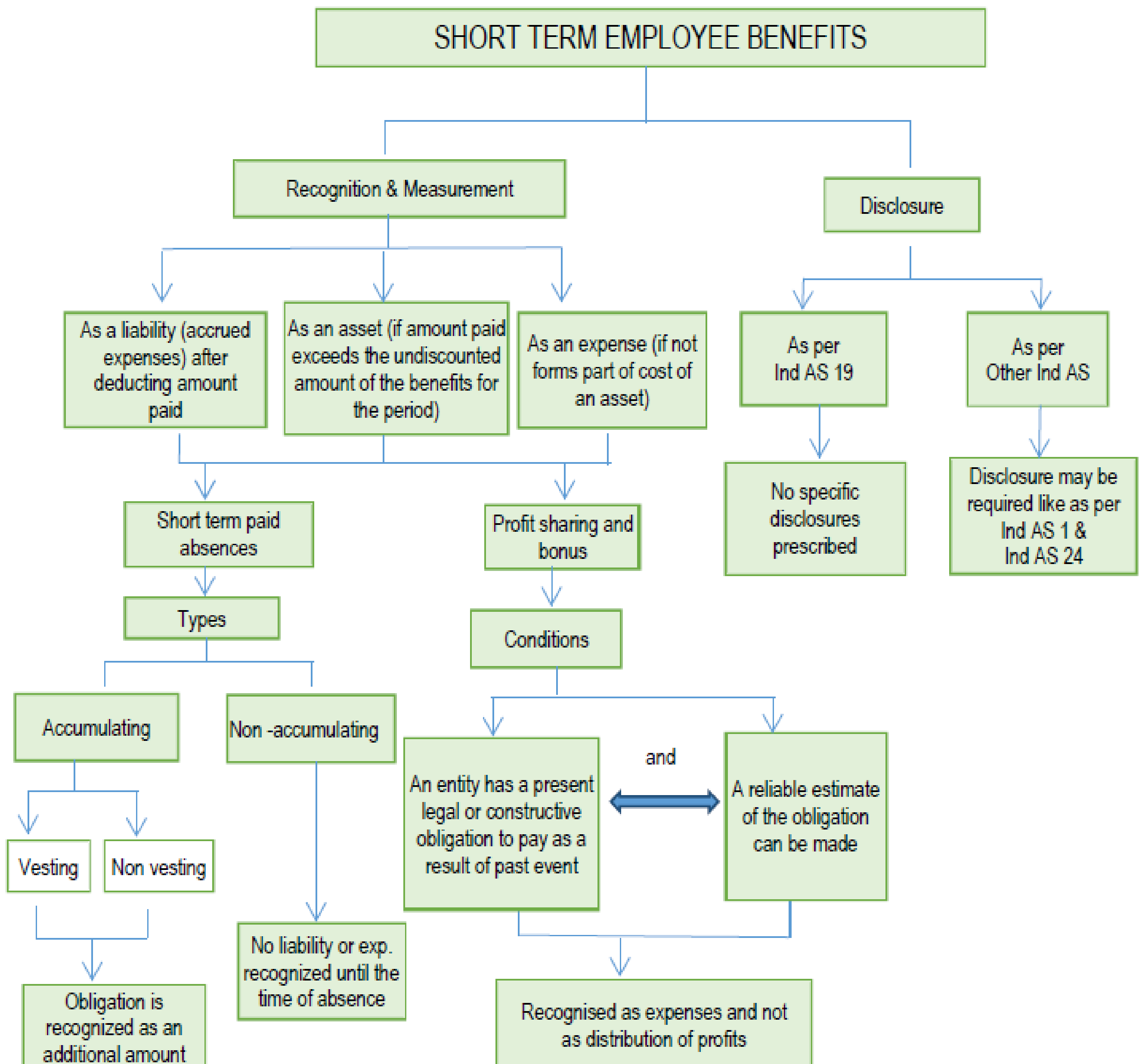
Profit-sharing and Bonus Plans :

- Expected costs of profit-sharing and bonus plans shall be recognised when: (a) the entity has a present legal or constructive obligation to make such payments as a result of past events; and (b) a reliable estimate of the obligation can be made by the entity.
- A present obligation exists when, and only when, an entity has no realistic alternative but to make the payments in lieu of profits and bonuses to its employees.
- An obligation under profit-sharing and bonus plans results from employee service and not from a transaction with the entity's owners.
- Therefore, an entity recognises the cost of profit-sharing and bonus plans not as a distribution of profit but as an expense.

Question 2 – Laxmi Mills

Laxmi Mills is a profit making entity and has reported Rs 200 crore in the financial year 2011-2012. According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation. As

under these kinds of plans, an entity is under an obligation to pay if the employees complete a specified period with the organisation. Laxmi mills has estimated that due to turnover in the organisation, the estimated pay-out would be around 4.5%. Compute the liability and expense of the company under this plan.



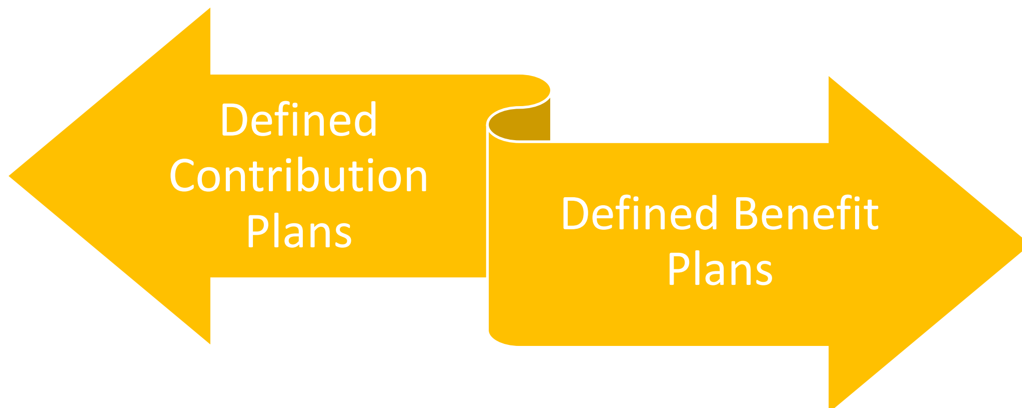
6. POST-EMPLOYMENT BENEFITS :

Post-employment benefits include:

(a) Retirement benefits such as pensions and lump sum payments on retirement; and

(b) Other post-employment benefit plans such as post-employment life insurance and postemployment medical care.

Classification of Post-employment Benefit Plans into Defined Contribution Plan vs Defined Benefit Plans :



The above difference can be summarized as follows :

No.	Particulars	Defined Contribution Plans	Defined Benefit Plans
1.	Amount contributed	The entity agrees to **contribute a limited amount** to the fund as its legal or constructive obligation.	The entity's obligation is to **provide the agreed benefits** to current and formed employees.
2.	Risk bearer	Actuarial risk and investment risk **fall on the employee** and not on the entity.	Actuarial risk and investment risk **fall on the entity** and not o the employees
3.	Change in the obligation	Generally, no change in the contribution of an entity is made except certain conditions.	If actuarial or investment experience are worse than expected, **the entity's obligation may be increased** for providing to the employees.
4.	Determination of the amount of post-employment benefit	The amount of the post-employment benefits received by the employee is determined by the amount of contribution paid by an entity and employees as well.	Pre-determined / Agreed post-employment benefits are received by the employee.

Multi-employer Plans :

In case the multi-employer plan is a defined benefit plan, an entity shall:

(a) account for its proportionate share of the

- (i) defined benefit obligation,
- (ii) plan assets and
- (iii) cost associated with the plan in the same way as for any other defined benefit plan; and

(b) disclose the information required.

Question 3 – Paras Pvt. Ltd.

Paras Pvt. Ltd. does not have sufficient information to about a defined benefit plan and thus accounts for the plan as if it were defined contribution plan. In this kind of plan, there is a contractual agreement between Paras Pvt. Ltd. and its participants to share the deficit amongst all. This kind of funding valuation shows a deficit of Rs.500 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next 10 years. The entity's total contributions under the contract are Rs.30 million

7. ACCOUNTING FOR DEFINED CONTRIBUTION PLANS :

- The reporting entity's obligation for each period is determined by the amounts to be contributed for that period.
- No actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss.
- The obligations are measured on an undiscounted basis.

Exception:
Discounting is done where the obligation falls due after twelve months after the end of the annual reporting period in which the employees render the related service.

Recognition and Measurement :

In case when an employee renders service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) as a liability (accrued expense), after deducting any contribution already paid.
In case the amount of contribution already paid under a defined contribution plan exceeds the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, a reduction in future payments or a cash refund; and

(b) as an expense if not included in the cost of an asset as per other Ind AS (for example, according to Ind AS 2 and Ind AS 16).

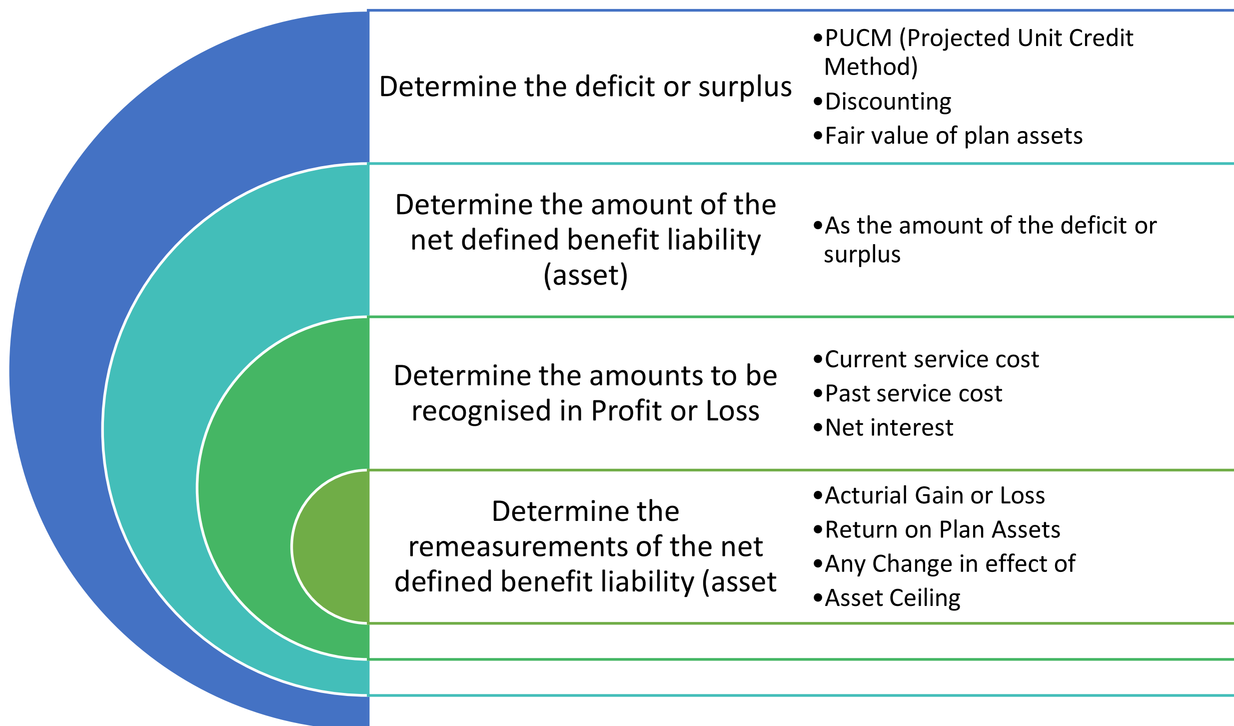
Where contributions to a defined contribution plan do not fall due wholly before twelve months after the end of the annual reporting period in which the employees render the related service, the contributions shall be discounted using the discount rate as specified in this Standard.

8. ACCOUNTING FOR DEFINED BENEFIT PLANS :

Accounting for defined benefit plans is complex as –

- actuarial assumptions are required to measure the obligation and the expense
- there is a possibility of recognising actuarial gains and losses
- the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

Steps involved in Accounting by an entity for defined benefit plans :



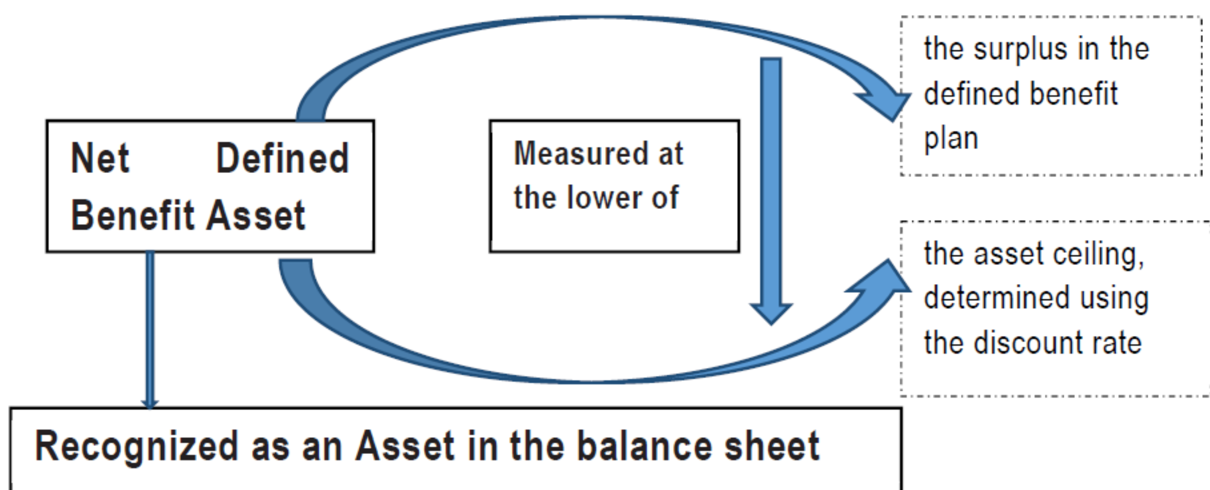
Accounting for the Constructive Obligation :

- Accounting for any constructive obligation will also be done by an entity that arises from the entity's informal practices and for its legal obligation under the formal terms of a defined benefit plan.
- Constructive obligation arises due to informal practices where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.
- The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Hence, it is usually difficult for an entity to cancel a plan if employees are to be retained. Hence, accounting for post-employment benefits assumes that an entity which is currently promising such benefits will continue to do so over the remaining working lives of employees in the absence of evidence to the contrary.

Balance Sheet :

- An entity is required to recognise the net defined benefit liability (asset) in the balance sheet.
- When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:
  - (a) the surplus in the defined benefit plan; and
  - (b) the asset ceiling, determined using the discount rate.

- A net defined benefit asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised. An entity recognises an asset in such cases because:
  (a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;
  (b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and
  (c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.



9. RECOGNITION AND MEASUREMENT: PRESENT VALUE OF DEFINED BENEFIT OBLIGATIONS AND CURRENT SERVICE COST :

The cost of a defined benefit plan is influenced by many variables, such as final salaries, employee turnover and mortality, employee contributions and medical cost trends. Hence, the final cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time.

In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) apply an actuarial valuation method;
(b) attribute benefit to periods of service; and
(c) make actuarial assumptions.

Actuarial Valuation Method :

- Projected Unit Credit Method is used by an entity to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.
- The Projected Unit Credit Method (which is also sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) perceives each period of service as which gives rise to an additional unit of benefit entitlement and measures each unit separately to report the final obligation.

- An entity discounts the whole of a post-employment benefit obligation, even if part of the obligation is expected to be settled before twelve months after the reporting period.

Attributing Benefit to Periods of Service :

- An entity shall attribute benefit to periods of service under the plan's benefit formula, in determining the present value of its defined benefit obligations and the related current service cost.
- However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from: (a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until (b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.
- The Projected Unit Credit Method is a methodology which requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations).
- An entity will attribute benefit to periods in which the obligation to provide post-employment benefits arises as employees render services in return for post-employment benefits which an entity expects to pay in future reporting periods.
- These kind of actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.

Question 4 –

A defined benefit plan provides a lump-sum benefit of Rs.200 payable on retirement for each year of service. A benefit of Rs.200 is attributed to each year. The current service cost is the present value of Rs.200. The present value of the defined benefit obligation is the present value of Rs.200, multiplied by the number of years of service up to the end of the reporting period. What is the current service cost?

Question 5 –

A plan pays a benefit of Rs.150 for each year of service. The benefits vest after ten years of service. Compute the benefit to be attributed each year?

Question 6 – Amra Pvt. Ltd.

Amra Pvt. Ltd. has a plan for its employees where it has decided to pay a lump-sum benefit of Rs.2,000 that will vest after ten years of service to the employee. However, such kind of plan will provide no further benefit for subsequent service. Compute the benefit attributed for last 10 years and after these years?

Question 7 –

A plan pays a lump-sum retirement benefit of Rs.4,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service. Compute the benefit attributed?

Question 8 – Sanat Pvt. Ltd.

Sanat Pvt. Ltd. has a plan for the employees where employees are entitled to a benefit of 5 % of final salary for each year of service before the age of 55. Compute the benefit attributed up to 55 years and after 55?

Actuarial Assumptions :

Actuarial Assumptions shall be Unbiased and Mutually Compatible :

- Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits.
- Actuarial assumptions comprise:
  - (a) demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:
    - (i) mortality, both during and after employment;
    - (ii) rates of employee turnover, disability and early retirement;
    - (iii) the proportion of plan members with dependants who will be eligible for benefits;
    - (iv) the proportion of plan members who will select each form of payment option available under the plan terms; and
    - (v) claim rates under medical plans; and
  - (b) financial assumptions, dealing with items such as:
    - (i) the discount rate;
    - (ii) future salary and benefit levels;
    - (iii) in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments; and
    - (iv) the expected rate of return on plan assets.

Actuarial Assumptions: Mortality and Discount Rate :

1. **Mortality Assumptions :**

Entity is required to determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment. In order to estimate the ultimate cost of the benefit an entity shall takes into consideration the expected changes in mortality, for example by modifying standard mortality tables with estimates of mortality improvements.

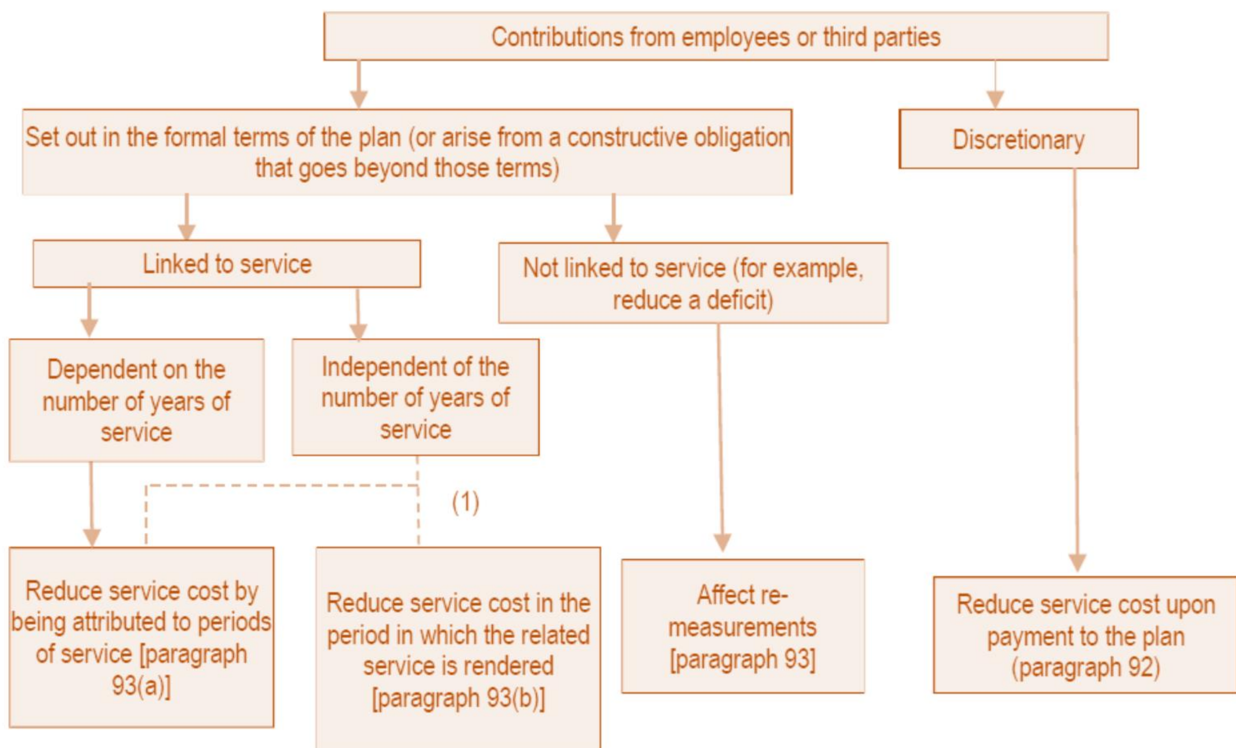
2. **Discount Rate Assumptions :**

- The rate which is used to discount post-employment benefit obligations (both funded and unfunded) is determined by reference to market yields on government bonds at the end of the reporting period.
- Subsidiaries, associates, joint ventures and branches domiciled outside India shall discount post-employment benefit obligations arising on account of post-employment benefit plans using the rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds.
- In case, such subsidiaries, associates, joint ventures and branches are domiciled in countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds of that country shall be used.
- The currency and term of the government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations as the pay- outs will happen in same currency only.
- The discount rate reflects the estimated timing of benefit payments/time value of money and not the actuarial or investment risk. This also does not reflect entity-specific credit risk borne by the entity's creditors.
- Thus, practically speaking, it is achieved by an entity by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid.
- Where there is no deep market in government bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments, an entity uses current market rates of the appropriate term to discount shorter-term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve.
- Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period and taking account of any material changes in the obligation.

Actuarial Assumptions: Salaries, Benefits and Medical Costs :

- Defined benefit obligations shall be measured on a basis that reflects:
  `(a) estimated future salary increases;
  (b) the benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the end of the reporting period;
  (c) the effect of any limit on the employer's share of the cost of the future benefits;
  (d) contributions from employees or third parties that reduce the ultimate cost to the entity of those benefits; and
  (e) estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:
    (i) those changes were enacted before the end of the reporting period; or
    (ii) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

- Estimates of future salary increases are calculated after taking account inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.
- The formal terms of a plan (or a constructive obligation that goes beyond those terms) require an entity to change benefits in future periods; the measurement of the obligation reflects those changes.



Actuarial Gains and Losses :

- An entity shall recognise immediately in other comprehensive income all of its actuarial gains and losses in measuring its defined benefit liability and this shall be presented in the statement of profit and loss.
- Actuarial gains and losses and adjustments that have been recognised in other comprehensive income shall not be reclassified to profit or loss in a subsequent period.

10. RECOGNITION AND MEASUREMENT: PLAN ASSETS

Fair Value of Plan Assets :

- The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus.
- Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.
- Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those

insurance policies is deemed to be the present value of the related obligations, (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements :

- An entity will recognise its right to reimbursement as a separate asset when, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation. The assets are measured at fair value by the entity and in all other respects, an entity shall treat that asset in the same way as plan assets. In the statement of profit and loss, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.
- Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. An entity accounts for qualifying insurance policies in the same way as for all other plan assets. When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset.
- In such a scenario, an entity recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability and in all other respects, the entity treats that asset in the same way as plan assets.
- If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation.

11. COMPONENTS OF DEFINED BENEFIT COST :

An entity is required to recognise the components of defined benefit cost, except to the extent that another Ind AS (refer Ind AS 2 and Ind AS 16) requires or permits their inclusion in the cost of an asset, as follows:

(a) service cost in profit or loss;

(b) net interest on the net defined benefit liability (asset) in profit or loss; and

(c) remeasurements of the net defined benefit liability (asset) in other comprehensive income.

12. PRESENTATION :

Offset :

- An asset relating to one plan will be offset against a liability relating to another plan in case the entity:
  (a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and
  (b) there is an intention either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.
- The offsetting criteria are similar to those established for financial instruments in Ind AS 32, Financial Instruments: Presentation.

Current/Non-current Distinction :

This Standard does not specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

Components of Defined Benefit Costs :

This Standard does not specify whether an entity should present current service cost and net interest cost on net defined liability (asset) as components of a single item of income or expense in the statement of profit and loss. An entity presents those components in accordance with Ind AS 1 Presentation of Financial Statements.

13. OTHER LONG-TERM EMPLOYEE BENEFITS :

- Other long-term employee benefits which are not expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.
- Other long-term employee benefits include, for example:
  - (a) long-term paid absences such as long-service or sabbatical leave;
  - (b) jubilee or other long-service benefits;
  - (c) long-term disability benefits;
  - (d) profit-sharing and bonuses; and
  - (e) deferred remuneration.
- The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. It is also there that the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. This method does not recognise remeasurements in other comprehensive income as required under the accounting required for post-employment benefits.

Recognition and Measurement :

- The amount recognised as a liability for other long-term employee benefits shall be the net total of the following amounts:
  - (a) the present value of the defined benefit obligation at the end of the reporting period;
  - (b) minus the fair value at the end of the reporting period of plan assets (if any) out of which the obligations are to be settled directly.
- An entity shall recognise the net total of the following amounts as expense or income for other long-term employee benefits, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:
  - (a) service cost;
  - (b) net interest on the net defined benefit liability (asset); and
  - (c) remeasurements of the net defined benefit liability (asset).
- One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of

benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

Disclosure :

Though this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures, for example, where the expense resulting from such benefits is material and so would require disclosure in accordance with Ind AS 1. When required by Ind AS 24, an entity discloses information about other long-term employee benefits for key management personnel.

14. TERMINATION BENEFITS :

- This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination of employment rather than employee service.

- Termination benefits results from:
  (a) either an entity's decision to terminate the employment or
  (b) an employee's decision to accept an entity's offer of benefits in exchange for termination of employment.

Recognition :

An entity is required to recognise a liability and expense for termination benefits at the earlier of the following dates:

(a) when the entity can no longer withdraw the offer of those benefits; and

(b) when the entity recognises costs for a restructuring which is within the scope of Ind AS 37 and involves the payment of termination benefits.

Measurement :

An entity shall measure termination benefits on initial recognition, and shall measure and recognise subsequent changes, in accordance with the nature of the employee benefit, provided that if the termination benefits are an enhancement to post-employment benefits, the entity shall apply the requirements for post-employment benefits. Otherwise:

(a) if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognised, the entity shall apply the requirements for short-term employee benefits.

(b) If the termination benefits are not expected to be settled wholly before twelve months after the end of the annual reporting period, the entity shall apply the requirements for other long term employee benefits.

Example on Termination Benefits

As a result of a recent acquisition, an entity plans to close a factory in ten months and, at that time, terminate the employment of all of the remaining employees at the factory. Because the

entity needs the expertise of the employees at the factory to complete some contracts, it announces a plan of termination as follows.

Each employee who stays and renders service until the closure of the factory will receive on the termination date a cash payment of Rs.30,000. Employees leaving before closure of the factory will receive Rs.10,000.

There are 120 employees at the factory. At the time of announcing the plan, the entity expects 20 of them to leave before closure. Therefore, the total expected cash outflows under the plan are Rs.3,200,000 (i.e. 20 × Rs.10,000 + 100 × Rs.30,000). As required by paragraph 160, the entity accounts for benefits provided in exchange for termination of employment as termination benefits and accounts for benefits provided in exchange for services as short-term employee benefits.

Termination benefits

The benefit provided in exchange for termination of employment is Rs.10,000. This is the amount that an entity would have to pay for terminating the employment regardless of whether the employees stay and render service until closure of the factory or they leave before closure. Even though the employees can leave before closure, the termination of all employees' employment is a result of the entity's decision to close the factory and terminate their employment (i.e. all employees will leave employment when the factory closes). Therefore, the entity recognises a liability of Rs.1,200,000 (i.e. 120 × Rs.10,000) for the termination benefits provided in accordance with the employee benefit plan at the earlier of when the plan of termination is announced and when the entity recognises the restructuring costs associated with the closure of the factory.

Benefits provided in exchange for service

The incremental benefits that employees will receive if they provide services for the full tenmonth period are in exchange for services provided over that period. The entity accounts for them as short-term employee benefits because the entity expects to settle them before twelve months after the end of the annual reporting period. In this example, discounting is not required, so an expense of Rs.200,000 (i.e. Rs.2,000,000 ÷ 10) is recognised in each month during the service period of ten months, with a corresponding increase in the carrying amount of the liability.

15. SELF PRACTICE QUESTIONS :

Question 9 –

A plan provides a monthly pension of 0.3% of final salary for each year of service. The pension is payable from the age of 65. What is the current service cost?

Question 10 –

A plan pays a benefit of Rs.140 for each year of service, excluding service before the age of 25. The benefits vest immediately. Compute the benefit to be attributed before the age of 25 and after 25?

Question 11 – B Pvt. Ltd.

B Pvt. Ltd. has a post-employment medical plan which will reimburse 20% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service. Compute the benefit attributed for last 20 years, 10 and 20 years and within 10 years?

Question 12 – Cisca Pvt.

Cisca Pvt. Ltd. has a headcount of around 1,000 employees in the organisation in 2010-2011. As per the company policy, the employees are given 35 days of privilege leave (PL), 15 days of sick leave (SL) and 10 days of casual leave. Out of the total PL and sick leave, 10 and 5 can be carried forward to next year. On the basis of past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 as PL and 5 as SL. Also the company has been incurring profits since 2000. It has decided in 2010-2011 to distribute profits to its employees @ 4% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Cisca Pvt. Ltd. is expected to be around 3.5%. The profits earned during 2010-2011 is Rs.2,000 crores.

Cisca Pvt. Ltd. has a post-employment benefit plan also available which is the nature of defined contribution plan where contribution to this fund amounts to Rs.100 crores which will fall due within 12 months from the end of accounting period.

The company has paid Rs.20 crores to its employees in 2010-2011.

What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Cisca Pvt. Ltd?

Thanks ....

CHAPTER

9

IND AS 115 – REVENUE FROM CONTRACT WITH CUSTOMER

CONCEPTS COVERED

1. OVERVIEW
2. INTRODUCTION
3. SCOPE
4. RECOGNITION (5 STEP MODEL)
   A. IDENTIFYING THE CONTRACT
   B. IDENTIFYING PERFORMANCE OBLIGATION
   C. DETERMINATION OF TRANSACTION PRICE
   D. ALLOCATION OF TRANSACTION PRICE OF PERFORMANCE OBLIGATION
   E. SATISFACTION OF PERFORMANCE OBLIGATION
5. SPECIAL ISSUES
   A. BILL AND HOLD
   B. CONTRACT COSTS
   C. SERVICE ARRANGEMENT CONCESSIONS
6. SELF PRACTICE QUESTIONS

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1. OVERVIEW

The world we knew has changed and is changing as we still speak. The older days of doing business has changed. The way buy and sell used to take place changed. Let us look at some new ways of business

1. Maruti offering free services along with the car.
2. Exchange offers – buy new product at discounted price when exchanged with old product.
3. Discounts coupons / cash backs / bundled goods and services / return offers and so on

To deal with all such issues we needed a comprehensive standard.

2. INTRODUCTION

After more than a decade of work, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) had published their largely converged standards on revenue recognition in May 2014. The IASB issued IFRS 15 Revenue from Contracts with Customers and FASB issued ASU 2014-09 with the same name.

In convergence with IFRS, the Ministry of Corporate Affairs (MCA) issued Ind AS 115, Revenue from Contracts with Customers vide its notification dated 28 March 2018.

Ind AS 115 supersedes and replaces Ind AS 11 and Ind AS 18 and guidance note on real estate transactions.

Ind AS 115 is based on a core principle that requires an entity to recognise revenue:

(a) In a manner that depicts the transfer of goods or services to customers

(b) At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

3. SCOPE ;

Ind AS 115 applies to all contracts with customers to provide goods or services that are outputs of the entity's ordinary course of business in exchange for consideration, unless specifically excluded from the scope of the new guidance, as described below. An entity shall apply this Standard to all contracts with customers, except the following:

A. lease contracts within the scope of Ind AS 116, Leases;

B. insurance contracts within the scope of Ind AS 104, Insurance Contracts

C. financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Financial Instruments, Ind AS 110, Consolidated Financial Statements, Ind AS 111, Joint Arrangements, Ind AS 27, Separate Financial Statements and Ind AS 28, Investments in Associates and Joint Ventures; and

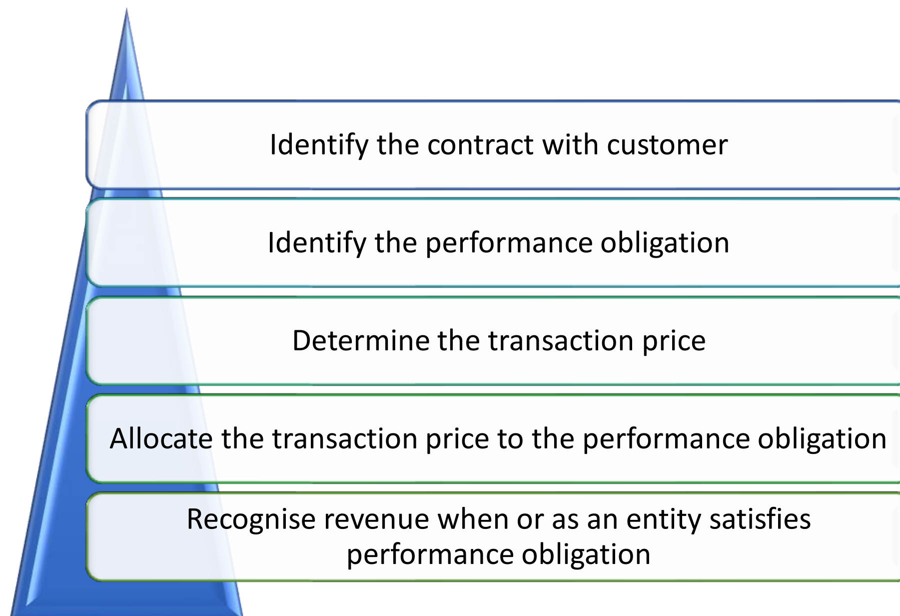
D. non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

A contract with a customer may be partially within the scope of Ind AS 115 and partially within the scope of other Ind AS. In such cases, the following steps should be followed to identify how it should be split between Ind AS 115 and other Ind AS:

(i) If the other Ind AS specify how to separate and/or measure a portion of the contract, then that guidance should be applied first. The amounts measured under other Ind AS should be excluded from the transaction price that is allocated to performance obligations under Ind AS 115.

(ii) If the other Ind AS do not stipulate how to separate and/or measure a portion of the contract, then Ind AS 115 would be used to separate and/or measure that portion of the contract (refer discussion relating to Step 4 - Allocation of transaction price to performance obligation).

4. RECOGNITION



A. Identify the contract with customer :

(i) Definition :

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. None of the parties have right to unilaterally cancel the wholly unperformed contract without paying consideration. Contracts can be written, oral, or implied by an entity's customary business practices.

(ii) Criteria of recognising the contract :

An accounting contract exists only when an arrangement with a customer meets each of the following five criteria:

1. The parties have approved (in writing, orally or in accordance with other customary business practices) the contract and are committed to perform their contractual obligations
2. The entity can identify each party's rights regarding the goods or services to be transferred
3. The entity can identify the payment terms for the goods or services to be transferred
4. The contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract), and

5. It is probable that the entity will collect substantially all of the consideration to which it expects to be entitled.

Consider if the contract meets each of the five criteria to pass Step 1:

Have the parties approved the contract? → No

↓ Yes

Can the entity identify each party's rights regarding the goods/services to be transferred? → No

↓ Yes

Can the entity identify the payment terms for the goods/services to be transferred? → No

↓ Yes

Does the contract have commercial substance? → No

↓ Yes

Is it probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods/services that will be transferred to the customer? → No

↓ Yes

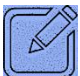
Proceed to Step 2 and only reassess the Step 1 criteria if there is an indication of a significant change in facts and circumstances.

(No →) Recognise consideration received as a liability until each of the five criteria in Step 1 are met or one of the following occurs:

1. entity has no remaining performance obligations and substantially all consideration has been received and is non-refundable.
2. contract is terminated and consideration is non-refundable

↑

Continue to assess the contract to determine if the Step 1 criteria are met. (→ back to: Consider if the contract meets each of the five criteria to pass Step 1)



Question 1 - New Way Limited

New Way Limited decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New way enters into an arrangement with a customer in the new region for networking products for promised consideration of Rs.1,250,000. At contract inception, New way expects that it may not be able to collect the full amount from the customer. Determine how New way will recognise this transaction?

(iii) Contract Term :

Some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply this Standard to the duration of the contract (ie the contractual period) in which the parties to the contract have present enforceable rights and obligations.

Question 2 - A gymnasium

A gymnasium enters into a contract with a new member to provide access to its gym for a 12month period at Rs.4,500 per month. The member can cancel his or her membership without penalty after three months. Specify the contract term.

(iv) Combining Contracts :

Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with the same customer (or with related parties), and if one of the following conditions exists:

1. The contracts are negotiated as a package with a single commercial objective
2. The amount of consideration paid in one contract depends on the price or performance in the other contract; or
3. The goods or services promised in the contract are a single performance obligation.

Question 3 - Manufacturer of airplanes

Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases. Would these contracts be combined?

(v) Contract Modification :

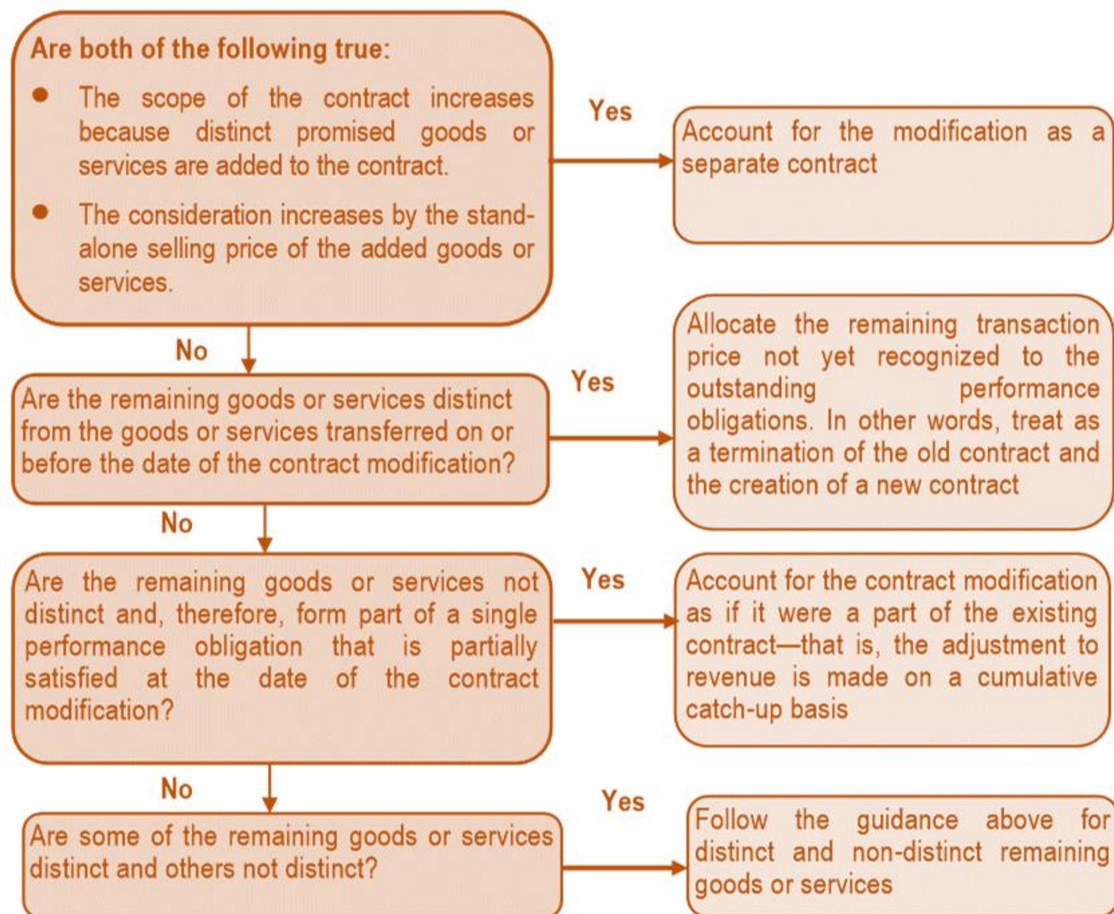
Modifications that change the terms of a contract are common in many industries, including manufacturing, telecommunications, defence, and construction. Depending upon the industry or jurisdiction, the modification may be better known as a change order, a variation, or an amendment.

The modification guidance under Ind AS 115 requires an entity to

(a) Identify if a contract has been modified.

(b) Determine if the modification results in a separate contract, a termination of the existing contract and the creation of a new contract, or a continuation of the existing contract.

(c) Account for the contract modification accordingly.



Question 4 - An entity

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

Question 5 – KLC Ltd.

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

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

On 1 October 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from Rs.55,000 per month to Rs.45,000 per month. Determine the effect of change in the contract?

Question 6 – Growth Ltd.

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

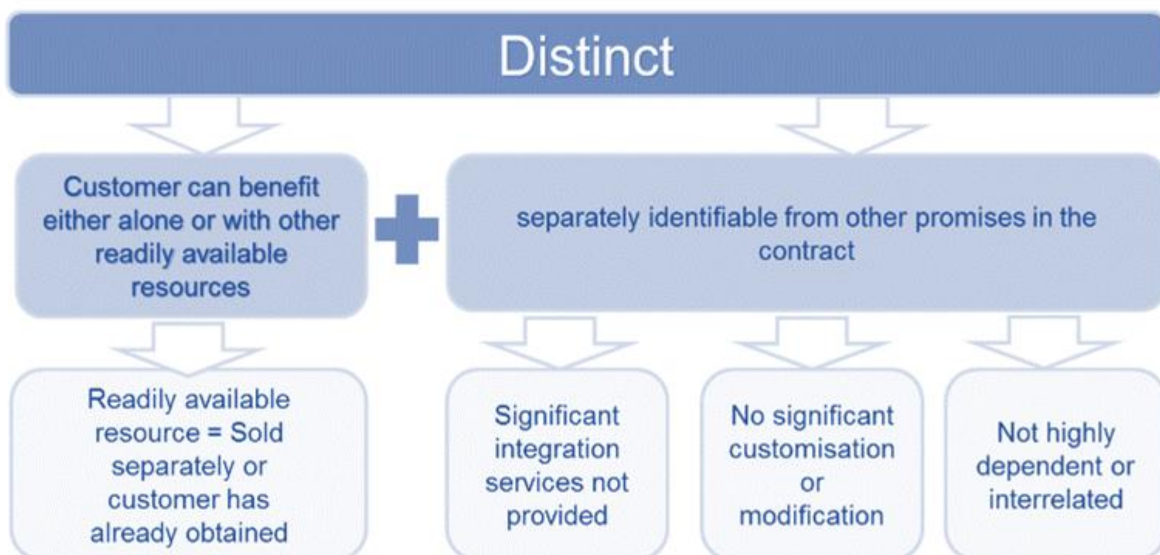
B. Identifying performance obligation :

(i) Definition :

Performance obligations has been defined as a promise in a contract with a customer to transfer to the customer either:

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

(ii) Distinct Performance Obligation :



Each of the criteria mentioned above are discussed in more detail below:

A.1 Customer can benefit either alone or with other readily available resources :

The customer can benefit from the good or service either on its own or with other resources readily available to them. A readily available resource is a good or service that is sold separately (by the entity or by another entity) or that the customer has already obtained from the entity or from other transactions or events.

A customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits.

Sometimes, a customer can benefit from a good or service only with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources.

For e.g, the fact that the entity regularly sells a good or service on its own is an indicator that the good or service is capable of being distinct.

A.2 Separately identifiable from other promises in the contract :

Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable include, but are not limited to, the following:

1. **Significant integration service :**
   It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the entity provides significant integration services. Stated differently, the entity is using the goods or services as inputs to produce the combined output called for in the contract.
2. **Significant modification or customization :**
   It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if one or more of the goods or services significantly modifies or customizes other promised goods or services in the contract. In some industries, such as the software industry, the notion of inseparable risks is more clearly illustrated by assessing whether one good or service significantly modifies or customizes another good or service in the contract. In this case, the goods or services are inputs to create a combined output—a customized product.
3. **Highly interdependent or highly interrelated :**
   It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the goods or services are highly interdependent or highly interrelated.
   Sometimes it may be unclear whether the entity provides an integration service or whether the goods or services are significantly modified or customized; yet the individual goods or services are not separately identifiable from other goods or services because they are highly dependent on, or highly interrelated with, other promised goods or services in the contract

Question 7 – Canan Ltd.

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

Determine whether the company has a single or multiple performance obligations under the contract?

Question 8 – Best Fibre Ltd.

Best Fibre Ltd. provides broadband services to its customers along with voice call service.

Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both. Are the performance obligations under the contract distinct?

Question 9 – Clean Power Ltd.

Clean Power Ltd. enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be provided like engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

Determine how many performance obligations does the entity have?

(iii) Promise to transfer a series of distinct goods or services :

There might be cases, where distinct goods or services are provided continuously over a period of time. For e.g. security services, or bookkeeping services. This will be considered as single performance obligation, if the consumption of those services by the customers is symmetrical.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

(a) each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation satisfied over time; and

(b) the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

Question 10 – Hotel Management Services

Could the series requirement apply to hotel management services where day to day activities vary, involve employee management, procurement, accounting, etc?

(iv) Multiple Element Arrangements/ Goods and services that are not distinct :

If the good or services are not considered as distinct, those goods or services are combined with other goods or services under the contract till the time the entity identifies a bundle of distinct goods or services.

Question 11 – Mahek Ltd.

Mahek Ltd., a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping centre with a customer car parking facility located in sub-levels underneath the shopping centre. Entity B solicited bids from multiple firms on both phases of the project — design and construction.

The design and construction of the shopping centre and parking facility involves multiple goods and services from architectural consultation and engineering through procurement and installation of all of the materials. Several of these goods and services could be considered separate performance obligations because Mahek Ltd. frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. Entity A may require to continually alter the design of the shopping centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the Mahek Ltd. have?

Question 12 – Excel 3 Software

Excel 3 Software, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The Excel 3 Software sells the license, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support. Determine how many performance obligations does the Excel 3 Software have?

Question 13 –

The promised goods and services are the same as in the above Illustration, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to

interface with other customised software applications used by the customer. The customised installation service can be provided by other entities. Determine how many performance obligations does the entity have?

(v) Customer options for additional goods or services :

Retail and consumer products entities frequently give certain customers the option to purchase additional goods or services. These options come in many forms, including sales incentives (e.g., coupons with a limited distribution, competitor price matching programs aimed at only some customers, gift cards issued by a retailer as a promotion) and customer award credits (e.g., loyalty or reward programs).

The standard requires the entity to classify if such an option

1. Creates separate performance obligation
2. Or it is just a marketing offer

1. Creates separate performance obligation :

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer. The right is material if it results in a discount that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

2. It is an marketing Offer :

If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right.

In such 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.

Question 14 – Parmeshwar

Parmeshwar enters into a contract for the sale of Product A for Rs.1,000. As part of the contract, Parmeshwar gives the customer a 40% discount voucher for any future purchases up to Rs.1,000 in the next 30 days. Parmeshwar intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher. Parmeshwar believes there is 80% likelihood that a customer will redeem the voucher and on an

average, a customer will purchase Rs.500 of additional products. Determine how many performance obligations does Parmeshwar have and their stand-alone selling price and allocated transaction price?

(vi) **Long Term arrangements :**

Entities frequently enter into arrangements to provide services on a long-term basis, such as maintenance services to be provided over a long period of time.

For example, should a three-year maintenance agreement be considered a single performance obligation representing the entire contractual period, or should it be broken into smaller periods (daily, monthly or yearly)? It may be appropriate to treat a three-year services contract as three separate one-year performance obligations, if the contract can be renewed or cancelled by either party at discrete points in time (that is, at the end of each service year).

The entity would separately account for its rights and obligations for each period in which the contract cannot be cancelled by either party.

In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

Question 15 – A cable company

A cable company provides television services for a fixed rate fee of Rs.800 per month for a period of 3 years. Cable services is satisfied overtime because customer consumes and receives benefit from services as it is provided i.e. customer generally benefits each day that they have access to cable service. Determine how many performance obligations does the cable company have?

(vii) **Consignment Arrangement :**

A consignment agreement is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods.

The following indicators have been provided to evaluate whether the arrangement is a consignment arrangement:

(a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;

(b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and

(c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Accounting for consignment arrangement :

- Revenue generally would not be recognized for consignment arrangements when the goods are delivered to the consignee because control has not yet transferred.
- Revenue is recognized when the entity has transferred control of the goods to the end consumer.

Question 16 – Rupvati

Rupvati enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's stores. Retailer A is obligated to pay Rupvati Rs.20 per dress when the dress is sold to an end customer.

During the consignment period, Rupvati has the contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Rupvati is also required to accept the return of the inventory. State when the control is transferred.

(viii) Principal V/s Agent :

The determination of whether the entity is acting as a principal or an agent affects the amount of revenue the entity recognises. That is,

- when the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled.
- when the entity is acting as an agent, the revenue recognised is the net amount i.e. the amount, entity is entitled to retain in return for its services under the contract.

Question 17 – Skyway Airlines

Skyway Airlines negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The Skyway Airlines agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the Skyway Airlines for each ticket purchased is negotiated and agreed in advance. The Skyway Airlines determines the prices at which the airline tickets will be sold to its customers. The Skyway Airlines sells the tickets and collects the consideration from customers when the tickets are purchased; therefore, there is no credit risk.

The Skyway Airlines also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the Skyway Airlines is a principal or an agent.

(ix) Non Refundable Upfront Fees :

In some contracts, an entity charges the customer a non-refundable upfront fee. Examples include joining fees in health club membership, activation fees for

telecom services, setup fees in certain service contracts and initial fees or joining fees in some supply contracts with the distributors or customers.

To identify performance obligations in such contracts, an entity shall assess whether the fee relates to an activity that the entity is required to undertake at the inception of the contract, or that activity does not result in the transfer of a promised good or service to the customer.

In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer. Instead the upfront fee is an advance payment for future goods and services and, therefore, would be recognised as revenue when those future goods and services are provided.

If the non-refundable upfront fee relates to a goods or service, the entity shall evaluate whether to account for the goods or services as a separate performance obligation. An entity may charge a non-refundable as a part of compensation of costs incurred in setting up a contract (or other administrative tasks). If those setup activities do not satisfy performance obligation, the entity shall disregard those activities (and related costs) when measuring progress. That is because the costs of setup activities do not depict transfer of services to customer.

Question 18 – Sanjay

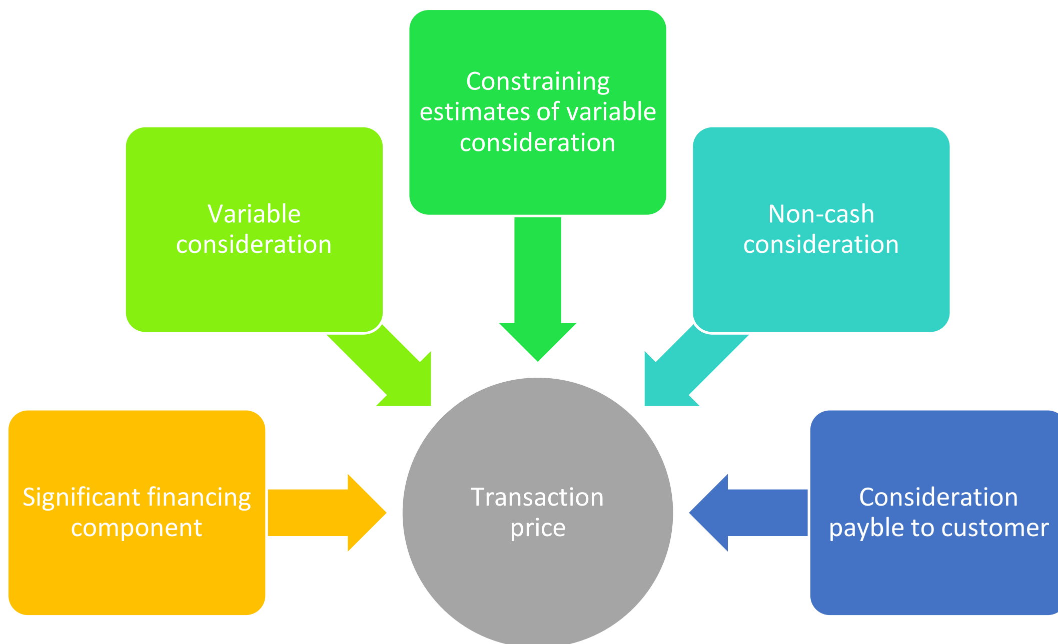
Sanjay buy a new data connection from the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection. The Sanjay will be charged based on the usage of the data services of the connection on monthly basis.

Are the performance obligations under the contract distinct?

C. Determining the transaction Price :

Measurement

"When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation."



(i) **Definition :**

What is transaction price?

"The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes)."

(ii) **Variable Consideration :**

What is variable consideration?

"If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer."

Examples of variable consideration :

"An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or nonoccurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone."

Variable consideration may be fixed in amount, but the entity's right to receive that consideration is contingent on a future outcome. For example, the amount of a performance bonus might be fixed, but because the entity is not entitled to that bonus until a performance target is met, the outcome is uncertain and therefore the amount is considered variable.

The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

(a) the customer has a valid expectation arising from an entity's customary business practices, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.

(b) other facts and circumstances indicate that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.

An entity shall estimate an amount of variable consideration by using either of the following methods

(a) The expected value –
the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount –
the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

Question 19 – XYZ Limited

XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is Rs.2.5 crore, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31st March, 20X1 that the asset is incomplete, the promised consideration is reduced by Rs.1 lakh. For each day before 31st March, 20X1 that the asset is complete, the promised consideration increases by Rs.1 lakh.
In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of Rs.15 lakh.
Determine the transaction price.

Question 20 – AST Limited

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

over time. Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of Rs.25 crores.
The entity has the opportunity to earn a performance bonus for early completion as follows:

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

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

Penalties

Penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration.

For example, where an entity agrees to transfer control of a good or service in a contact with customer at the end of 30 days for Rs.100,000 and if it exceeds 30 days, the entity is entitled to receive only Rs.95,000, the reduction of Rs.5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

Refund liabilities

An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price). The refund liability (and corresponding change in the transaction price and, therefore, the contract liability) shall be updated at the end of each reporting period for changes in circumstances.

(iii) Constraining estimates of variable consideration :

"Variable consideration will be considered in transaction price only when it is HIGHLY PROBABLE (both in terms of likelihood & magnitude) that no significant reversal will occur.

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.

Question 21 – HT Limited

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

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

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

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

Question 22 – Union Assets

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

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

Sale or Return

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

(a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);

(b) a refund liability; and

(c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Question 23 – Mohan

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

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

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

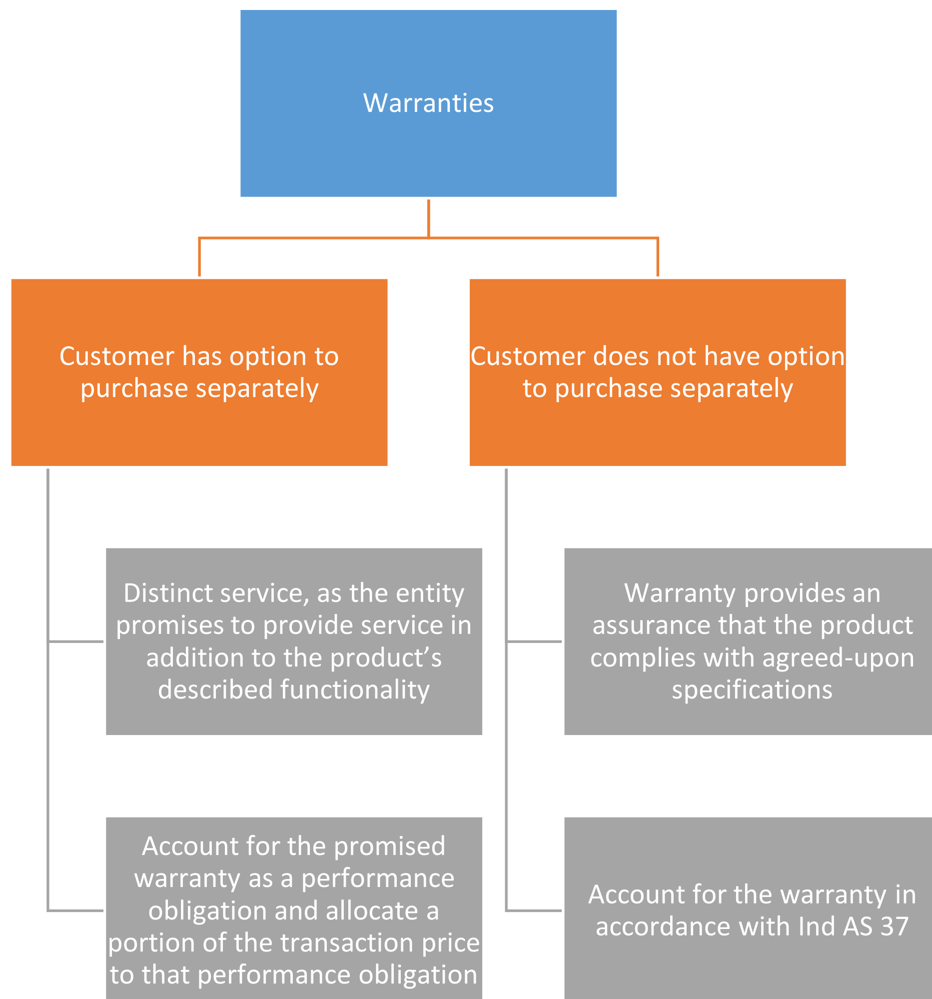
Determine the amount of revenue, refund liability and the asset to be recognised by Mohan for the said contracts.

Warranties

It is common for an entity to provide (in accordance with the contract, the law or the entity's customary business practices) a warranty in connection with the sale of a product (whether a good or service).

Some warranties provide a customer with **assurance** that the related product will function as the parties intended because it complies with agreed-upon specifications.

Other warranties provide the customer with a **service** in addition to the assurance that the product complies with agreed upon specifications.



Note : 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.

(iv) Significant Financing Component :

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

Question 24 – A commercial airplane

A commercial airplane component supplier enters into a contract with a customer for promised consideration of Rs.7,000,000. Based on an evaluation of the facts and circumstances, the supplier concluded that Rs.140,000 represented a insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.

State whether company needs to make any adjustment in determining the transaction price.

What if the advance payment was larger and received further in advance, such that the entity concluded that Rs.1,400,000 represented the financing component based on an analysis of the facts and circumstances.

Question 25 – NKT Limited

NKT Limited sells a product to a customer for Rs.121,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is Rs.100,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is Rs.80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of Rs.121,000 to the cash selling price of Rs.100,000).

Analyse the above transaction with respect to its financing component.

Question 26 – VT Limited

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

Determine the discounting rate and the transaction price when

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

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

Question 27 – ST Limited

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

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

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

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.
Pass journal entries showing how the entity would account for the significant financing component

Question 28 – ABC Limited

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid to the entity only when the building is complete.
Analyse whether the contract contains any financing component.

Question 29 – XYZ Limited

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional Rs 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available).
Analyse whether there is any significant financing component in the contract or not.

Question 30 – Bitsy

Bitsy hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time.
Analyse whether there is any significant financing component in the contract or not.

Question 31 – A computer

A software vendor enters into a contract with a customer to provide a license solely in exchange for a sales-based royalty. Analyse whether there is any significant financing component in the contract or not.

Question 32 – An EPC

An EPC contractor enters into a two-year contract to develop customized machine for a customer. The contractor concludes that the goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component.

Analyse whether there is any significant financing component in the contract or not.

Question 33 – Company Z

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms.

As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to Rs.100 crores. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the Rs.100 crores award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed. The contract specifies Company Z will earn up to Rs.100 crores based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy. Partial award fees may be awarded based on a pre-determined scale based on their success.

Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of Rs.80 crores in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize revenue over time for a single performance obligation using a cost-to-cost input method.

Analyse whether there is any significant financing component in the contract or not.

Question 34 – Company H

Company H enters into a two-year contract to develop customized software for Company C. Company H concludes that the goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, Company H determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to Company C.
Company C agrees to provide Company H monthly progress payments. Based on the expectation of the timing of costs to be incurred, Company H concludes that progress payments are being made such that the timing between the transfer of control and payment is never expected to exceed one year.
Analyse whether there is any significant financing component in the contract or not.

(v) Non cash Consideration :

Sometimes a customer promises to pay for a good or service in a form other than cash, such as shares of common stock or other equity instruments, advertising, or equipment.

To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall:

- In the first instance, measure the non-cash consideration (or promise of non-cash consideration) at fair value.
- And, if it cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

Question 35 – An entity

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April, 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).
In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.
How should the entity decide the transaction price?

- If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), the entity is required to apply the guidance on variable consideration and the constraint when determining the transaction price.

Question 36 – RT Limited

RT Limited enters into a contract to build an office building for AT Limited over an 18-month period. AT Limited agrees to pay the construction entity Rs.350 crores for the

project. RT Limited will receive a bonus of 10 lakhs equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of Rs.100 per share at contract inception. Determine the transaction price.

Customer-provided goods or services :

If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

Question 37 – MS Limited

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

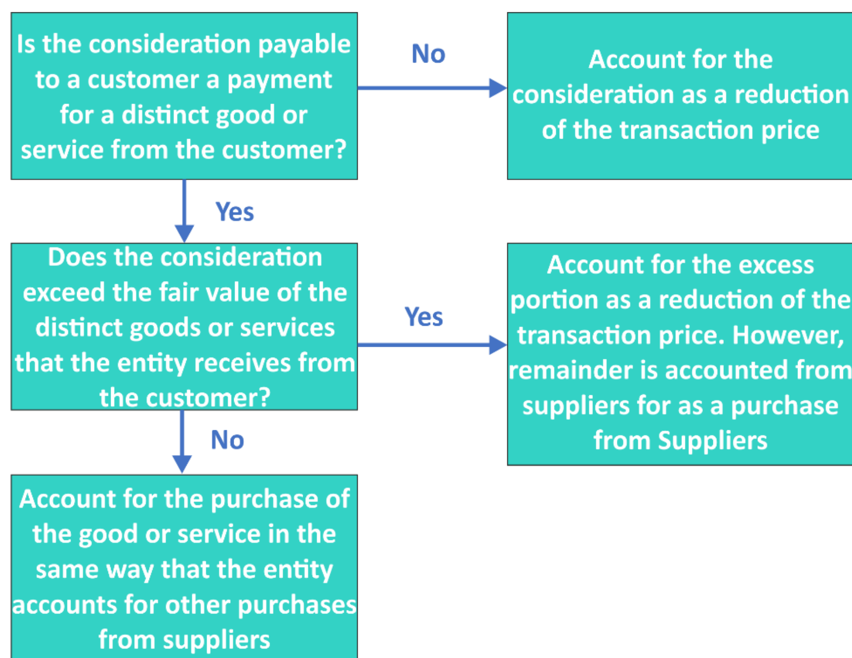
The tooling has a fair value of Rs.2 crores at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

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

Determine the transaction price?

(vi) Consideration payable to a customer :

The rationale behind the accounting provisions related to "consideration payable to a customer" is that an entity should not overstate its revenue by amounts given to customers in a contract that it will receive back through the purchase of its goods or services.



Question 38 – An entity

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

D. Allocating the Transaction Price to Performance Obligations :

While allocating the transaction price, the objective of the entity should be to allocate the transaction price to each performance obligation.

To meet the above allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis as per the standard, except for

- allocating discounts, and
- allocating variable consideration

(i) Determining stand alone price :

The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer.

As per Ind AS 115, the best evidence of a stand-alone selling price is - **the observable price** of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.

If a stand-alone selling price is **not directly observable**, for example, the entity does not sell the good or service separately, an **entity shall estimate** the stand-alone selling price at an amount that would result in the allocation of the transaction price

Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

(a) Adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services.

(b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

(c) Residual approach—an entity may estimate the stand-alone selling price by reference to

(1) the total transaction price, less

(2) the sum of the observable stand-alone selling prices of other goods or services promised in the contract.

However, an entity may use a residual approach to estimate the stand-alone selling price of a good or service only if one of the following criteria is met:

(i) the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or

(ii) the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

(ii) Allocation of Discount :

A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract.

Entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

(a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

(b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and

(c) the discount attributable to each bundle of goods or services described in (b) above 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.

Question 39 – RM

RM enters into a contract with a customer to sell Products A, B and C in exchange for Rs 10,000. RM will satisfy the performance obligations for each of the products at different points in time. RM regularly sells Product A separately and therefore the stand-alone selling price is directly observable.

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

RM estimates the stand-alone selling prices as follows:

Product	Stand alone selling price	Method
Product A	5,000	Directly Observable
Product B	2,500	Adjusted Market Assessment Approach
Product C	7,500	Expected Cost Plus Margin Approach
Total	**15,000**	

Determine the transaction price allocated to each product.

Question 40 – Nauroji

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

Product	Stand Alone Selling Price
Product X	50,000
Product Y	25,000
Product Z	45,000
Total	**1,20,000**

In addition, Nauroji regularly sells Products Y and Z together for Rs 50,000.

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

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

Case B—Residual approach is appropriate

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

Case C—Residual approach is inappropriate

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

(iii) Allocation of variable consideration :

Variable consideration may be attributable to (1) the entire contract or (2) a specific part of the contract, such as either of the following:

(a) one or more, but not all, performance obligations in the contract. For example, a contract may include two performance obligations: the construction of a building and the provision of services related to the ongoing

maintenance of the property after construction. But a bonus for early completion may relate entirely to the construction of the building; or

(b) one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index).

How to allocate variable consideration?

In accordance with Ind AS 115, an entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:

- the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and
- allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective when considering all of the performance obligations and payment terms in the contract.

Question 41 – Piyush

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

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of Rs.1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, Piyush estimates its sales-based royalties (i.e. the variable consideration) to be Rs.2,000,000. Allocate the transaction price.

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

The price stated in the contract for Licence A is a fixed amount of Rs.600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. Piyush's estimate of the sales-based royalties (i.e. the variable consideration) is Rs.3,000,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is Rs.4,00,000.

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

(iv) Changes in the transaction price :

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.

If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

Question 42 – A Consultant

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

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

- Due diligence – Rs.80 lakhs
- Valuation – Rs.20 lakhs
- Software implementation – Rs.1 crore

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

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

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

Determine the transaction price.

(E) Satisfying Performance Obligation :

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. In other words, the transfer of 'control' is the key determinant under Ind AS 115. This 'control model' is different from and replaces the 'risk & rewards model' under Ind AS 18. Such decision making on how 'control' will be transferred to the customer is done at the inception of transaction.

(i) What does control mean?

Control of an asset refers to –

(i) the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

(ii) Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

(ii) Transfer of control over a period of time or at a point in time?

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if any of the following criteria is met:

Criteria (a) – The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

Or

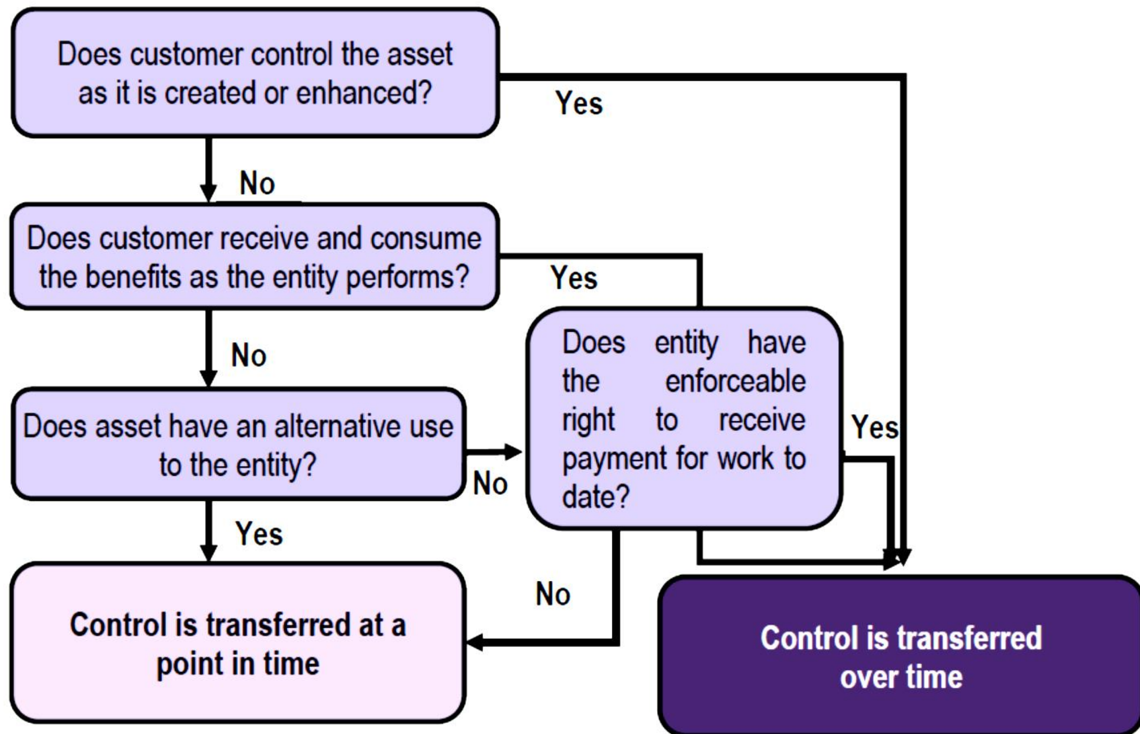
Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or

Or

Criteria (c) – the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Following diagram below depicts if the control is transferred over a period of time.

- If any of the criteria are met, then revenue is recognized over a period of time.
- If none of the criteria are met, then revenue is recognized at a point in time.



Criteria (a) – Customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs

This criterion is ordinarily applied in situations in which the benefits of seller's performance are immediately consumed by the customer, for eg.: routine or recurring services in which the consumer consumes the benefits immediately as the services are performed, which means that the customer obtains control of seller entity's output as soon as the entity performs.
Hence, in such situations, entity's performance is said to be performed over a period of time.

Question 43 – Minitek Ltd.

Minitek Ltd. is a payroll processing company. Minitek Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognise the revenue?

Question 44 – T&L Limited

T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horizon') enters into a contract with T&L for transportation of its goods from India to Sri Lanka through sea. The voyage is expected to take 20 days Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Colombo port.
Whether T&L's performance obligation is met over period of time?

Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced. Refer guidance on "control" given at the beginning of this section.

- In such cases, the customer ordinarily obtains control of the asset whose work is in progress and therefore, the entity carrying out the work can recognise revenue over a period of time
- Ordinarily, this criterion is applied to the following type of contracts with customers:
  - (a) Construction contracts, wherein the contractor engages to construct a specific asset for the customer on customer's land;
  - (b) Contracts with the government, wherein the government agency is ordinarily entitled to any work in process performed by the service provider.

Criteria (c) – the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

This criterion refers to situations in which an asset is created at customer's discretion, which the seller is restricted from using for any other purpose and at the same time, the seller entity reserves a right to seek payment for work in process. Therefore, this criterion is met if two factors exist simultaneously –

(i) The asset so created does not have an alternate use to the entity; and

(ii) Seller entity has a legally enforceable right to payment for performance completed to date.

Question 45 – AFS Limited

AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory firm for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

Whether risk advisory firm's performance obligation is met over period of time?

Question 46 – Space Limited

Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in this business for building such satellites for various customers across the world, however the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has right to enforce payment for work completed to date.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time?

Question 47 – ABC enters

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time?

(iii) Methods of measuring progress of a performance obligation satisfied over time :

Output Methods	Input Methods
Recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.	Recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation.
For Example: Surveys of performance completed to date, appraisals of results achieved	For Example: Resources consumed labour hours expended, costs incurred, time elapsed or machine hours used

Question 48 – An entity

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes. Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?

Question 49 – VP Architects

On 01 January 20X1, VP Architects contracts to renovate a building including the installation of new elevators. VP Architects estimates the following with respect to the contract:

Particulars	**Amount**

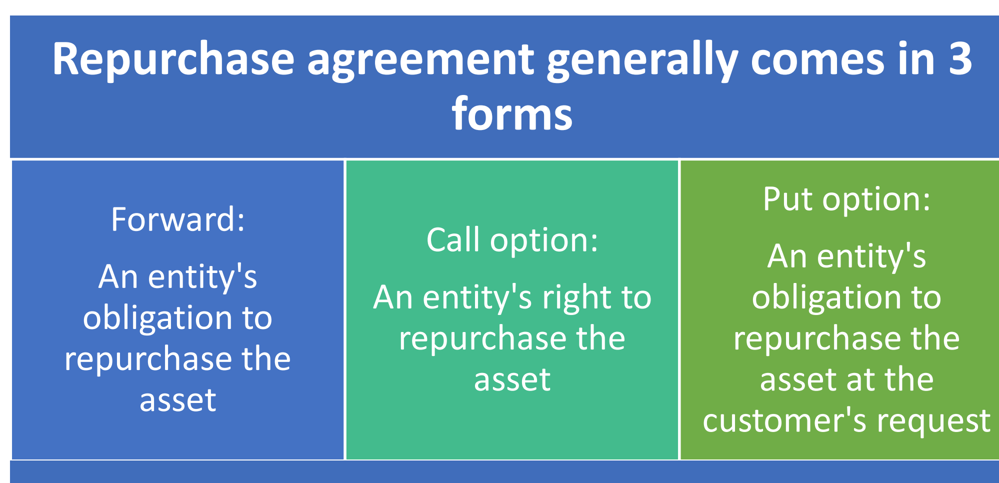
Transaction Price	5,00,000
Expected Cost	
a. Elevators	1,50,000
b. Other costs	2,50,000
Total	**4,00,000**

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

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

(iv) Repurchase Agreement :

When a company determines the timing of transfer of control, it is important to take into consideration any repurchase agreements that may have been executed by the Company.

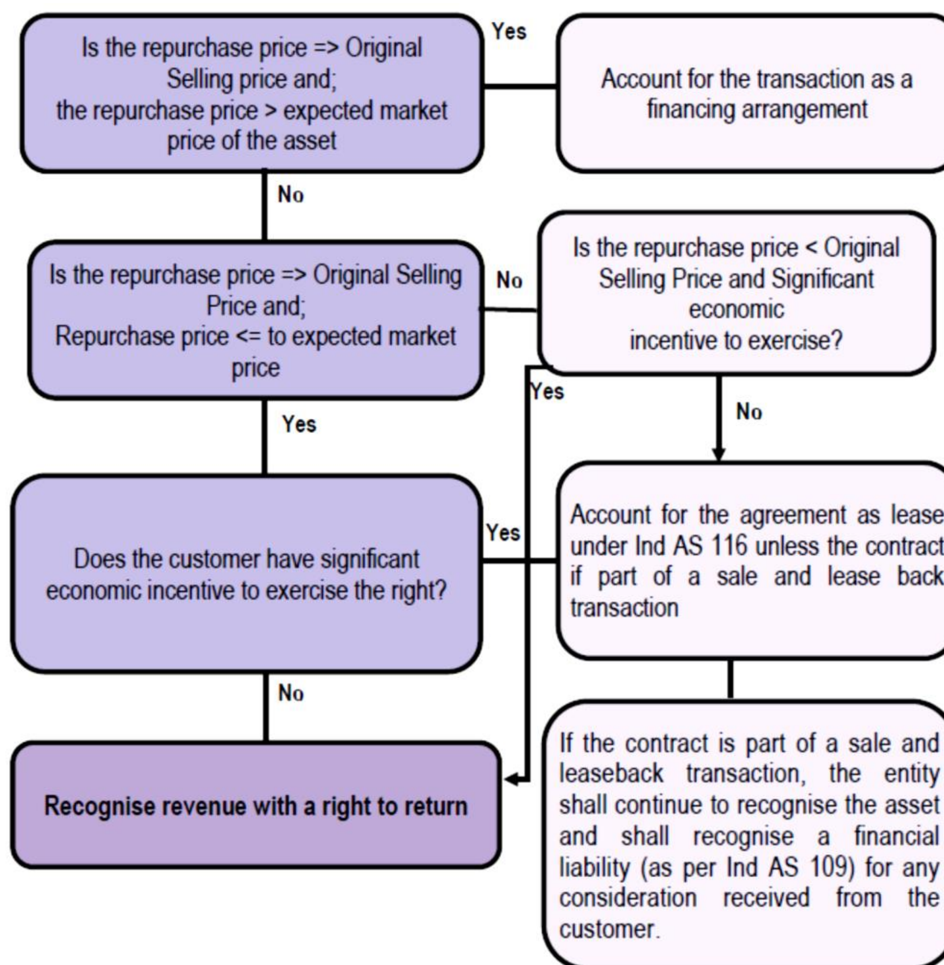


A. Forward or call option:

If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset.

B. Put option :

If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time.



Question 50 – An entity

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

Question 51 – An entity

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

5. SPECIAL ISSUES :

A. Bill and hold :

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future.

In such arrangements, the entity shall determine at which point does control transfer to the customer.

Question 52 – An entity

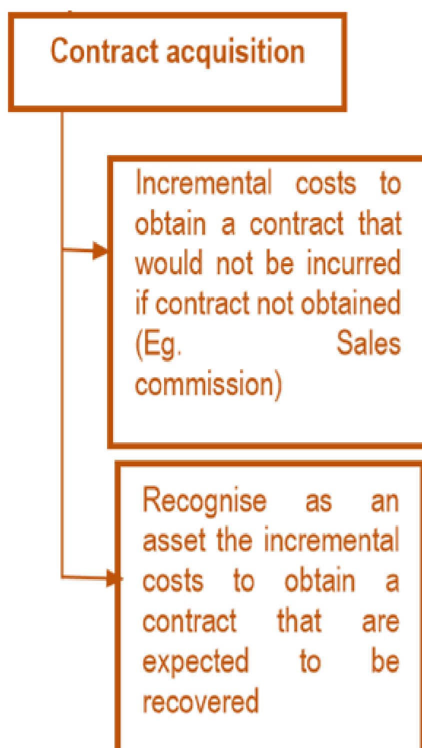
An entity enters into a contract with a customer on 1 April 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31 March 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

(B) Contract Costs :

Costs to obtain a contract



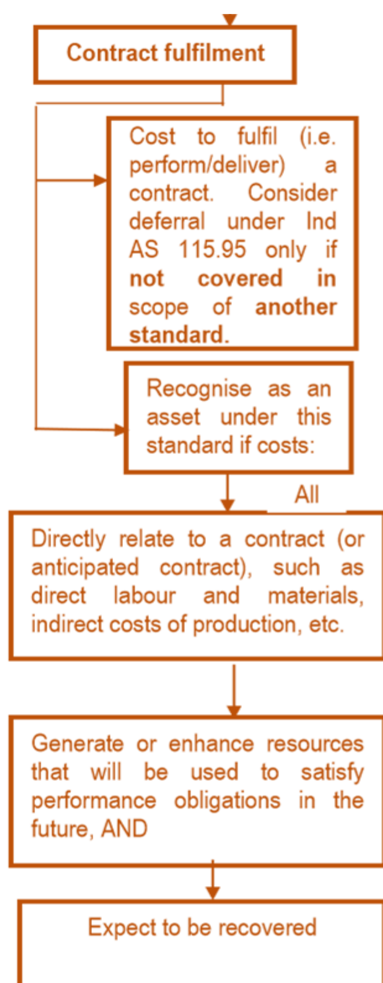
Entities may incur various costs to obtain or acquire a contract with a customer, including, but not limited to, legal fees, advertising expenses, travel expenses, and salespersons' salaries and commissions.

Incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Once an entity has determined that costs incurred relate to a specific contract with a customer, it should then determine if the costs meet the conditions for capitalisation. Incremental costs to obtain a contract that an entity expects to recover should be capitalised, while costs to obtain a contract that do not qualify for capitalisation should be expensed as incurred

Cost	Capitalise or Expense	Reason
Commission paid only upon successful signing of a contract	Capitalize	Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing.
Travel expenses for sales persons pitching a new client contract	Expense	Because the costs are incurred regardless of whether the new contract is won or lost, the entity expenses the costs, unless they are expressly reimbursable.
Legal fees for drafting terms of arrangement for parties to approve and sign	Expense	If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract.
Salaries for sales people working exclusively on obtaining new clients	Expense	The salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
Bonus based on quarterly sales target	Capitalize	Bonuses based solely on sales are incremental costs to obtain a contracts
Commission paid to sales manager based on contracts obtained by the sales manager's local employees	Capitalize	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract. Ind AS 115 does not differentiate costs based on the function or title of the employee that receives the commission.

Costs to fulfil a contract (contract fulfilment costs)



If costs incurred in fulfilling a contract with a customer are covered under another Standard (such as Ind AS 2 'Inventory' and Ind AS 16 'Property, Plant, and Equipment'), an entity accounts for those costs in accordance with those Standards. If not, an entity recognises an asset for such costs, provided all of the criteria mentioned below are met:
A. the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (i) direct labour (ii) direct materials (iii) allocations that relate directly to the contract or contract activities (for example, contract management and supervision costs and depreciation of tools and equipment used in fulfilling the contract) (iv) costs that are explicitly chargeable to the customer (v) other costs that the entity incurs only because it entered into the contract (e.g. payments to subcontractors)
(b) the costs generate or enhance resources of the entity that will be used to satisfy performance obligations in the future
(c) the entity expects to recover the costs, for e.g. through the expected margin.

Question 53 – Customer outsources

Customer outsources its information technology data centre
Term = 5 years plus two 1-yr renewal options
Average customer relationship is 7 years
Entity spends Rs 400,000 designing and building the technology platform needed to accommodate out-sourcing contract:

Design Services	Rs. 50,000
Hardware	Rs. 1,40,000
Software	Rs. 1,00,000
Migration and testing of data center	Rs. 1,10,000
Total	Rs.4,00,000

How should such costs be treated?

C. Service Arrangement concessions :

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.
- Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operatetransfer' or a 'public-to-private' service concession arrangement.

Example Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

Accounting Principles

A. Treatment of the operator's rights over the infrastructure

Infrastructure shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator

The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

B. Recognition and measurement

- Since the operator acts as a service provider, he shall recognise and measure revenue in accordance with Ind AS 115 for the services it performs. The operator constructs or upgrades infrastructure (construction or upgrade

services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

- If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.
- The nature of the consideration i.e. whether financial asset or intangible asset determines its subsequent accounting treatment.
- The operator shall account for revenue and costs relating to construction or upgrade services.
- The operator shall account for revenue and costs relating to operation services in accordance with Ind AS 115.

Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.

Borrowing costs incurred by the operator

- Borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service).
- If the operator does not have a contractual right to receive an intangible asset, borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement.

Question 54 – A Ltd.

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

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

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

- Other income relates to the services provided during the operation phase.

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

Required

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

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

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

6. SELF PRACTICE QUESTIONS :

Question 55 – A TV channel

A TV channel released an advertisement in a newspaper. Instead of paying for the same, the TV channel allowed the newspaper company free advertisement spot, which was duly utilised by the newspaper company.

How revenue for these barter transactions in the area of advertising will be recognised and measured?

Question 56 – A Ltd. and B Ltd.

A Ltd. and B Ltd. both are engaged in manufacturing of bottles. A Ltd. has factor in Gujarat. B Ltd. has factory in Maharashtra. A Ltd. fulfils the demands of its customers based in Maharashtra by using bottles manufactured by B Ltd. Similarly, B Ltd. fulfils the demands of customer based in Gujarat by delivering bottles manufactured by A Ltd.

How A Ltd .and B Ltd. should recognise the revenue?

Question 57 – Entitles N Ltd. and S Ltd.

Entitles N Ltd. and S Ltd. are both engaged in the extraction and supply of natural gas to different parts of India. Plants of N Ltd. are located in North India while that of S Ltd. are located in South of India. N Ltd. also contracts to supply natural gas customer in the South of India. Similarly, S Ltd contracts to supply natural gas to customers in North India. Consequently, N Ltd. purchases from S Ltd. to supply natural gas to customers located in the South and S Ltd. purchases from N to supply natural gas to customers in the North. The price of natural gas for this transaction would be based

on actual delivery date of gas by either parties. Further, the parties would do a monthly calculation of supplies and receipts of gas and do a net settlement based on the prices calculated as above.

How will this situation be treated under Ind AS 115?

Question 58 – Mercury Ltd

Mercury Ltd promises to sell 120 guitars to a customer for $12,000 (i.e. $100 per guitar). The guitars are transferred to the customer at various points in time over a six-month period. The contract is modified after 60 guitar have been transferred and Mercury promises to deliver an additional 30 products for an additional $2,850 or $95 per-guitar. This means totally 150 guitars will be transferred. The contract to deliver additional 60 guitars @ $95 is at the price prevailing at that time in market.

How will the contract modification be accounted?

Question 59 – Continuing with Question 4

Continuing with Question 4, what **if the pricing for the additional guitars did not reflect the stand-alone selling price to the additional guitars**,

How shall mercury account for the same?

Question 60 – C Ltd

C Ltd. entered into a contract to construct a factory building for M Ltd. According to the contract, C Ltd will undertake the construction work of the factory for a consideration of $2,00,000. C Ltd. expects to receive the full amount and does not expect any credit risk or default in payment from M Ltd. C Ltd. started the construction activity on 1st April, 2015. On 1st April, 2016 while the construction of the factory was yet to be completed, M Ltd. requested construction of quarters (residential building) for its workers next to the factory premises. The price for this construction of residential building was negotiated separately and agreed at $100,000.

Required : Explain the accounting treatment for this modification.

Question 61 – Z Ltd

Z Ltd is a manufacturer of electronic products. It enters into a distribution agreement with P Ltd.

The terms and conditions of the agreement provide the following :

(a) P Ltd. will obtain title to the goods and will sell them to retailers.

(b) P Ltd. will earn a fixed margin on the products sold to retailers, but will have no authority in establishing the sale price of the goods for retailers.

(c) P Ltd. has the right to return the goods to Z Ltd. if they remain unsold for 2 years.

Accordingly, Z Ltd sold goods worth $10,000 to P Ltd.

Required : When should the sale be accounted for?

Question 62 – C Ltd

C Ltd. is a multinational pharmaceutical company with operating divisions in eight countries. Since each of these countries has its own legislative requirements, on 1 January 2017.

C Ltd. has employed the services of Miller, Martinez and Ichikawa (MMI), an international management consultancy firm to study and recommend ways to streamline their operation through corporate restructuring. For this, C Ltd. would provide MMI with all the necessary resources. The entire process is agreed to be completed within six months, at the end of which MMI would present its findings to C Ltd's management. For its services, MMI would be paid $5 million after three months and another $5 million at the end of six months. The progress in satisfaction of contractual obligation is expected to be in the same proportion of payment as stated. If MMI breaches any of the terms of the agreement or are not able to come up with specific recommendations, then C Ltd would not pay MMI for its services. MMI is unsure about the outcome as it has never undertaken such assignment before.

Required : On which dates would MMI recognize the revenue?

Question 63 – Nigel & Co

Nigel & Co is a London based firm of architects and structural engineers specialising in the restoration of old heritage sites. On 31 December they received an $8 million contract from the Peruvian government to restore a 600 year old Inca worship site on the Peruvian Ecuadorian border. Nigel & Co has estimate that they would require two years to complete the restoration project.

The Peruvian government would pay Nigel & Co in the following manner :

- $4 million to be paid immediately
- $4 million on completion of the project

These charges pertain only to Nigel & Co's consultation and design fees. Nigel & Co. would have charged $5 million for consultation and $3 million for design fees has it agreed for these services on a standalone basis. It has also been specifically agreed upon to follow he Peruvian government's recommendation in addition to their ideas in order to preserve the cultural heritage of peru.

Required : State with reasons whether the revenue from service shall be recognised in the financial statements for the financial year ended on 31 December 20X7 and if yes, how?

Question 64 – Perfect Co

Perfect Co is a manufacturer of stereos and offers a warranty of a 'six months free repair period' for all its models. However a manufacturing defect is revealed in the

model 234 and Perfect Co has declared that it will refund the money for the model even after the warranty period is over, but before one year from sale.
What should be the accounting treatment?

Question 65 – Superb Co

Superb Co had a plot of land which it has sold to ASF Co for $400,000 (the prevailing market price of the land). It was decided at the time of the sale that Superb CO would repurchase that plot after four years. The repurchase price was fixed at $500,000.
Required : How should this transaction be accounted for?

Question 66 – M Ltd.

M Ltd has entered into an agreement to supply a machine worth $200,000 to B Ltd. B Ltd has made the payment and identified the machine. Special packing as required by M Ltd has been done but as the factory setup is not ready B Ltd has asked to hold the delivery for 20 days.
Required : How should this transaction be accounted for?

Question 67 – Delta

On 31 March 2019, Delta sold goods for a price of 412.1 million. The terms of the sale allowed the customer to extend the credit and the price was payable by the customer in cash on 31 March 2021. Appropriate discount rate is 10%. Explain how shall the contract be accounted for as per IND AS 115.

Question 68 – Textgo Co

Textgo Co entered into a contract with Milngo Co to sell a machine for $230. However, according to the terms of the contract, Milngo will pay the amount as agreed immediately but the machine will be sold and delivered only after 12 months. The transaction includes the impact of the financing arrangement, and the finance cost on the advance received is estimated to be $20. How much revenue shall textgo Co recognise from this contract on the date of sale when the contract is executed?

Question 69 – Dairy Products

Dairy Products enter into a contract with Publicity Ad agency for an advertisement campaign to increase the sale of its product. The advertisement would be aired on television after due approval from the central authorities of Dairy products. The commission for the work was fixed at 413,000, out of which 50% advance to be paid on signing the contract and 50% on completion of the contract.
Required : State the accounting treatment in the above case.

Question 70 – Limo Plc

Dairy Products enter into a contract with Publicity Ad agency for an advertisement campaign to increase the sale of its product. The advertisement would be aired on television after due approval from the central authorities of Dairy products. The commission for the work was fixed at 413,000, out of which 50% advance to be paid on signing the contract and 50% on completion of the contract.

Required : State the accounting treatment in the above case.

Question 71 – Zylo Plc

Zylo Plc entered into a contract with Milo Inc to sell machine A and B. Under the contract, Milo Inc will pay the consideration of $50,000 upfront. Sean Inc has agreed to provide machine A immediately and machine B after a year from the date of contract. Zylo Plc feels that the transaction price can be allocated to machine A and machine B in the ratio of 40 : 60. The appropriate finance cost for the entity based on its average cost of capital is estimated to be 10%.

Required : How should Limo Plc recognise the revenue arising from this contract?

Question 72 – T Ltd

T Ltd is a telecommunication company. P Ltd. is engaged in generation and supply of power. T and P enter into an arrangement whereby T Ltd will provide 1,00,000 minutes of talk time free to employees of P Ltd in exchange for getting free power equivalent to 20,000 units. A Ltd normally charges Re.050 per minute and B Ltd charges Rs.3 per unit. How to measure revenue in this case?

Question 73 – A seller

A seller provides sale incentives to a customer when entering into a contract. For examples it provides free goods that the seller normally sells or provides as part of is business (e.g. on purchase of two products, third product is free). How should an entity account for such sales incentives.

Question 74 – A manufacturer

A manufacturer enters into a contract to deliver a product to Customer for Rs.5,00,000. Customer pays a deposit of Rs.20,000 with the remainder due upon delivery (delivery will occur 3 weeks and a significant financing component does not exist). Revenue will be recognised upon delivery as that is when control of the product transfers to the customer. How should the manufacturer present the advance payment prior to delivery in the statement of financial position?

Question 75 –

The total sales value of a contract is $700,000. At the end of the reporting period, an entity estimates that 30% of the performance obligation has been satisfied. The outcome of the contract cannot be reliably estimated. Management wants to recognise 30% of the profit. Do you agree?

Question 76 – RM Ltd

RM Ltd is carrying out a contract. It raised progress billings worth $600,000 on customer no.1. The customer paid $540,000 after deducting 10% of the amount to be held as retention for year. Customer no.1 paid $50,000 for an activity not yet commenced.

Required : How will the items be disclosed in the financial statements?

Question 77 – Skymark Contractors

Skymark Contractors is working on a contract and has progress bills amounting to $815,000 on Garry. Garry paid $652,000 after deducting 20% retention amount to be held for 2 years. Larry paid $100,000 for a contract not yet commenced.

Required : State the treatment given for the above transactions by Skymark Contractors.

Thanks ....

CHAPTER

10

IND AS 101 – FIRST TIME ADOPTION

CONCEPTS COVERED

1. INTRODUCTION
2. OBJECTIVE
3. DEFINITIONS
4. SCOPE
5. RECOGNITION AND MEASUREMENT
6. EXCEPTIONS/ EXEMPTIONS
7. PRESENTATION AND DISCLOSURE
8. SELF PRACTICE QUESTIONS

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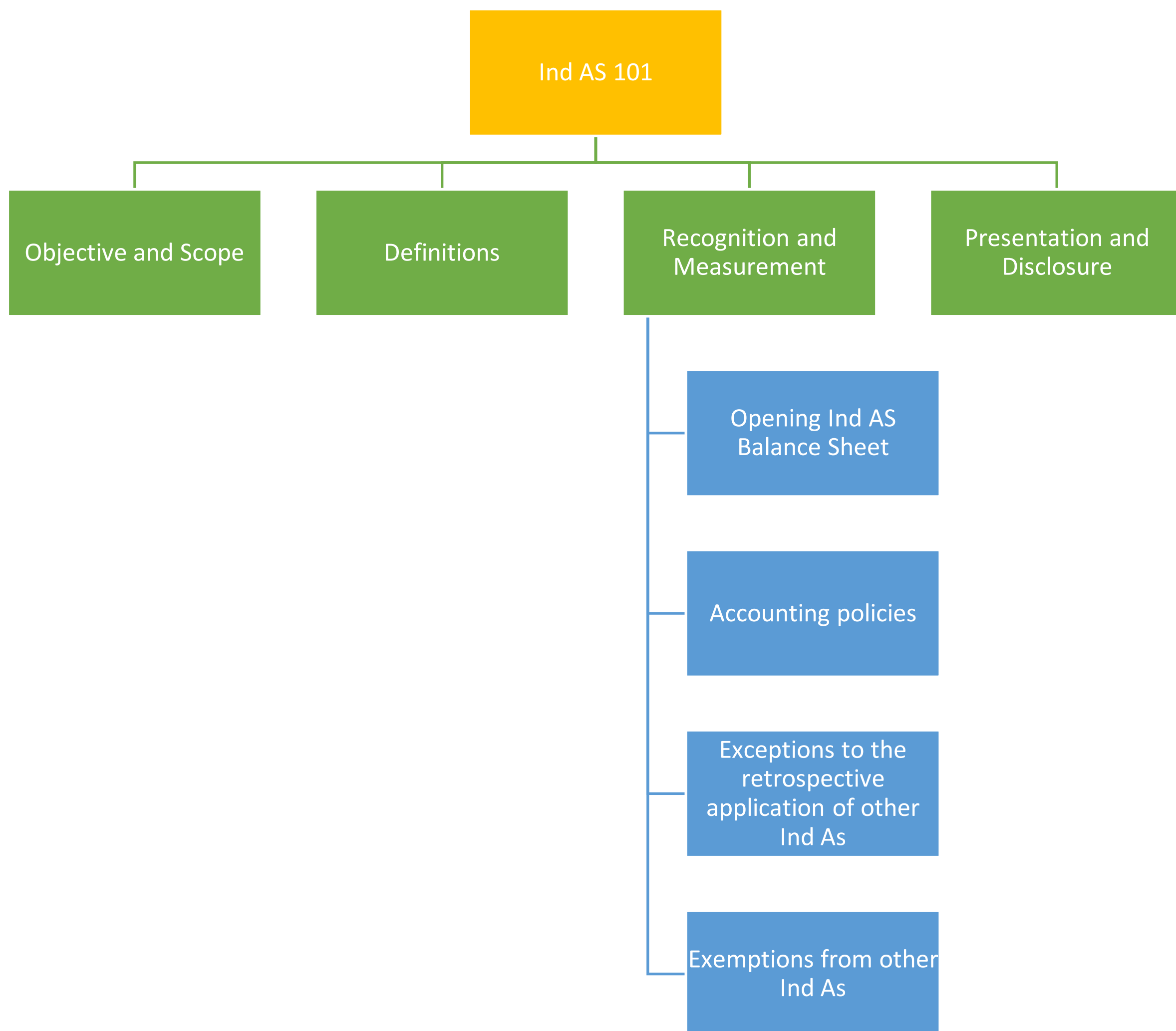
1. INTRODUCTION



Ind AS 101 prescribes the accounting principles for first - time adoption of Ind AS. It lays down various 'transition' requirements when a company adopts Ind AS for the first time, i.e., a move from Accounting Standards (Indian GAAP) to Ind AS.

The exemptions are broadly categorised into

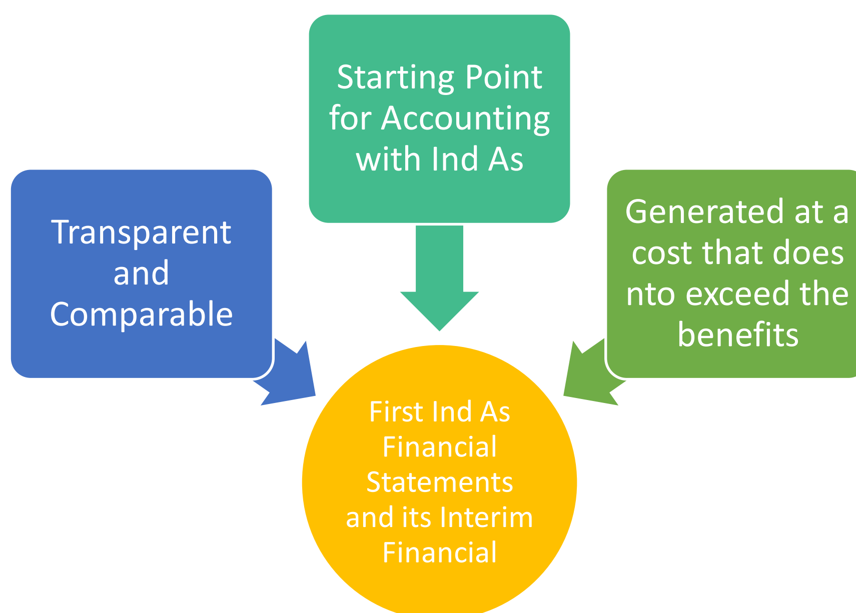
- those which are mandatory in nature (i.e., cases where the company is not allowed to apply Ind AS retrospectively) and
- those which are voluntary in nature (i.e., the company may elect not to apply certain requirements of Ind AS retrospectively).

Ind AS 101 also prescribes presentation and disclosure requirements to explain the transition to the users of financial statements including explaining how the transition from Indian GAAP to Ind AS affected the company's financial position, financial performance and cash flows.

2. OBJECTIVE :

The objective of this Ind AS is to ensure that an entity's first Ind-AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

- is transparent for users and comparable;
- provides a suitable starting point; and
- at a cost that does not exceed the benefits.



3. DEFINITIONS :

1. First Ind AS Financial Statements :

- The first annual financial statements in which an entity adopts Ind AS, by an explicit and unreserved statement of compliance with Ind AS.
- This means compliance with ALL Ind-AS, partial compliance is not enough to make entity Ind AS compliant.

2. First –time adopter :

- An entity that presents its first Ind AS financial statements, that entity is known as first time adopter

3. Opening Ind AS Balance sheet :

- An entity's balance sheet at the date of transition to Ind AS

4. Date of Transition to Ind AS :

- The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS Financial statements.

5. First Ind AS reporting period :

- The latest reporting period covered by an entity's first Ind AS financial statements

Example

XYZ Ltd. is a BSE listed company having net worth of Rs 100 cr. So XYZ Ltd. has to prepare financial statements as per Ind AS from 1st April 2011.

In this example, First Ind AS Financial Statements would be the statement for period ending as on 31.03.2012

First –time adopter- “XYZ Ltd” with effect from 01.04.2011
Opening Ind AS Balance sheet – 01.04.2010
Date of Transition to Ind ASs-01.04.2010
First Ind AS reporting period-01.04.2011 to 31.03.2012

6. Deemed cost :

An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.

7. Previous GAAP :

The basis of accounting that a first-time adopter used for its statutory reporting requirements in India immediately before adopting Ind AS. For instance, companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements.

Question 1 – Company B

Company B is a foreign subsidiary of Company A and has adopted IFRS as issued by IASB as its primary GAAP for its local financial reporting purposes. Company B prepares its financial statements as per Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 for the purpose of consolidation with Company A. On transition of Company A to Ind-AS, what would be the previous GAAP of the foreign subsidiary Company B for its financial statements prepared for consolidation with Company A?

4. SCOPE :

Ind AS 101 Applies to:

- First Ind AS financial statements
- Each interim financial report for part of the period covered by its first Ind AS financial statements.

However, it does not apply to:

- Changes in accounting policies made by an entity that already applied Ind AS.

Question 2 – E Ltd.

E Ltd. is required to first time adopt Indian Accounting Standards (Ind AS) from April 1, 2011. The management of E Ltd. has prepared its financial statements in accordance with Ind AS and an explicit and unreserved statement of compliance with Ind AS has been given. However, the there is a disagreement on application of one Ind AS. Can such financial statements of E Ltd. be treated as first Ind AS financial statements?

5. RECOGNITION AND MEASUREMENT :

5.1 Opening Ind AS Balance Sheet :

An entity shall prepare and present an opening Ind AS balance sheet at the date of transition to Ind AS. This is the starting point for its accounting in accordance with Ind AS.

5.2 Accounting Policies :

Entity uses the same accounting policies in its opening Ind AS Balance Sheet and through all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, subject to:

- Mandatory exceptions and
- Optional exemptions

An entity shall, in its opening Ind AS Balance sheet:

- Recognise all assets and liabilities whose recognition is required by Ind AS;
- Not recognise items as assets or liabilities if Ind AS do not permit such recognition;
- Reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and
- Apply Ind AS in measuring all recognised assets and liabilities.

Example: Consistent application of latest version of Ind AS

The end of entity A's first Ind AS reporting period is 31 March 20X2. Entity A decides to present comparative information in those financial statements for one year only. Therefore, its date of transition to Ind AS is the beginning of business on 1 April 20X0 (or, equivalently, close of business on 31 March 20X0).

Entity A presented financial statements in accordance with its previous GAAP annually to 31 March each year up to, and including, 31 March 20X1.

Application of requirements

Entity A is required to apply the Ind AS effective for periods ending on 31 March 20X2 in:

a) preparing and presenting its opening Ind AS balance sheet at 1 April 20X0; and

b) preparing and presenting its balance sheet for 31 March 20X2 (including comparative amounts for the year ended 31 March 20X1), statement of profit and loss, statement of changes in equity and statement of cash flows for the year to 31 March 20X2 (including comparative amounts for the year ended 31 March 20X1) and disclosures (including comparative information for the year ended 31 March 20X1).

If a new Ind AS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that Ind AS in its first Ind AS financial statements.

Question 3 – Y Ltd.

Y Ltd. is required to adopt Ind AS from April 1, 2011, with comparatives for one year, i.e., for 2010-2011. What will be its date of transition?

Question 4 – X Ltd.

X Ltd. was using cost model for its property, plant and equipment (tangible fixed assets) till March 31, 2011 under previous GAAP. On April 1, 2010, i.e., the date of its transition to Ind AS, it used fair values as the deemed cost in respect of its fixed assets. Whether it will amount to a change in accounting policy?

6. EXCEPTIONS/ EXEMPTIONS :

There are two kinds of exceptions / exemptions in this Ind AS

1. Mandatory (Exceptions to the retrospective application of other Ind AS)
2. Optional (exemptions from application of other Ind AS)

6.1 Mandatory (Exceptions to the retrospective application of other Ind AS) :

1. Estimates :

An entity's estimates in accordance with Ind AS at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Step 1 : Estimates required by previous GAAP? If yes - go to Step 2 otherwise Step 3.

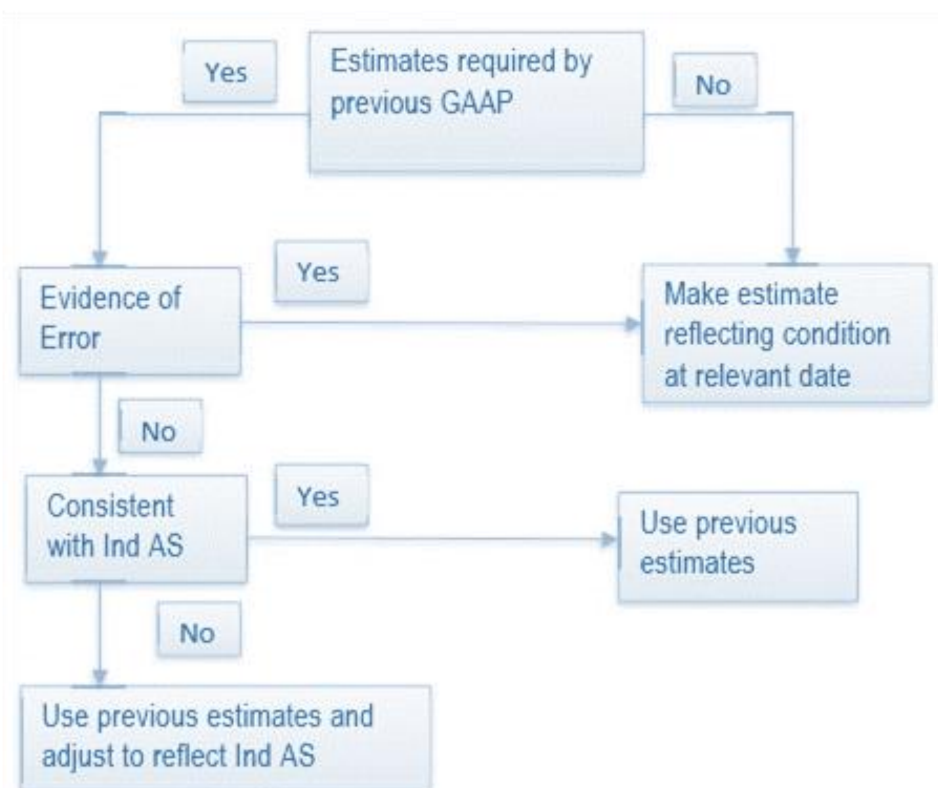
Step 2 : Evidence of Error? If yes then go to Step 3 otherwise Step 4.

Step 3 : Make estimate reflecting condition at relevant date.

Step 4 : Consistent with Ind AS? If yes then go to step 5 otherwise Step 6

Step 5 : Use previous estimates

Step 6 : Use previous estimates and adjust to reflect Ind AS.



Question 5 – A Ltd.

A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

2. Derecognition of financial assets and liabilities :

A first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind AS.

Example :

If a first time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind AS, it shall not recognise those assets and liabilities in accordance with Ind AS (unless they qualify for recognition as a result of a later transaction or event).

An entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of the entity's choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

3. Hedge accounting :

At the date of transition to Ind AS an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

An entity shall not reflect in its opening Ind AS Balance Sheet a hedging relationship of a type that does not qualify for hedge accounting in accordance with Ind AS 109 (for example, many hedging relationships where the hedging instrument is a stand-alone written option or a net written option; or where the hedged item is a net position in a cash flow hedge for another risk than foreign currency risk). However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate as a hedged item in accordance with Ind AS an individual item within that net position, or a net position if that meets the requirements in Ind AS 109, provided that it does so no later than the date of transition to Ind AS.
Ind AS 109 to discontinue hedge accounting. Transactions entered into before the date of transition to Ind ASs shall not be retrospectively designated as hedges.

4. Non-controlling interests :

A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind AS:

a) Total comprehensive income is attributed to the owners of the parent and to the noncontrolling interests even if this results in the non-controlling interests having a deficit balance;

b) Accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

c) Accounting for a loss of control over a subsidiary, and the related requirements of Ind AS 105, Non-current Assets Held for Sale and Discontinued operations.

However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 from that date.

Question 6 –

Ind AS requires allocation of losses to the non-controlling interest, which may ultimately lead to a debit balance in non-controlling interests, even if there is no contract with the noncontrolling interest holders to contribute assets to the Company to fund the losses. Whether this adjustment is required or permitted to be made retrospectively?

5. Classification and measurement of financial assets :

An entity shall assess whether a financial asset meets the conditions of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind AS.

- If it is impracticable to assess a modified time value of money element in respect of financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind AS without taking into account the requirements related to the modification of the time value of money element. An entity shall disclose the carrying amount at the reporting date of such financial assets until those financial assets are derecognized.
- If it is impracticable to assess whether the fair value of a prepayment feature is insignificant on the basis of the facts and circumstances that exist at the date of transition to Ind AS, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind AS without taking into account the exception for prepayment features. An entity shall disclose the carrying amount at the reporting date of such financial assets until those financial assets are derecognised.

- If it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS.

6. **Impairment of financial assets :**

An entity shall apply the impairment requirements of Ind AS 109 retrospectively subject to

- At the date of transition to Ind AS, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised.
- An entity is not required to undertake an exhaustive search for information when determining, at the date of transition to Ind AS, whether there have been significant increases in credit risk since initial recognition.
- If, at the date of transition to Ind ASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised, unless that financial instrument is low credit risk at a reporting date.

7. **Embedded derivatives :**

A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by Ind AS 109.

8. **Government Loans :**

A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, Financial Instruments: Presentation.

A first-time adopter shall apply the requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind AS and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

An entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government loan originated before the date of transition to Ind AS, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

6.2 Optional (exemptions from application of other Ind AS) :

1. Business combination :

Ind AS 103 need not be applied to combinations before date of transition. But, if one combination is restated, all subsequent combinations are restated.

When the exemption is used

- There won't be any change in classification
- Assets and liabilities of past combination measured at carrying amount (deemed cost)
- Assets and liabilities measured at fair value restated at date of transition-adjusted retained earnings.

Question 7 – A Ltd.

A Ltd. had made certain investments in B Ltd.'s convertible debt instruments. The conversion rights are substantive rights and would provide A Ltd. with a controlling stake over B Ltd. A Ltd. has evaluated that B Ltd. would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS consolidated financial statements. B Ltd. was not considered as a subsidiary, associate or a joint venture under previous GAAP. How should B Ltd. be consolidated on transition to Ind AS assuming that A Ltd. has opted to avail the exemption from retrospective restatement of past business combinations?

Question 8 – A Ltd.

A Ltd. has a subsidiary B Ltd. On first time adoption of Ind AS by B Ltd., it availed the optional exemption of not restating its past business combinations. However, A Ltd. in its consolidated financial statements has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of A Ltd. considering that A Ltd. does not avail the business combination exemption? Will the answer be different if the A Ltd. adopts Ind AS after the B Ltd?

2. Insurance contracts :

Ind AS 104 will apply for annual periods beginning on or after date of transition to Ind AS. If an insurer changes its accounting policies for insurance liabilities, it is permitted to reclassify some or all of its financial assets as FVTPL (fair value through profit or loss).

3. Share based payment transactions :

Apply Ind AS 102, Share-based Payment, to equity instruments that vested before date of transition to Ind AS.

However, a first-time adopter may apply Ind AS 102 to equity instruments, if it has disclosed publicly the fair value of those equity instruments, determined at the measurement date.

It is encouraged to apply Ind AS 102 to liabilities arising from share-based payment transactions that were settled before the date of transition to Ind AS.

Question 9 – X Ltd.

X Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. It has given 200 stock options to its employees. Out of these, 75 options have vested on November 30, 20X0 and the remaining 125 will vest on November 30, 20X1. What are the options available to X Ltd. at the date of transition?

4. Deemed cost for PPE and intangible assets :

If an entity uses fair value in its opening Ind AS Balance Sheet as deemed cost for an item of property, plant and equipment or an intangible asset, the entity's first Ind AS financial statements shall disclose, for each line item in the opening Ind AS Balance Sheet:

(a) the aggregate of those fair values; and

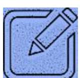
(b) the aggregate adjustment to the carrying amounts reported under previous GAAP

A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to Ind AS as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index.

For Investment Property Ind AS 40,
Investment Property permits only the cost model. Therefore, option of availing fair value as deemed cost for investment property is not available for first time adopters of Ind AS for its financial statements.



Question 10 – X Ltd.

X Ltd. is the holding company of Y Ltd. X Ltd. is required to adopt Ind AS from April 1, 20X1. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of its property, plant and equipment whereas Y Ltd. wants to use fair value of its property, plant and equipment as its deemed cost on the date of transition. Examine whether X Ltd. can do so for its consolidated financial statements. Also, examine whether different entities in a group can use different basis for arriving at deemed cost for property, plant and equipment in their respective standalone financial statements.

Question 11 – X Ltd.

For the purpose of deemed cost on the date of transition, an entity has the option of using the carrying value as the deemed cost. In this context, suggest which carrying value is to be considered as deemed cost: original cost or net book value? Also examine whether this would have any impact on future depreciation charge?

Question 12 –

Is it possible for an entity to allocate cost as per the previous GAAP to a component based on its fair value on the date of transition even when it does not have the component-wise historical cost?

Question 13 –

Revaluation under previous GAAP can be considered as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to fair value or cost or depreciated cost of assets in accordance with Ind AS, adjusted to reflect, e.g., changes in a general or specific price index. What is the acceptable time gap of such revaluation from the date of transition? Can adjustments be made to take effects of events subsequent to revaluation?

5. Cumulative translation difference :

No need to:

- Recognise some translation differences in other comprehensive income.
- Reclassify cumulative translation differences for foreign operation from entity to profit or loss as part of gain or loss on its disposal

If first time adopter uses this exemption:

- Cumulative translation differences set to zero for all foreign operations.
- Gain/ loss on subsequent disposal of a foreign operation shall exclude these differences that arose before transition

A first time adopter may continue the policy adopted for accounting for exchange differences arising from long term monetary foreign currency items, as per previous GAAP.

Question 14 – Y Ltd.

Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2011. On the date of transition, there is a long- term foreign currency monetary liability of Rs 60 crores (US $ 10 million converted at an exchange rate of US $ 1 = Rs 21 60). The accumulated exchange difference on the date of transition is nil since Y Ltd. was following AS 11 notified under the Companies (Accounting Standards) Rules, 2006 and has not exercised the option provided in paragraph 46/46A of AS 11. The Company wants to avail the option under paragraph 46A of AS 11 prospectively or

retrospectively on the date of transition to Ind AS. How should it account for the translation differences in respect of this item under Ind AS 101?

Question 15 – Y Ltd.

Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X1, it obtained a 7 year US$ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company wants to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so?

6. Investment in subsidiaries, joint ventures and associates :

It is measured at cost, the cost may be :

- Cost determined in accordance with Ind AS 27 or
- Deemed cost (which may be fair value or previous GAAP carrying amount)

Question 16 – A Ltd.

A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

7. PRESENTATION AND DISCLOSURE :

I. Comparative Information :

- Ind AS does not require historical summaries to comply with the recognition and measurement requirement of Ind AS.
- In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:
  - Label the previous GAAP information prominently as not being prepared in accordance with Ind AS; and
  - Disclose the nature of the main adjustments that would make it comply with Ind AS. An entity need not quantify those adjustments.

II. Explanation of transition to Ind AS :

- Reconciliation of
  - Equity from previous GAAP to Ind AS at transition and last year end;
  - Last year's total comprehensive income under previous GAAP to Ind AS.
- Sufficient detail to understand adjustments to each line item.
- Reconciliation to distinguish correction of errors identified during transition from change in accounting policy.

- Fair value as deemed cost and the amount of the adjustment.
- Ind AS 36 disclosures for impairment during transition.
- If adopted first time exemption option, to disclose the fact and accounting policy until such time those PPE, Intangible Assets, investment properties or intangible assets significantly depreciated/impaired/derecognized.
- Interim financial reports to include reconciliation with equity and profit or loss under previous GAAP.
- Further information to comply with Ind AS 34.

8. SELF PRACTICE QUESTIONS :

Question 17 – Company A

Company A intends to restate its past business combinations with effect from 30 June 20X0 (being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for property, plant and equipment (PPE), can be adopted?

Question 18 – X Ltd.

X Ltd. was using cost model for its property, plant and equipment till March 31, 20X2 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 20X2. On April 1, 20X1, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS financial statements would amount to a change in accounting policy?

Question 19 – Y Ltd.

Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X0, it obtained a 7 year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21, The Effects of Changes in Foreign Exchange Rates with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so?

Question 20 – A company

A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101. However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to property, plant and equipment i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of property, plant and equipment under previous GAAP?

Thanks ....

CHAPTER

11

CORPORATE SOCIAL RESPONSIBILITY

CONCEPTS COVERED

1. INTRODUCTION
2. CORPORATE SOCIAL RESPONSIBILITY (CSR)
3. WHICH COMPANY TO PERFORM CORPORATE SOCIAL RESPONSIBILITY?
4. IMPORTANT DEFINITIONS
5. STATUTORY PROVISIONS
6. ROLE OF CSR BOARD
7. ROLE OF BOARD
8. PERMISSIBLE ACTIVITIES UNDER CORPORATE SOCIAL RESPONSIBILITY POLICIES: SCHEDULE VII
9. ACCOUNTING FOR CSR TRANSACTIONS
10. WHETHER ANY UNSPENT AMOUNT OF CSR EXPENDITURE IS TO BE PROVIDED FOR?
11. WHETHER THE EXCESS AMOUNT CAN BE CARRY FORWARD TO SET OFF AGAINST FUTURE CSR EXPENDITURE?
12. CSR EXPENDITURE IN THE INCOME TAX SCENARIO
13. SELF PRACTICE QUESTIONS

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1. INTRODUCTION

Corporate Social Responsibility ('CSR') is corporate initiative to assess and take responsibility for the company's effects on the environment and its impact on social welfare. It can be conceptualized as the corporations' obligation to take necessary action to reduce the negative externalities and enhance the positive externalities associated with their business. In doing so, the corporations could protect and promote the interests of their stakeholders and society as a whole.

Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth.

2. CORPORATE SOCIAL RESPONSIBILITY (CSR) :

"Corporate Social Responsibility (CSR)" means and includes but is not limited to:

(1) Projects or programs relating to activities specified in Schedule VII or

(2) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company

3. WHICH COMPANY TO PERFORM CORPORATE SOCIAL RESPONSIBILITY?

Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India which fulfils the criteria specified in sub-section (l) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Question 1 – KKK Ltd.

KKK Ltd. is a company which is formed with charitable objects under Section 8 of the Companies Act, 2013. As a result, the management of the company believes that as all the activities of the company will be with the intent of charity, the CSR provisions are not applicable to ABC Ltd. as these activities are activities in normal course of business.

Whether the provisions of CSR are applicable to KKK Ltd. provided it fulfils the criteria of Section 135 of the Act?

4. IMPORTANT DEFINITIONS :

(a) **Average Net Profit :** "Average Net Profit" is the amount as calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

(b) **Financial Year :** "Financial Year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up.

(c) **Net Profit :** "Net Profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:

- (i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
- (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

(d) **Net worth :** "Net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

(e) **Turnover :** "Turnover" means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year;

(f) **Spend :** The term 'spend' in accounting parlance generally means the liabilities incurred during the relevant accounting period.

5. STATUTORY PROVISIONS :

As per section 135 of the Companies Act 2013

Every company having either

- net worth of Rs 500 crore or more, or
- turnover of Rs 1,000 crore or more or
- a net profit of Rs 5 crore or more

during the immediate preceding financial year

shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors (including at least one independent director).

Question 2 – ABC Ltd.

ABC Ltd. is a company which has a net worth of INR 200 crore, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

Required financial details of the following financial years are as follows (INR in crore)

	March 31, 20X4 (Current year) projected	March 31, 2003	March 31, 2002	March 31, 2001
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Does ABC Ltd. has an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year?

6. ROLE OF CSR BOARD

Role of Corporate Social Responsibility (CSR) Committee The CSR Committee shall—

(a) formulate and recommend to Board-

- a CSR Policy indicating the activities to be undertaken by the company in the areas or subject specified in Schedule VII;
- the amount of expenditure to be incurred on the above activities and

(b) monitor the CSR Policy of the company from time to time.

7. ROLE OF BOARD

Board shall disclose-

(a) The composition of CSR Committee in its report

(b) Approve the recommended CSR Policy for the company

(c) Disclose the contents of such Policy in its report and place it on the company's website

(d) Ensure that the activities included in CSR Policy of the company are duly executed by the company

(e) Ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years [or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years], by giving preference to the local area and areas around it where it operates

(f) In case the company fails to spend such amount, the Board shall specify the reasons for not spending the amount [and unless the unspent amount relates to any ongoing project, transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year]

(g) Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within thirty days from the end of the financial year to a special account

(opened by the company in that behalf for that financial year in any scheduled bank) to be called the Unspent Corporate Social Responsibility Account.

Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within thirty days from the date of completion of the third financial year.

(h) If a company contravenes the above provisions, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every defaulting officer of such company shall be punishable with imprisonment for a term upto three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Question 3 – XYZ Ltd.

XYZ Ltd. manufactures consumable goods like bath soap, tooth brushes, soap cases etc. As part of its CSR policy, it has decided that for every pack of these goods sold, INR 0.80 will go towards the 'Save Trees Foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 25,000 such packs and a total of INR 20,000 was recognised as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year.

Will the amount of INR 20,000 qualify to be a CSR expenditure?

Question 4 –

How can companies with small CSR funds take up CSR activities in a project/ program mode?

Question 5 – Due to immense

Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the Financial Statements for the year 20X1-X2, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge Corporate Social Responsibility.

State whether the treatment done by the management of management is correct. Explain with reasons.

Question 6 – BBC Ltd.

BBC Ltd. is a company which comes under the ambit of Section 135 and CSR Rules. The Board of BBC Ltd did not appropriate the CSR funds and as a result there was no annual report on CSR in the Board's report for financial year ended March 31, 20X1. Is this a non-compliance as per the Act?

8. PERMISSIBLE ACTIVITIES UNDER CORPORATE SOCIAL RESPONSIBILITY POLICIES: SCHEDULE VII :

As per Schedule VII of Companies Act 2013, following activities may be included by companies in their Corporate Social Responsibility Policies Activities relating to:

1. eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.
2. promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
3. promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
4. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;
5. protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
6. measures for the benefit of armed forces veteran, war widows and their dependents;
7. training to promote rural sports nationally recognized sports and Olympic sports;
8. contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
9. contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
10. rural development projects.
11. slum area development.
12. disaster management, including relief, rehabilitation and reconstruction activities.

9. ACCOUNTING FOR CSR TRANSACTIONS :

Revenue Expenditure made in the Current Financial Year

CSR Expenditure (Profit and loss statement)	XXX	
To Cash/Vendor		XXX

CSR Expenditure made towards a Capital Asset

CSR Asset (Balance Sheet)	XXX	
To Cash/Vendor		XXX

Question 7 – A building

A building is used for CSR activities of the company. The same is capitalised as 'an asset' in the books and depreciation is charged on the same as per the Companies Act, 2013. The Company claims the cost of the building as 'CSR expenditure' and also the depreciation thereon.

Is this the correct treatment as per the Act?

10. WHETHER ANY UNSPENT AMOUNT OF CSR EXPENDITURE IS TO BE PROVIDED FOR?

- Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy". A proviso to this Section states that "if the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount and, unless the unspent amount relates to any ongoing project, transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year".

- Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the Unspent Corporate Social Responsibility Account. uch amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

- If a company contravenes the provisions, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twentyfive lakh rupees and every officer of such company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

11. WHETHER THE EXCESS AMOUNT CAN BE CARRY FORWARD TO SET OFF AGAINST FUTURE CSR EXPENDITURE?

Where a company spends more than that required under law, a question arises as to whether the excess amount 'spent' can be carried forward to be adjusted against amounts to be spent on CSR activities in future period.

As per Section 135 (5) of the Companies Act, the Board shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

Since 2% of average net profits of immediately preceding three years is the minimum amount which is required to be spent under section 135(5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future

Question 8 – Precision Ltd.

Precision Ltd. is a company which is covered under the ambit of CSR rules. As part of its CSR contribution an amount of Rs.15,00,000 was spent as CSR expense towards the education of girl child. The average net profit of the company for the past three years was Rs.70,00,000. As the company incurred a CSR expense in excess of what is required by the rules, it decided to utilise this expense as a carry forward to the next year and reduce next year's CSR spend by Rs.1,00,000.
Can the excess expenditure towards CSR be carried forward to next financial year?

Question 9 – After the havoc

After the havoc caused by flood in Jammu and Kashmir, a group of companies undertakes during the period from October, 20X1 to December, 20X1 various commercial activities, with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 20X1-20X2.
State whether the management's intention is correct or not and why?

12. CSR EXPENDITURE IN THE INCOME TAX SCENARIO :

1. CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business. As the application of income is not allowed as deduction for the purposes of computing taxable income of a company, amount spent on CSR cannot be allowed as deduction for computing the taxable income of the company.

2. The CSR expenditure which is of the nature described in section 30 to section 36 of the Income-tax Act shall be allowed as deduction under those sections subject to fulfilment of conditions, if any, specified therein. If the nature of CSR expenditure incurred is not covered under the aforesaid sections of the Act and is covered under section 37(1) of the Act, ie any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.

Question 10 – SKK Ltd.

SKK Ltd. carries out CSR activities from rented premises in Pune. The rent paid for such premises is disclosed as CSR expenditure and subsequently SKK Ltd. also claimed deduction of the same under the Income-tax Act. Is this permissible?

13. SELF PRACTICE QUESTIONS:

Question 11 – A property

A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the financials regarding this?

Question 12 – XYZ Ltd.

In the year 20X1, XYZ Ltd. falls within the purview of CSR provisions as per the Companies Act, 2013 since its net profit for the financial year exceeded ` 5 crore. The company discharged CSR obligations in the year 20X2. However, the net profit of the year 20X2 was less than ` 5 crores. Also, it was also not satisfying the other two criteria of the section 135 for CSR compliance. Therefore, the company stopped performing CSR activities from the year 20X3 onwards. Comment on the company's accountability for CSR.

Thanks ....

CHAPTER 12

ANALYSIS OF FINANCIAL STATEMENTS

CONCEPTS COVERED

1. INTRODUCTION
2. CHARACTERTICS OF GOOD FINANCIAL STATEMENTS
3. BEST PRACTICES – APPLICABLE TO ALL COMPANIES
4. CASE STUDIES
5. SELF PRACTICE QUESTIONS

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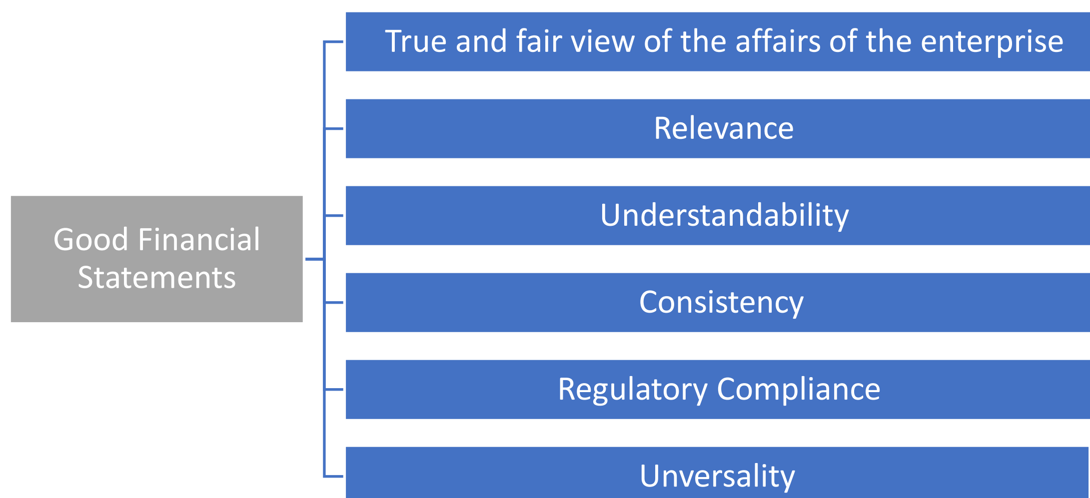
1. INTRODUCTION

Business is important organ of society that helps in its overall development. A typical business has a variety of stakeholder that include its employees, owners, banks, trade associations, government, general public and so on. These stakeholders, particularly investors are keenly interested in knowing about the financial well-being of business organisations.

Financial reporting is an important means of communication for entities to disseminate information of its operations to various stakeholders. With the increased focus on governance the significance of financial reporting has exponentially increased. The importance of robust financial reporting cannot be emphasized enough. As India and Indian enterprises move ahead in the growth path at much faster pace and exposure of Indian entities to global environment expands, ever increasing complexities of transactions throws up newer challenges in financial reporting and related guidance. Presentation and disclosures, in this context, are assuming greater significance as enterprises aim to achieve excellence in financial reporting. Today, there are a number of requirements mandated by the regulators. It has now become imperative for entities to keep pace with the fast evolving requirements in the area of financial reporting.

2. CHARACTERTICS OF GOOD FINANCIAL STATEMENTS :



The key features to any set of financial statements are:

1. **True and fair view of the affairs of the enterprise :** This is the most important feature of any set of financial statements. The user of the financial statements depends fully on the same and hence the reliability factor is supreme.
2. **Relevance :** The financial statements should provide the relevant information for the period it is presented. There is no point in presenting historical data of past several years that are redundant as of date. The key here is that the user of the financial statements should be in a position to take independent decision after reading the financial statements. This decision can be different for different users – for an investor the decision whether to hold the shares of the enterprise will stem from the set of statements, for a senior employee of the company it can be the future growth prospects of the company etc. But what is important is that the users should be empowered to make decisions through the financial statements

3. **Understandability :** For the user to make sense, the financial statements should be readable and content lucid to digest. Even a layman should be able to read the same, and understand the basic information, if not the accounting policies and procedures.

4. **Consistency :** The users of the financial statements will be benefitted only if the statements are released in periodic intervals and in standard formats. Else, the entire purpose of furnishing financials will be defeated. That's the reason that laws are prescribed for presentation formats and periodicity.

5. **Regulatory Compliance :** Needless to say, the tax authorities, market regulators etc. rely hugely on financial statements to understand and gauge the compliances met by the enterprise.

6. **Universality :** Last but not the least; the financial statements should be comparable both within the industry and outside. So financial statements by two different companies should look in similar lines if both are engaged in, say, manufacturing steel. Likewise, the financials of a company manufacturing steel in India should be comparable to the set of financial statements of a company based out of US engaged in the similar line of business.

3. BEST PRACTICES – APPLICABLE TO ALL COMPANIES :

Following are some of the practices, if followed by the preparers of the financial statements, it would lead to better presentation and disclosure and will also serve the meaningful purpose for various stakeholders in understanding the functioning, financial position and financial performance of the entity and in appropriate decision making:

1. **Compliance :**

   Financial reporting is a regulated activity and compliance with the requirements is a must. Comply with the standards and regulations but also ensure your financial statements are an effective part of your wider communication with your stakeholders. It should be simple and understandable without any change in the interpretation.

2. **Complete :**

   The information disclosed in the financial statements should be complete and should not lead to any further cross questioning in the mind of the users. Ensure consistency of disclosures across the financial statements.

3. **Simple and specific :**

   - Draft your notes, accounting policies, commentary on more complex areas in simple and plain English. Ensuring that there are no vague or ambiguous notes.
   - Make your policies clear and specific.
   - Ensure that there should not be any vague or ambiguous notes, with no further information or explanation which may lead to misinterpretation of information.
   - Reduce generic disclosures and focus on company specific disclosures that explain how the company applies the policies.

4. **Transparency :**

   In preparation of financial statements many a times certain assumptions, or other bases are taken. Disclose those assumptions and bases transparently, so that they users are not misled. Rather such transparency shall provide useful additional information and substantiate your decision/judgement.

5. **Materiality :**

- The lack of clarity in how to apply the concept of materiality is perceived to be one of the main drivers for overloaded financial statements. Make effective use of materiality to enhance the clarity and conciseness of your financial statements.
- Information should only be disclosed if it is material. It is material if it could influence users' decisions which are based on the financial statements.
- Your materiality assessment is the 'filter' in deciding what information to disclose and what to omit.
- Once you have determined which specific line items require disclosure, you should assess what to disclose about these items, including how much detail to provide and how best to organise the information.

6. **Integration of Notes :**
   - Notes cover the largest portion of the financial statements. They are an effective tool of communication and have the greatest impact on the effectiveness of your financial statements.
   - Group notes into categories, place the most critical information more prominently or a combination of both.
   - Integrate your main note of a line item with its accounting policy and any relevant key estimates and judgements.
   - Ensuring that the accounting policies are disclosed in one place and not scattered across various notes.

7. **Disclosure of Significant Accounting Policies :**
   - The financial statements should disclose your significant accounting policies. Disclose only your significant accounting policies – remove your non-significant disclosures that do not add any value.
   - Your disclosures should be relevant, specific to your company and explain how you apply your policies.
   - The aim of accounting policy disclosures is to help your investors and other stakeholders to properly understand your financial statements.
   - Use judgement to determine whether your accounting policies are significant, considering not only the materiality of the balances or transactions affected by the policy but also other factors including the nature of the company's operations.

8. **Disclosures of Key Estimates and Judgements :**
   - Effective disclosures about the most important estimates and judgements enable investors to understand your financial statements.
   - Focus on the most difficult, subjective and complex estimates.
   - Include details of how the estimate was derived, key assumptions involved, the process for reviewing and an analysis of its sensitiveness.
   - Provide sufficient background information on the judgement, explain how the judgement was made and the conclusion reached.

9. **Integrated Approach :**
   - Financial statements are just one part of your communication with the stakeholders. An annual report typically includes financial statements, a management commentary and information about governance, strategy and

business developments, CSR Reporting, Business Responsibility Reporting etc. There is also a growing trend towards integrated reporting.

- To ensure overall effective communication consider the annual report as a whole and deliver a consistent and coherent message throughout.
- Ind AS 1 also acknowledges that one may present, outside the financial statements, a financial review that describes and explains the main features of the company's financial performance and financial position, and the principal uncertainties it faces.
- Many companies also present, outside the financial statements, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group.
- Even though the reports and statements presented outside financial statements are outside the scope of AS / Ind AS, they are not out of the scope of regulation.

4. CASE STUDIES :

Case Study 1 :

On 1st April, 20X1, Pluto Ltd. has advance a loan for Rs 10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. Rs 10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs 40,000 (Rs 10 lakhs x 4%).

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

Case study 2 :

Pluto Ltd. has purchased a manufacturing plant for Rs 6 lakhs on 1st April, 20X1. The useful life of the plant is 10 years. On 30th September, 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September, 20X3 and 31st March, 20X4 was Rs.4 lakhs and Rs.3.5 lakhs respectively.

The accountant has performed the following working:

Carrying amount on initial classification as held for sale		
Purchase Price of Plant	6,00,000	
Less: Accumulated dep (6,00,000/ 10 Years) x 2.5 years	(1,50,000)	4,50,000
Fair Value less cost to sell as on 31st March, 20X4		4,00,000
The value will be lower of the above two		4,00,000

Balance Sheet extracts as on 31st March, 20X4

Assets	
Current Assets Other Current Assets Assets classified as held for sale	 3,50,000

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith the necessary workings.

Case Study 3 :

On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March, 20X2 costing Rs 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of Rs.9 lakhs.

The accountant of Jupiter Ltd treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

Rs.lakhs

Cost	8.00
Net Realizable Value	7.60
Inventories (lower of cost and net realizable value)	7.60

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Case Study 4 :

On 1st April, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for Rs 30 lakhs. Sun Ltd. has 3 cash-generating units A, B and C with fair value of Rs 12 lakhs, Rs 8 lakhs and Rs 4 lakhs respectively. The company recognizes goodwill of Rs 6 lakhs that relates to CGU 'C' only. During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment. Analyse whether the view adopted by the CFO of Sun Ltd is in compliance of the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS.

5. SELF PRACTICE QUESTIONS :

Question 1 – Venus Ltd.

Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

Particulars	Property 1	Property 2	Property 3

	Factory	Factory	Let – Out
Purchase price	15,000	10,000	12,000
Market value 31.03.2012	16,000	11,000	13,500
Life	10 years	10 years	10 years
Subsequent Measurement	Cost	Revaluation	Revaluation

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a nonrelated party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:

Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment alongwith working for the same.

Question 2 – Sun Ltd.

On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of Rs 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ` 12 lakhs to the customer on 15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

Question 3 – Mercury Ltd.

Dhara Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for Rs.10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for Rs.2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Question 4 – Mercury Ltd.

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

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

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

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

Thanks ….

About The Author

Rahul Malkan is a proficient faculty of Financial Reporting and Strategic Financial Management at CA Final level. He is an MBA in business financial. He has 20 years of experience in teaching industry and has authored 20 books in academics.

A good mentor for students and guides them to the path of success by assisting in other subjects as well.

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