Rahul Malkan

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CA FINAL

FINANCIAL REPORTING

A Comprehensive Guide to
INDIAN ACCOUNTING STANDARDS (Ind AS)

DESCRIPTION
This book provides a step-by-step approach to Indian Accounting Standards (Ind AS). It also covers both the concepts and questions in one place.

Prof. Rahul Malkan

BOOK 1

CONCEPTUAL CLARITY
Understand Concepts Clearly

STEP-BY-STEP APPROACH
Learn in a Systematic Manner

EXAM-FOCUSED CONTENT
Designed for Better Exam Performance

CONCEPTS & QUESTIONS
Practice More. Score More. Succeed.

LEARN | UNDERSTAND | APPLY | EXCEL

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CHAPTER 1

INTRODUCTION TO ACCOUNTING STANDARDS (AS) AND INDIAN ACCOUNTING STANDARDS (IND AS)

CONCEPTS COVERED

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1. ACCOUNTING STANDARDS :

1.1 INTRODUCTION :

Accounting as a "language of business" communicates the financial results of the enterprise to various stakeholders by means of financial statements.

If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business rather than the true.

To ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies.

Accounting Standards (Ass) provide framework and standard accounting polices for treatment of transactions and events so that the financial statements of different enterprise become comparable

1.2 WHAT ARE ACCOUNTING STANDARDS? :

Accounting Standards (Ass) provide framework and standard accounting polices for treatment of transactions and events so that the financial statements of different enterprise become comparable.

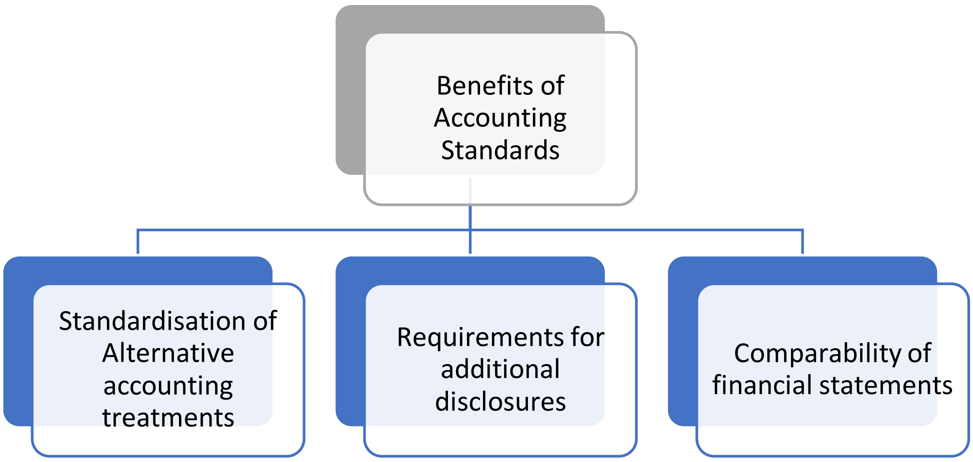
Accounting Standards are written policy documents issued by the expert accounting body or by government or other regulatory body, to harmonies the accounting process to that financial statement presents true and fair picture of business.

1.3 ACCOUNTING STANDARDS DEALS WITH :

Accounting Standards Deal with			
Recognition of events and transactions	Measurement of trasaction and Events	Presentation of transactions and Events	Disclosure requirements

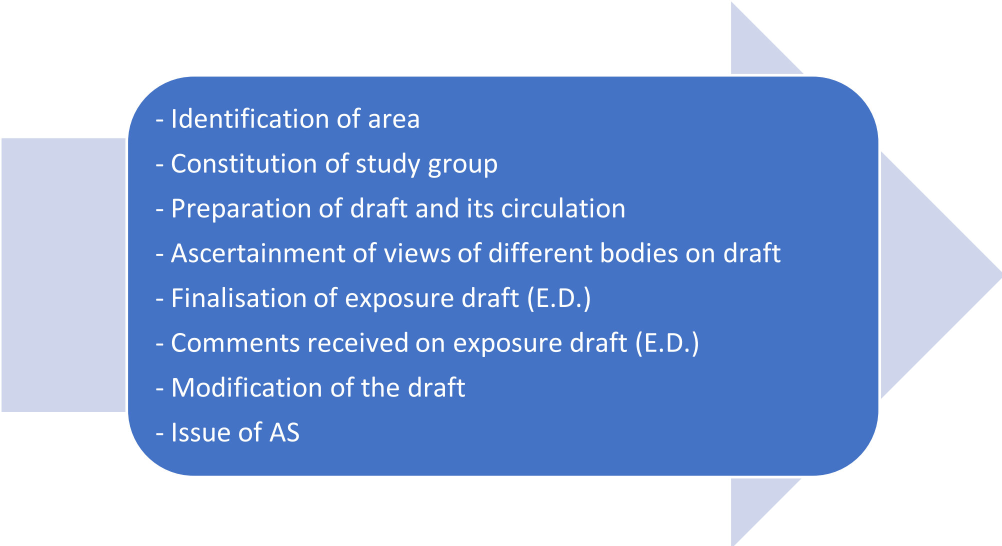
1.4 BENEFITS OF ACCOUNTING STANDARDS :

Accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. By setting the accounting standards, the accountant has following benefits:



1.5 ACCOUNTING STANDARDS SETTING PROCESS :

The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977.

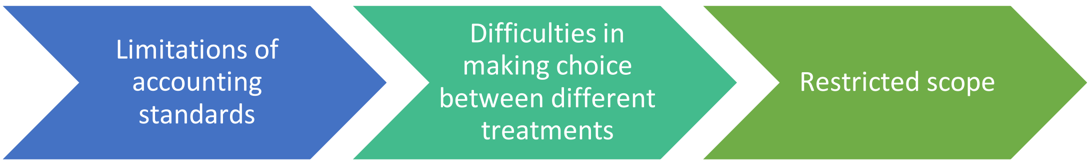


1.6 LIMITATIONS OF ACCOUNTNG STANDARDS :

However, there are some limitations of accounting standards:

(i) **Difficulties in making choice between different treatments:** Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) **Restricted scope:** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.



2. INDIAN ACCOUNTING STANDARDS :

2.1 WHY IND AS? :

In the present era of globalization and liberalization, the world has become an economic village.

More and more Indian companies are being listed on overseas stock exchanges. The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality accounting standards. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

2.2 WHAT ARE IND AS? :

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).

ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. icsi, icai, representatives from ASSOCHAM, CII, FICCI, etc. National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

2.3 INTERNATIONAL ACCOUNTING STANDARDS :

IFRS – Collectively includes

International Accounting Standard Committee (IASC) – formed in 1973 issued	
International Accounting Standards (IAS)	Standard interpretation committee (SIC)

International Accounting Standard Board (IASB) – from 2000 issued	
International Financial Reporting Standards (IFRS)	International Financial Reporting Interpretation Committee (IFRIC)

In short IFRS means IAS/SIC/IFRS/IFRIC

2.4. KEY FEATURES OF IND AS :

Key Features

- Principle Based Standard – they establish broad rules rather than dictating specific treatments
- Applicable to CFS and SFS
- Substance over form
- Rely more on Fair Valuation Approach and measurements based on Time Value of Money
- Requires more disclosure of all the relevant information and assumption used.
- Requires higher degree of judgement and estimates.

2.5 NEED FOR CONVERGENSE :

Need for Convergense

- Standardization
- International capital Flow
- Beneficial to regulators

1. **Standardization :** A single set of accounting standard would enable standardization. In fact, they establish broad rules rather than dictating specific treatments. Standardization would ensure better quality of financial statements.
2. **International capital Flow :** It would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems.
3. **Beneficial to regulators :** It would be beneficial to the regulators too, as complexity associated with understanding various reporting regimes would be reduced.

2.6 WHAT ARE CARVE IN / CARVE OUT :

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating IFRS converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential.

2.7 GOI COMMITMENT TO IND AS :

Consistent, comparable and understandable financial reporting is essential to develop a robust economy. With a view to achieve international benchmarks of financial reporting, the Institute of Chartered Accountants of India (ICAI), as a proactive role in accounting, set out to introduce Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS). This endeavour of the ICAI is supported by the Government of India.

Initially Ind AS were expected to be implemented from the year 2011. However, keeping in view the fact that certain issues including tax issues were still to be addressed, the Ministry of Corporate Affairs decided to postpone the date of implementation of Ind AS.

ROAD MAP TO IMPLEMENTATION OF IND AS

PHASE 1	PHASE 2	PHASE 3
• VOLUNTARY • 1/4/2015	• MANDATORY • 1/4/2016	• MANDATORY • 1/4/2017

PHASE 1	1st April 2015 or thereafter: Voluntary Basis for all companies	
PHASE 2	1st April 2016: Mandatory Basis	
	A	Companies listed / in process of listing on Stock Exchanges in India or Outside India having net worth =/> 500 crore
	B	Unlisted Companies having net worth =/> 500 crore
	C	Parent, Subsidiary, Associate and Joint venture of above
PHASE 3	1st April 2017: Mandatory Basis	
	A	All companies which are listed/or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)
	B	Unlisted companies having net worth =/> 250 crore
	C	Parent, Subsidiary, Associate and Joint venture of above

Thanks ....

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CHAPTER

2

IND AS 1 – PRESENTATION OF FINANCIAL STATEMENTS

CONCEPTS COVERED

1. DIVISION II OF THE SCHEDULE III TO THE COMPANIES ACT, 2013
2. INTRODUCTION – IND AS 1
3. DEFINITIONS
4. GENERAL FEATURES OF FINANCIAL STATEMENT
5. STRUCTURE AND CONTENT
6. SELF PRACTICE QUSTIONS

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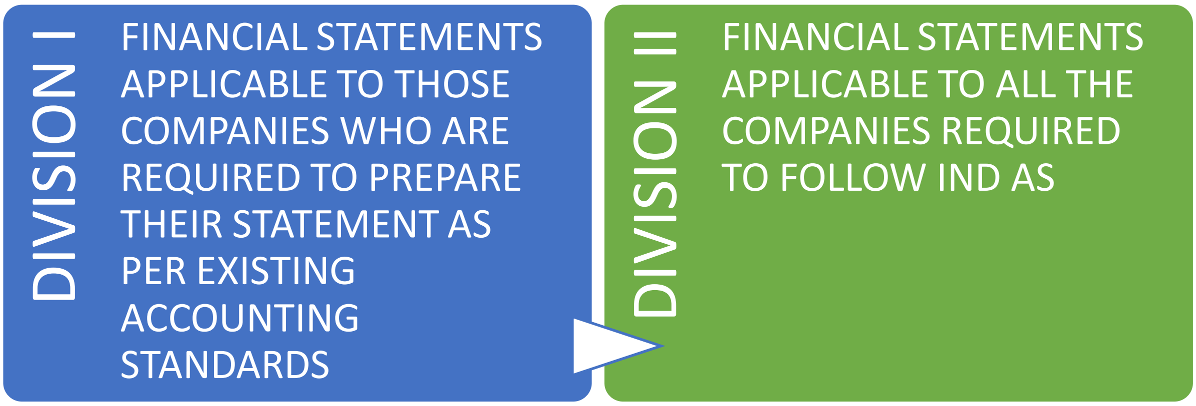
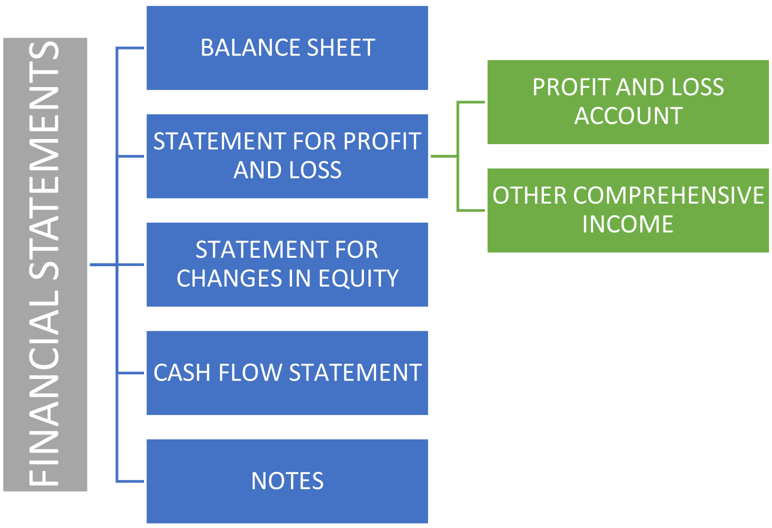
1. DIVISION II OF THE SCHEDULE III TO THE COMPANIES ACT, 2013 :

The Ministry of Corporate Affairs vide its notification dated 6th April, 2016 notified amendments to Schedule III to the Companies Act, 2013 thereby inserting Division II to Schedule III for preparation of financial statements by those entities who have to comply with Indian Accounting Standards (Ind AS). Now

1. Division I is applicable to a company whose financial statements are required to comply with the current accounting standards
2. Division II is applicable to a company whose financial statements are drawn up in compliance with Ind AS.



FINANCIAL STATEMENTS – DIV II :



PART 1 – BALANCE SHEET :

	Particulars	Note No	Current Year	Previous Year
	Assets			
1.	Non Current Assets			
	a. Property, Plant and Equipment		XX	XX
	b. Capital Work in Progress		XX	XX

	c. Investment property		XX	XX
	d. Goodwill		XX	XX
	e. Other Intangible Assets		XX	XX
	f. Intangible Assets Under Development		XX	XX
	g. Biological Assets other than bearer plants		XX	XX
	h. Financial Assets			
	i) Investments		XX	XX
	II) Trade Receivables		XX	XX
	III) Loans		XX	XX
	iv) Others (to be specified)		XX	XX
	i) Deferred Tax Assets (Net)		XX	XX
	j) Other Non-Current Assets		XX	XX
2.	Current Asset			
	a) Inventories		XX	XX
	b) Financial Assets			
	i) Investments		XX	XX
	II) Trade Receivables		XX	XX
	III) Cash and Cash Equivalents		XX	XX
	iv) Bank Balance		XX	XX
	v) Others (to be Specified)		XX	XX
	c) Current Tax Assets (Net)		XX	XX
	d) Other Current Assets		XX	XX
	TOTAL		XX	XX

	Particulars	Note No	Current Year	Previous Year
	Equity and Liabilities			
	Equity			
	a. Equity Share Capital		XX	XX
	b. Other Equity		XX	XX
	Liabilities			
1.	Non-current Liability			
	a. Financial Liabilities			
	(i) Borrowings		XX	XX
	(ii) Trade Payable		XX	XX
	(iii) Other financial Liabilities (to be specified)		XX	XX
	b. Provisions		XX	XX
	c. Deferred tax Liabilities		XX	XX

	d. Other non – current liabilities		XX	XX
2.	Current Liabilities a. Financial Liabilities (i) Borrowings (ii) Trade Payable (iii) Other financial Liabilities (to be specified) b. Provisions c. Current tax Liabilities d. Other non – current liabilities		 XX XX XX XX XX XX	 XX XX XX XX XX XX
	TOTAL		XX	XX

PART 2 – STATEMENT FOR CHANGES IN EQUITY :

The Statement of Changes in Equity has been introduced on the lines of IFRS. An SOCE is prepared in order to reconcile the various components of equity in the balance sheet for any period.

A. Equity share capital

B. Other Equity
  - a. Share Application money pending Allotment
  - b. Equity Component of Compound Financial Instrument
  - c. Reserves and Surplus
    - i. Capital Reserve
    - ii. Security Premium Reserve
    - iii. Other Reserve (to be Specified)
    - iv. Retained Earnings
  - d. Debt instrument through other comprehensive income
  - e. Equity instrument through other comprehensive income
  - f. Effective portion of cash flow hedges
  - g. Revaluation Reserve
  - h. Exchange difference on translating the financial statements of a foreign operations
  - i. Other items of other comprehensive income
  - j. Money received against share warrant

PART 3 – STATEMENT OF PROFIT AND LOSS ACCOUNT :

	Particulars	Note No	Current Year	Previous Year
I	Revenue from operations		XX	XX
II	Other income		XX	XX
III	Total Income (I + II)		XX	XX
IV	Expenses Cost of Material Consumed Purchase of Stock in Trade		 XX XX	 XX XX

	Changes in inventory of Finished goods, Stock in trade		XX	XX
	and work in progress		XX	XX
	Employee benefit Expense		XX	XX
	Finance Cost		XX	XX
	Depreciation and Amortisation Expense		XX	XX
	Other Expense			
	TOTAL EXPENSES (IV)		XX	XX
V	Profit / Loss before exceptional Items and Tax		XX	XX
VI	Exceptional Items		XX	XX
VII	Profit Before Tax		XX	XX
VIII	Tax Expense			
	1. Current Tax		XX	XX
	2. Deferred Tax		XX	XX
IX	Profit / Loss for the period from continuing operations		XX	XX
X	Profit / Loss from discontinued operations		XX	XX
XI	Tax expense from discontinued operations		XX	XX
XII	Profit / Loss from discontinued operations (After Tax)		XX	XX
XIII	Profit / Loss for the period (IX + XII)		XX	XX
XIV	Other comprehensive Income			
	A (I) Items that will not be reclassified to profit and loss Account		XX	XX
	(II) Income tax relating to above items		XX	XX
	B (I) Items that will be reclassified to profit and loss Account		XX	XX
	(II) Income tax relating to the above items		XX	XX
XV	Total comprehensive income for period (XIII + XIV)		XX	XX
XVI	Earnings per share (for continuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX
XVII	Earnings per share (for discontinuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX
XVIII	Earnings per share (for continuing and discontinuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX

OTHER COMPREHENSIVE INCOME :

1. It contains generally unrealised gains and losses arising from re-measurements of Assets and Liabilities
2. On Realisation, with few exceptions, gains and losses are recognised in profit or loss section
3. Exceptions
   a. Sale of revalued assets
   b. Equity instruments opted to be measured at fair value through OCI

At outset, it is worthwhile to note that Total Comprehensive Income is different from Other Comprehensive Income and can be better understood as follows:

PART 4 – CASH FLOW STATEMENT :

Alike under the IGAAP, Schedule III for Ind AS does not provide for a format of the Cash Flow Statement and requires that the statement be prepared in accordance with the relevant Ind AS. However, in a sharp contrast to the AS 3 on Cash Flow Statements, Ind AS 7 on Cash Flow Statements Statements "encourages" the use of Direct Method instead of the Indirect Method for preparing the Cash Flow Statements but provides no format for the preparation of the same.

PART 5 – NOTES :

Notes containing information in addition to that which is presented in the financial statements would be provided, including, where required, narrative descriptions or disaggregation of items recognised in the financial statements and information about items that do not qualify for such recognition.

Disclosure under Ind AS (for e.g., fair value measurement reconciliation, fair value hierarchy, risk management and capital management, disclosure of interests in other entities, components of other comprehensive income, reconciliations on first-time adoption of Ind AS, etc.) shall be made in the Notes or by way of additional statement(s) unless required to be disclosed on the face of the Financial Statements.

2. INTRODUCTION – IND AS 1 :

Ind AS 1 is a basic Standard, which prescribes the overall requirements for the presentation of financial statements and guidelines for their structure, i.e., components of financial statements, viz., balance sheet, statement of profit and loss, statement of cash flows and notes comprising significant accounting policies, etc. Further, the Standard prescribes the minimum disclosures that are to be made in the financial statements and explains the general features of the financial statements.

3. DEFINITIONS :

Definitions

- General purpose financial statements
- Impracticable
- Indian Accounting Standards (Ind AS)
- Material
- Notes
- Owners
- Profit or loss
- Reclassification adjustments
- Total comprehensive income
- Other comprehensive income

1. General purpose financial statements :

General purpose financial statements (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs

2. Impracticable :

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

3. Indian Accounting Standards (Ind AS) :

Indian Accounting Standards (Ind AS) are Standards prescribed under Section 133 of the Companies Act, 2013.

4. Material :

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

5. Notes :

Notes contain information in addition to that presented in the balance sheet (including statement of changes in equity which is a part of the balance sheet), statement of profit and loss and statement of cash flows.

6. Owners :

Owners are holders of instruments classified as equity

7. **Profit or loss :**

Profit or loss is the total of income less expenses, excluding the components of other comprehensive income

8. **Reclassification adjustments :**

Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

9. **Total comprehensive income :**

Total comprehensive income is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'

10. **Other comprehensive income :**

Other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind AS.

The components of Other Comprehensive Income include the following:

No.	Components	Reference
1	Changes in revaluation surplus	Ind AS 16
2	Remeasurements of defined benefit plans	Ind AS 19
3	Gains and losses arising from translating the financial statements of a foreign operation	Ind AS 21
4	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	Ind AS 109
5	Gains and losses on financial assets measured at fair value through other comprehensive income	Ind AS 109
6	The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income	Ind AS 109
7	For particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk	Ind AS 109
8	Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value	Ind AS 109

9	Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument	IND AS 109

4. GENERAL FEATURES OF FINANCIAL STATEMENT :

4.1 Presentation of True and Fair View and compliance with Ind AS :

Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity.

An explicit and unreserved statement :

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

4.2 Departure from the Requirements of an Ind AS — Whether Permissible? :

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

Question 1 – An entity

An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

4.3 Going Concern :

Financial statements prepared under Ind AS should be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

If management has significant doubt of the entity's ability to continue as a going concern, the uncertainties should be disclosed.

Question 2 – Entity XYZ

Entity XYZ is a large manufacturer of plastic products for the local market. On 1 April 2016 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency (CU(2)) appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 2016 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ reported a loss of CU 4,000 for the year ended 31 March 2017. At 31st March 2017, entity XYZ's equity was CU 1,000. Management restructured entity B's operations in the second quarter of 2017. That restructuring helped reduce losses for the third and fourth quarters to CU 400 and CU 380, respectively.

In January 2017 the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15 March 2017, the government announced that it would reintroduce limited plastic import tariffs in 2018. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term. Management of entity XYZ undertook a going concern assessment at 31 March 2017. Management projects/forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31 March 2017 annual financial statements?

4.4 Accrual basis of accounting :

4.5 Materiality and aggregation :

4.6 Offsetting :

- An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.

Question 3 –

Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

4.7 Frequency of reporting :

- An entity shall present a complete set of financial statements (including comparative information) at least annually.

4.8 Comparative information :

- An entity should present comparative information in respect of the preceeding period for all amounts reported in the current period's financial statements except when Ind AS permit or require otherwise.
- Comparative information for narrative and descriptive information should be included if it is relevant to understand the current period's financial statements.
- An entity shall present, as a minimum:
  - 2 Balance Sheets
  - 2 Statement of Profit and Loss
  - 2 Statement of Cash Flows
  - 2 Statement of Changes in Equity and
  - Related Notes.
- When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or when it reclassifies items in its financial statements, it shall present, as a minimum, three balance sheets, two of each of the other statements, and related notes. An entity presents balance sheets as at
  - the end of the current period,
  - the end of the previous period (which is the same as the beginning of the current period), and
  - the beginning of the earliest comparative period.

Question 4 – A retail chain

A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 20X1 annual financial statements. The business combination accounting was finalised in 20X1-20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-20X2 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 20X0?

4.9 Consistency of presentation :

5. STRUCTURE AND CONTENT :

Ind AS 1 requires particular disclosures in the balance sheet (including statement of changes in equity which is a part of the balance sheet) or in the statement of profit and loss and requires disclosure of other line items either in those statements or in the notes.

Balance Sheet

"Format as per last chapter"

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet except when a presentation based on liquidity provides information that is reliable and more relevant.

Current and Non-Current Assets

An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or

(d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

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

Current and Non-current Liabilities :

An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

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

Operating Cycle :

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets classified as held for trading in accordance with Ind AS 109) and the current portion of non-current financial assets.

Question 5 – X Ltd.

X Ltd provides you the following information:

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

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

Question 6 – Inventory or trade

Inventory or trade receivables of X Ltd. are normally realised in 15 months. How should X Ltd. classify such inventory/trade receivables: current or non-current if these are expected to be realised within 15 months?

Question 7 – B Ltd.

B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery. (a) What is the length of operating cycle? (b) How should it treat its inventory and debtors?

Question 8 – Charming Ltd.

On 1st April, 20X3, Charming Ltd issued 100,000 Rs. 10 bonds for Rs. 1,000,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs. 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

Question 9 – X Ltd.

X Ltd provides you the following information:

Raw material stock holding period	: 3 months
Work-in-progress holding period	: 1 month

Finished goods holding period : 5 months
Debtors collection period : 5 months
The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

Question 10 – Entity A

Entity A has two different businesses, real estate and manufacture of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Question 11 – An entity

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

(a) Electricity Deposit

(b) Tender Deposit/Earnest Money Deposit [EMD]

(c) GST Deposit paid under dispute or GST payment under dispute

Question 12 – Ind AS 1

Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payments upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non- current?

Question 13 – An entity

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

(a) How should such loan be classified in the balance sheet of the entity?

(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?

(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?

(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

Question 14 – In December 2001

In December 2001 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 2005. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2002, failing which the loan becomes payable on demand. As on March 24, 2002, the entity has not been able to get the promoter's contribution. On March 25, 2002, the entity approached the bank and obtained a grace period up to June 30, 2002 to get the promoter's contribution. The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 2002.

(a) As on March 31, 2002, how should the entity classify the loan?

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 2002, the entity approached the bank and got the compliance date extended up to June 30, 2002 for getting promoter's contribution. In this case will the loan classification as on March 31, 2002 be different from (a) above?

6. SELF PRACTICE QUESTIONS :

Question 15 – Entity A

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

Rs.

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

Question 16 – XYZ Limited

XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word "standalone" before each of the components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in Rs. Is it necessary to write in the financial statements that the financial statements has been presented in Rs.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

Evaluate the above matters with respect to preparation and presentation of general purpose financial statement

Question 17 – A Company

A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. I t will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

(i) Can management present the third statement of profit and loss as additional comparative in the general purpose financial statements?

(ii) If management present third statement of profit and loss in the general purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?

(iii) Can management present third statement of profit and loss only as additional comparative in the general purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

Question 18 – A Company

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of Rs. 10 Crore. The total revenue reported in FY 20X1-20X2 was Rs. 80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?

(ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

Question 19 – XYZ Limited

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

S. No.	Items/transactions
(1)	The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle.
(2)	The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed.
(3)	The Company was awarded a contract of Rs. 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of Rs. 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.
(4)	The Company has also given certain contracts to third parties and have received security deposits from them of Rs. 2 Crore on March 31, 20X2

	which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:

(i) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

(ii) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?

(iii) Can the security deposit of Rs. 5 Crore made by the Company with the customers be presented as current?

(iv) Can the security deposit of Rs. 2 Crore taken by the Company from contractors be presented as non-current?

Thanks ....

CHAPTER

3

IND AS 2 – INVENTORIES

CONCEPTS COVERED

1. DEFINITIONS
2. MEASUREMENT OF INVENTORIES
3. RECOGNITION AS AN EXPENSE
4. SELF PRACTICE QUSTIONS

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1. DEFINITIONS :

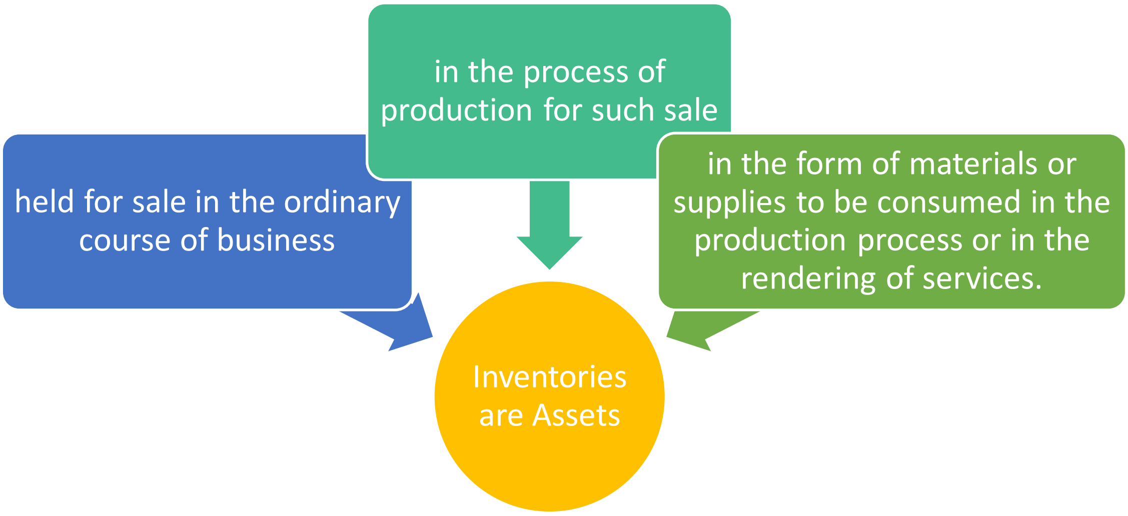
1. Inventories :

Inventories are Assets

a) held for sale in the ordinary course of business; (Finished Goods)

b) in the process of production for such sale; or (Work in progress)

c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. (Raw material)



Question 1

As per Ind AS 2, inventories include 'materials and supplies awaiting use in the production process'. Whether packing material and publicity material are covered by the term 'materials and supplies awaiting use in the production process'.

2. Net realisable value :

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3. Fair Value :

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

Difference between Net Realisable Value (NRV) and Fair Value (FV)

Basis	NRV	FV
Meaning	NRV refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.	FV reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date

Measurement base	Entity-specific value i.e. the amount that the entity actually expects to make from selling the particular inventory	Market based measurement

2. MEASUREMENT OF INVENTORIES :

Measurement of Inventories

- Cost of Inventories
- Cost of Purchase
- Cost of Conversion
- Other costs
- Allocation of cost to joint products and by-products
- Cost Formulas
- Net realisable value

"Inventories shall be measured at the lower of cost and net realisable value."

At lower of → COST → Net Realisable Value

1) Cost of Inventories :

COST
- Cost of Purchase
- Conversion Cost
- Other costs incurred in bringing the inventories to their present location and condition

2) Cost of Purchase :

Cost of Purchase
- Purchase Price
- Import Duties and Other Taxes
- Transport, handling and
- other costs directly attributable to the acquisition of finished goods, materials and services.
- Trade discounts, rebates and other similar items

Question 2 – ABC Ltd

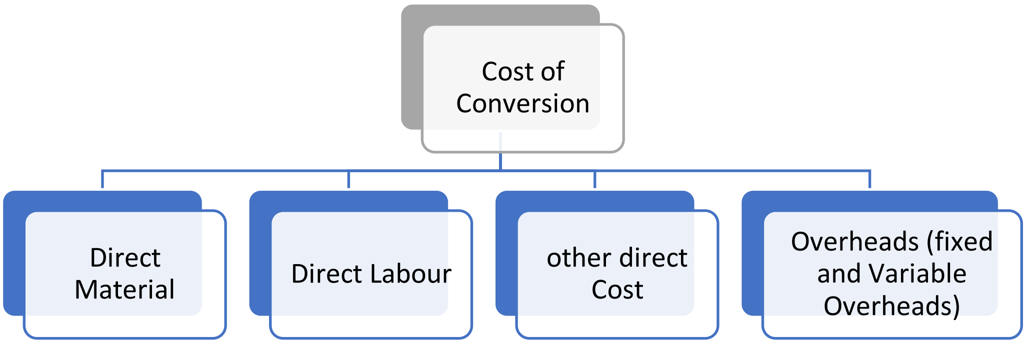
ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was Rs. 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of Rs. 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of Rs. 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

3) Cost of Conversion :



Question 3 – Pluto Ltd

Pluto Ltd. has a plant with the normal capacity to produce 5,00,000 unit of a product per annum and the expected fixed overhead is Rs.15,00,000. Fixed overhead on the basis of normal capacity is Rs.3 per unit (15,00,000/5,00,000). How shall u treat Fixed overheads under following circumstances

a. Actual production is 5,00,000 units

b. Actual production is 3,75,000 units

c. Actual production is 7,50,000 units.

Question 4 – A business

A business plans for production overheads of Rs. 10,00,000 per annum.

The normal level of production is 1,00,000 units per annum.

Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were Rs. 126.

Calculate the per unit cost and amount of overhead to be expensed during the year.

Question 5 – ABC Ltd

ABC Ltd. manufactures control units for air conditioning systems.
Each control unit requires the following:
1 component X at a cost of Rs. 1,205 each
1 component Y at a cost of Rs. 800 each
Sundry raw materials at a cost of Rs. 150 each
The company faces the following monthly expenses:
Factory rent Rs. 16,500
Energy cost Rs. 7,500
Selling and administrative costs Rs. 10,000
Each unit takes two hours to assemble. Production workers are paid Rs. 300 per hour. Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.
Determine the cost of inventory.

Question 6 – A dealer

A dealer has purchased 1,000 cars costing Rs. 2,80,000 each on deferred payment basis as Rs. 25,000 per month per car to be paid in 12 equal instalments.
At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Question 7 – Venus Trading Company

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:
1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.

Question 8 – As per IND AS 2

As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognised as an expense in the period in which these are incurred. Whether the distribution costs would now be included in the cost of inventories under Ind AS 2.

Question 9 – In a manufacturing

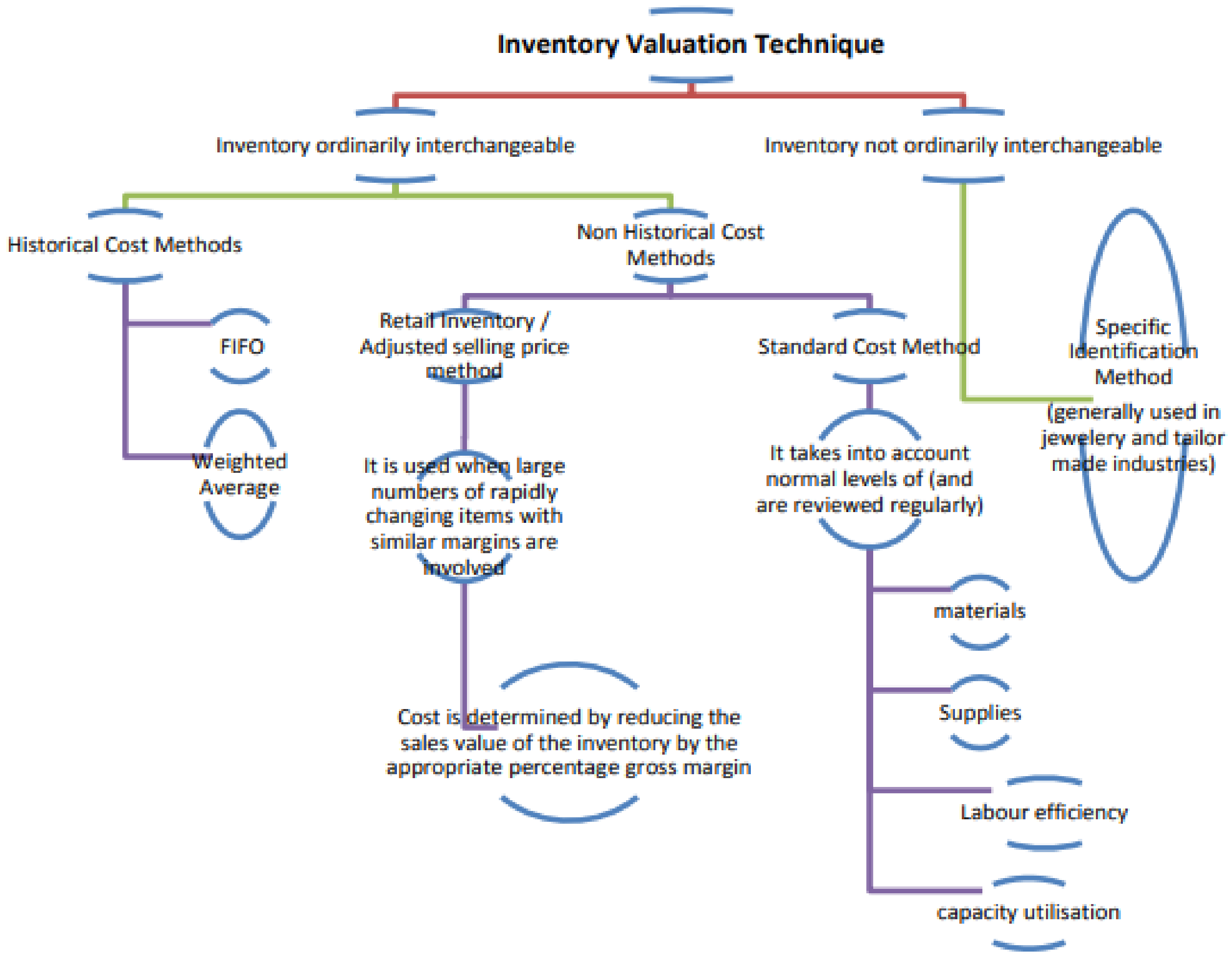
In a manufacturing process of Mars ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing Stock 31/3/2011
Raw Material	14500	150000	MP I-5,000 units	250
Wages	-	90000	MP II-4,000 units	100
Fixed Overhead	-	65000	BP- 2,000 units	
Variable Overhead	-	50000		

Average market price of MP1 and MP2 is Rs 60 per unit and Rs 50 per unit respectively, by- product is sold @ Rs 20 per unit. There is a profit of Rs 5,000 on sale of by-product after incurring separate processing charges of Rs. 8,000 and packing charges of Rs 2,000, Rs 5,000 was realised from sale of scrap.

Required: Calculate the value of closing stock of MP1 and MP2 as on 31-03-2011.

4) Cost Formulas :



Question 10 – Mars Fashions

Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

(a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department. The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

(b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the head office factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Question 11 – FIFO and Weighted Average Method

Particulars	Units available	Units sold	Actual Cost/unit (Rs.)	Actual Total Cost (Rs.)
Opening inventory	100	-	2.1	210
Sale	-	75	-	-
Purchases	150	-	2.8	420
Sale	-	100	-	-
Purchase	50	-	3	150
Total	300	175	-	780

Solution:

FIFO Method:

Cost of Goods Sold: 100 units x Rs. 2.10 + 75 units x Rs. 2.80 = Rs. 420

Closing Inventory: 50 units x Rs. 3.00 + 75 units x Rs. 2.80 = Rs. 360

Weighted Average Method:

Weighted average cost / unit: 780 units / Rs. 300 = Rs. 2.60

Cost of Goods Sold: 175 units x Rs. 2.60 = Rs. 455

Closing Inventory: 125 units x Rs. 2.60 = Rs. 325

Note: Weighted average method in practice is a moving average so computed after each purchase made and so sales are costed at most recent averages.

Cost of Goods Sold:

75 units @ Rs. 2.10 and 100 units @ Rs. 2.70 i.e. total cost = Rs. 427.50

Closing Inventory: 125 units x Rs. 2.82 = Rs. 352.50

Question 12

Whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it.

Question 13 – Mercury Ltd.

Mercury Ltd. uses a periodic inventory system. The following information relates to 2011 -2012

Date	Particulars	Unit	Cost P.U	Total Cost
April	Inventory	200	10	2000
May	Purchase	50	11	550
Sept	Purchase	400	12	4800
Feb	Purchase	350	14	4900
	Total	**1000**		**12250**

Physical inventory at 31.03.2012 400 units. Calculate ending inventory value and cost of sales using: (a) FIFO (b) Weighted Average.

Question 14

Whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?

(a) Costs of completion of work-in-progress;

(b) Trade discounts expected to be allowed on sale; and

(c) Cash discounts expected to be allowed for prompt payment

Question 15 – ABC Ltd.

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of Rs. 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was Rs. 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of Rs. 15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value and inventory write-down (loss) amount.

Question 16 – Company P

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of Rs. 10 per unit. The current market price is Rs. 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at Rs. 11 per unit, which cannot be settled net. Estimated incremental selling cost is Rs. 1 per unit.

Determine Net Realisable Value (NRV) of the inventory of Company P.

Question 17 – A business

A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

			Rs.
	Cost	Estimated Sales price	Selling costs
Inventory item A1	8,000	7,800	500
Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150

Determine the value of closing inventory in the financial statements of a business.

Question 18

Particulars		**Kg.**	**Rs.**
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was Rs. 20 per kg and the replacement cost for the raw material was Rs. 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

Question 19 – Sun Pharma Limited

Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The Cost and Net realizable value is given as follows:

Item	Cost	Net Realisable Value
A	2,000	1,900

B	5,000	5,100
C	4,400	4,550
D	3,200	2,990
Total	14,600	14,540

Determine the value of Inventories:

a. On an item by item basis

b. On a group basis

3. RECOGNITION AS AN EXPENSE :

1) The amount of inventories recognised as an expense in the period will generally be:
   a) carrying amount of the inventories sold in the period in which related revenue is recognised; and
   b) the amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs; reduced by the amount of any reversal in the period of any write-down of inventories, arising from an increase in net realisable value shall be recognized as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.
2) Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset through charging of depreciation on that asset.

4. SELF PRACTICE QUESTIONS :

Question 20 – UA Ltd.

UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

Question 21 – Sun Ltd.

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31.3.20X3 are as follows:

Solar power panel (WIP)	Rs. 85 lakhs
Solar power panel (finished products)	Rs. 55 lakhs
Sundry Debtor (solar power panel)	Rs. 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Question 22 – ABC

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were approved by the Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million.

What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2

Question 23

The following is relevant information for an entity:

- Full capacity is 10,000 labour hours in a year.
- Normal capacity is 7,500 labour hours in a year.
- Actual labour hours for current period are 6,500 hours.
- Total fixed production overhead is Rs. 1,500.
- Total variable production overhead is Rs. 2,600.
- Total opening inventory is 2,500 units.
- Total units produced in a year are 6,500 units.
- Total units sold in a year are 6,700 units.
- The cost of inventories is assigned by using FIFO cost formula.

How overhead costs are to be allocated to cost of goods sold and closing inventory?

Question 24 – Sharp Trading Inc.

Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

(a) Cost of purchases (based on vendors' invoices) 5,00,000

(b) Trade discounts on purchases 10,000

(c) Import duties 200

(d) Freight and insurance on purchases 250

(e) Other handling costs relating to imports 100

(f) Salaries of accounting department 15,000

(g) Brokerage commission payable to indenting agents for arranging imports 300

(h) Sales commission payable to sales agents 150

(i) After-sales warranty costs 600

Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Question 25

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts. On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for Rs. 5,50,000, including Rs. 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of Rs. 5,55,000 (including Rs. 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer.

Design costs included:

- cost of external designer = Rs. 7,000; and
- labour = Rs. 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of Rs.. 3,000 recovered from the sale of the scrapped output = Rs. 21,000;
- labour = Rs. 11,000; and
- depreciation of plant used to perform the modifications = Rs. 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = Rs. 55,000;
- labour = Rs. 65,000; and

- depreciation of plant used to manufacture the customised corporate gifts = Rs. 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

Thanks ….

CHAPTER

4

IND AS 16 – PROPERTY, PLANT & EQUIPMENT

CONCEPTS COVERED

1. DEFINITIONS
2. RECOGNITION
3. MEASUREMENT
   - INITIAL MEASUREMENT
   - SUBSEQUENT MEASUREMENT
4. DEPRECIATION
5. IMPAIRMENT
6. DERECOGNITION
7. SELF PRACTICE QUESTIONS

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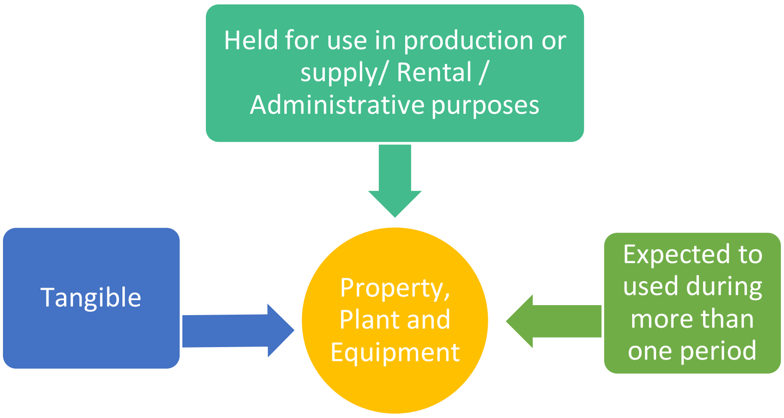
1. DEFINITIONS :

1. Property, Plant and Equipment :
   (b) are the tangible items that
   (b) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
   (c) are expected to be used during more than one period



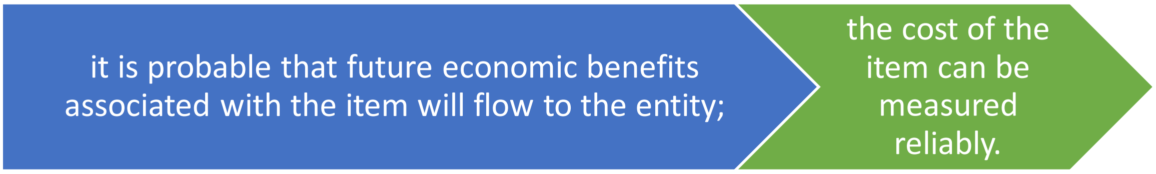
2. A **bearer plant** is a living plant that:
   (a) is used in the production or supply of agricultural produce;
   (b) is expected to bear produce for more than one period; and
   (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

2. RECOGNITION :

The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

A. it is probable that future economic benefits associated with the item will flow to the entity; and

B. the cost of the item can be measured reliably.



Spare parts, stand-by equipment and servicing equipment :

Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Aggregation of individually insignificant items :

This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.

Initial Cost :

Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets.

Repair and Maintenance :

An entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts.

Replacement Parts :

- Under the recognition principle, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard.

Major inspections and Overhauls :

- When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied.

Question 1 – RM acquired

RM acquired an aircraft for Rs.1.5 crore on 1.4.2018. It has a life of 15 years. RM is required to get the aircraft inspected every 3 years to check its travel worthiness. On 1.4.2018, it carried out inspection at a cost of Rs.60,00,000. On 1.4.2021, its incurred Rs.75,00,000 as the cost of new inspection. Show treatment

Question 2 – A shipping company

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul.

A ship which cost Rs.15 million with a 20 year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is Rs.5 million.

Explain how the asset shall be Capitalised and Depreciated for year 1 to 5.

Question 3 –

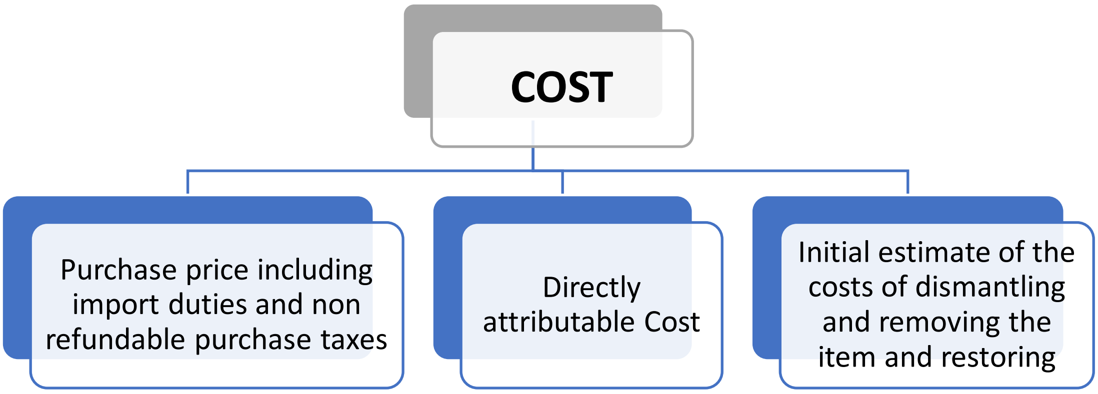
Assuming actual overhaul costs incurred at the end of year 5 are Rs 6 million. Explain the treatment for the cost incurred and depreciation for year 6 to 10.

3. MEASUREMENT :

1. INITIAL MEASUREMENT :

An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost.

COMPONENT OF COST :



Question 4

The purchase price of the machine is Rs.1,10,000. Other cost are as follows : Freight Rs.2000, Import duty Rs.5000. Installation Expenses Rs.1000. This are all initial cost. What will be the cost of the machinery.

Question 5

The purchase price of the machinery is Rs.110,000. The basic price is 1,00,000 + 10,000 Vat. The entity get the credit of VAT paid on the machinery, while calculating the tax payable on the finished goods sold. What will be the cost of machinery?

Cost of self-constructed asset :

Ind AS 23, Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self constructed item of property, plant and equipment.

Question 6 – An entity

An entity constructs a building for its own use. It spends Rs.50 million for material (Rs.2 million of it was lost in a fire) and Rs.5 million on wages and other direct expenses for constructing the building, it uses borrowed cost of Rs.30 million on which it pays interest of Rs.3 million upto the date of completion of construction. What is the amount to be recognised as cost construction.

Question 7 – RM Ltd.

RM Ltd purchased a plant for Rs.200 million. The seller granted rebate of 0.5%. The gross price includes GST Rs.18 million for which the buyer will get tax refund. It has also incurred Rs.15 million for transport, Rs.5 million for installation and Rs.3 million for testing and professional fees.

It has earned Rs.0.2 million from selling goods produced out of testing. The company borrowed Rs.100 million for financing new plant at 10%. The entire process of purchase to make it operational took 15 months.

The company earned Rs.0.1 million from short term parking of money borrowed pending payment to supplier and meeting all costs.

What should be initial cost of the plant ?

Cost of dismantling, removal and site restoration :

Cost incurred by an entity in respect of obligation for dismantling, removing and restoring the site on which an item of property, plant and equipment is located are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

PPE A/c	Dr	XXX	
To Provision for Decommissioning Expenses			XXX

Question 8 – SK Ltd.

SK Ltd set up fire safety devices around its factory premises. The price paid for devices is Rs.1,10,000 (Including tax of Rs.10,000). The entity gets credit on VAT.

Additional cost are Freight Rs.2000, Import Duty Rs.5000 (No refund), installation expense of Rs.1000. The initial expense of dismantling and removing was Rs.3000. After the machinery was put to use Rs.1500 was spent for maintenance.

Calculate the initial cost of the asset.

Question 9 – RM Mining Ltd

RM Mining Ltd. has projected site restoration expenses of Rs.1,57,04,710 after 40 years. The rate of Discount is 11%. Pass journal entry at initial recognition.

Question 10 – Entity A

Entity A has existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facility to another temporary site. The following incremental cost will be incurred.

1. Setup cost of Rs.5,00,000 to install machinery in new Location

2. Rent of Rs.15,00,000
3. Removal Cost of Rs.3,00,000 to transport machinery from old location to the temporary location.

Can this cost be capitalised in cost of new building.

Question 11 – SM Ltd.

SM Ltd. which operates a major chain of super markets has acquired a new store location.

The new location requires significant renovation expenditure. Management expects that the renovation will last for 3 months during which the super market will be closed.

Management has prepared the budget for this period including

Expenditure relating to construction and remodelling cost

Salaries of the staff who will be preparing the store before its opening and related utilities cost.

What will be treatment of such expenditure?

Question 12 – Moon Ltd.

Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market.

Particulars	Rs 000's (cost incurred)
Site Preparation costs	150
Direct Material	2000
Direct Labour Cost, including 10,000 incurred during an industrial strike	1160
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	450
General overheads	550
Estimated Costs to dismantle (at present value)	200

Determine the cost that should be capitalised.

Deferred payment beyond normal credit terms :

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

Question 13

The purchase price of the machinery is Rs.40,000. The company did not have enough cash, and therefore agreed to pay a year later. However they will pay Rs.45,000. What shall be the treated with reference to the above arrangement.

Question 14 – On 1st April, 2011

On 1st April, 2011, an item of property is offered for sale at Rs.10 million, with payment terms being three equal instalments of Rs.33,33,333 over a two years period (payments are made on 1st April, 2011, 31st March, 2012 and 31st March, 2013). The property developer is offering a discount of 5 percent (i.e. Rs.0.5 million) if payment is made in full at the time of completion of sale. Implicit interest rate of 5.36 percent p.a. Show how the property will be recorded in accordance of Ind AS 16.

Exchange of Assets :

A. One or more items of property, plant and equipment may be acquired in exchange for a nonmonetary asset or assets, or a combination of monetary and nonmonetary assets. The cost of such an item of property, plant and equipment is measured at fair value (even if an entity cannot immediately derecognise the asset given up) unless:

   1. the exchange transaction lacks commercial substance; or
   2. the fair value of neither the asset received nor the asset given up is reliably measurable.

B. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Question 15 – DM Ltd.

DM Ltd. purchases a Machinery in exchange of Motor Car B. Motor car B has a book Value of Rs.1,50,000. Fair Value of car given up is Rs.1,70,000. Fair value of Machine is Rs.1,80,000. Fair value of Machinery is more evidently known. Journalise.

Question 16 – VP Ltd.

VP Ltd purchases a Machinery by issuing 1000 shares of Rs.100 each. The fair value of Machine is Rs.1,50,000. Journalise.

Question 17 – Pluto Ltd.

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of Rs 10 million. The fair value of such asset is Rs 15 million. It exchanges the land and building for a private jet, which has a fair value of Rs 18 million, and pays additional Rs 3 million in cash.

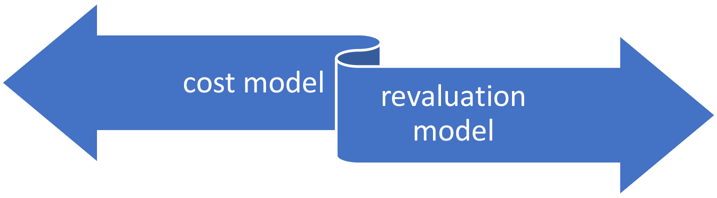
Show the necessary treatment as per Ind AS 16.

Question 18 – Fill in the blanks

Possible Situation	1	2	3	4
Fair Value of Asset acquired	12 (More evident)	Not evident	12	Not Measured at Fair Value
Fair Value of Asset Given up	10	10	Not Evident	Not Measured at Fair Value
Carrying Amount	8	8	8	8
Cost is Measured at	?	?	?	?
Profit / Loss	?	?	?	?

2 SUBSEQUENT MEASUREMENT :

An entity may choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment.



Method to Revalue :

When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

A. the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

B. the accumulated depreciation is eliminated against the gross carrying amount of the asset.

Question 19 – Jupiter Ltd.

Jupiter Ltd. has an item of plant with an initial cost of Rs.100,000. At the date of revaluation accumulated depreciation amounted to Rs.55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be Rs.65,000. Find out the entries to be passed?

Revaluation to be made for entire class of assets :

If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations.

The following are examples of separate classes:

Separate Classes								
Land	Land and Building	Machinery	Ships	Aircraft	Motor Vehicles	Furniture & Fixtures	Office Equipment	Bearer Plants

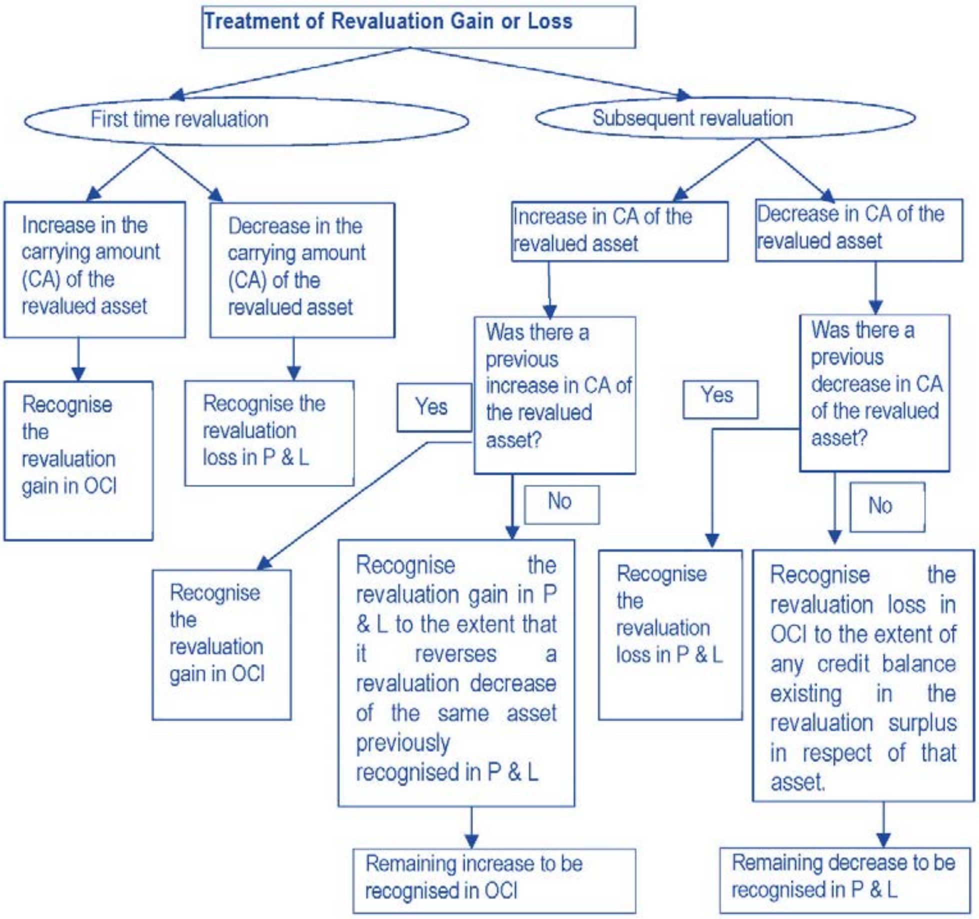
Question 20 – XYZ Ltd.

XYZ Ltd. purchased a land at 50000. Professional valuer have at Rs.70,000. Journalise.

Question 21 – Venus Ltd.

Venus Ltd. is a large manufacturing group. It owns a considerable number of industrial buildings, such as factories and warehouses, and office buildings in several capital cities. The industrial buildings are located in industrial zones whereas the office buildings are in central business districts of the cities. Venus's Ltd. management wants to apply the Ind AS 16 revaluation model to subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. Is this acceptable under Ind AS 16, Property, Plant and Equipment?

Treatment of surplus or deficit arising on revaluation :



Question 22 – An item of PPE

An item of PPE was purchased for Rs.9,00,000 on 1st April, 2011. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1st April, 2013, the asset is revalued to Rs.9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes.
Show the necessary treatment as per Ind AS 16.

4. DEPRECIATION :

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include:

1. Straight-line depreciation method results in a constant charge over the useful life if the asset's residual value does not change.
2. Diminishing balance method results in a decreasing charge over the useful life.
3. Units of production method results in a charge based on the expected use or output.

The depreciation method applied to an asset is reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. **Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8 i. change is accounted for prospectively**

Question 23 – Nish Ltd.

Nish Ltd., a steel manufacturer industry commissioned a power plant at its steel plant at a cost of Rs.700 crore. The cost break up of Rs.700 crore is as follows

Component	Cost (in Rs crore)	Useful life
Erection, fabriation & construction of building structure	100	30
Electrical panels	50	10
Plant & Equipment (boiler, Turtine, generator, condenser etc)	500	40
Transformer grids	50	10

Calculate depreciation residual value may be assumed to be 5%.

RESIDUAL VALUE AND USEFULL LIFE :

The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Question 24 – An asset

An asset which cost Rs.10,000 was estimated to have a useful life of 10 years and residual value Rs.2000. After two years, useful life was revised to 4 remaining years. Calculate the depreciation charge.

Commencement of Depreciation :

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Cessation of depreciation :

- Depreciation of an asset ceases at the earlier of:
  - a) the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105.
  - b) and the date that the asset is derecognised.
- Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

Question 25 – An entity

An entity acquired an asset 3 years ago at a cost of Rs.5 million. The depreciation method adopted for the asset was 10 percent reducing balance method. At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits. Show the necessary treatment in accordance of Ind AS 16.

5. IMPAIRMENT :

To determine whether an item of property, plant and equipment is impaired, an entity applies Ind AS 36, Impairment of Assets. Ind AS 36 explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

6. DERECOGNITION :

- The carrying amount of an item of property, plant and equipment should be derecognised:
  1. on disposal; or
  2. when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.

Question 26 – WDV

WDV of the item of PPE is 10,00,000. The asset is sold for Rs.12,00,000 during 2016. However the buyer will the proceeds after 1 year. The discounting rate is 10%. How should it be accounted as per IND AS 16.

7. SELF PRACTICE QUESTIONS :

Question 27 – MS Ltd.

MS Ltd. has acquired a heavy machinery at a cost of Rs.1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is Rs.45,00,000. The discount rate assumed is 5%.

Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

Question 28 – XYZ Ltd.

On April 1, 2018, XYZ Ltd. acquired a machine under the following terms:

	Rs.
List Price of the Asset	80,00,000
Import Duty	5,00,000
Delivery Fees	1,00,000
Electrical installation Costs	10,00,000
Pre-production costs	4,00,000
Purchase of a five year maintenance contract with vendor	7,00,000

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on April 20, 2018. At what cost the asset will be recognised?

Question 29 – KBC Ltd.

The term of an operating lease allows a tenant, KBC Ltd. to tailor the property to meet its specific needs by building an additional internal wall, but on condition that the tenant returns the property at the end of the lease in its original state. This will entail dismantling the internal wall. KBC Ltd. incurs a cost of Rs.25,00,000 on building the wall and present value of estimated cost to dismantle the wall is Rs.10,00,000. At what value should the leasehold improvements be capitalised in the books of KBC Ltd.

Question 30 – X Ltd.

X Limited started construction on a building for its own use on April 1, 2010. The following costs are incurred:

	Rs.
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000
General overheads	1,00,000

Other relevant information: Material costing Rs.1,00,000 had been spoiled and therefore wasted and a further Rs.1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 2010 and it is estimated that Rs.22,000 of the labour cost relate to that period. The building was completed on January 1, 2011 and brought in use April 1, 2011. X Limited had taken a loan of Rs.40,00,000 on April 1, 2010 for construction of the building (which meets the definition of qualifying asset as per Ind AS 23). The loan carried an interest rate of 8% per annum and is repayable on April 1, 2012.

Calculate the cost of the building that will be included in tangible non-current asset as an addition?

Question 31 – XYZ Ltd.

XYZ Ltd. purchased an asset on January 1, 2010, for Rs.1,00,000 and the asset had an estimated useful life of ten years and a residual value of nil. The company has charged depreciation using the straight-line method at Rs.10,000 per annum. On January 1, 2014, the management of XYZ Ltd. Reviews the estimated life and decides that the asset will probably be useful for a further four years and, therefore, the total life is revised to eight years. How should the asset be accounted for remaining years?

Question 32 – Sun Ltd.

On 1st April, 2011, Sun Ltd purchased some land for Rs.10 million (including legal costs of Rs.1 million) in order to construct a new factory. Construction work commenced on 1st May, 2011.

Sun ltd incurred the following costs in relation with its construction:

– Preparation and levelling of the land – Rs.3,00,000.
– Purchase of materials for the construction – Rs.6·08 million in total.
– Employment costs of the construction workers – Rs.2,00,000 per month.
– Overhead costs incurred directly on the construction of the factory – Rs.1,00,000 per month.

– Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – Rs.50,000 per month.

– Income received during the temporary use of the factory premises as a car park during the construction period – Rs.50,000.

– Costs of relocating employees to work at the new factory – Rs.300,000.

– Costs of the opening ceremony on 31st January, 2011 – Rs.150,000.

The factory was completed on 30th November, 2011 and production began on 1st February, 2012. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be Rs.20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs.1 payable in 40 years' time at an annual discount rate of 8% is Rs.4.6.

The construction of the factory was partly financed by a loan of Rs.17·5 million taken out on 1st April, 2011. The loan was at an annual rate of interest of 6%. During the period 1st April, 2011 to 31st August, 2011 (when the loan proceeds had been fully utilised to finance the construction), Sun Ltd received investment income of Rs.100,000 on the temporary investment of the proceeds.

Required:

Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 2012. You should explain your treatment of all the amounts referred to in this part in your answer.

Question 33 – ABC Ltd.

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	Rs.25,00,000
2.	Initial delivery and handling costs	Rs.2,00,000
3.	Cost of site preparation	Rs.6,00,000
4.	Consultants used for advice on the acquisition of the plant	Rs.7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	Rs.2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	Rs.3,00,000
7.	Operating losses before commercial production	Rs.4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

Question 34 – A Ltd.

A Ltd. has an item of plant with an initial cost of Rs.2,00,000. At the date of revaluation, accumulated depreciation amounted to Rs.110,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be Rs.140,000.

Pass Journal Entries with regard to Revaluation?

Question 35 – B Ltd.

B Ltd. owns an asset with an original cost of Rs.2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be Rs.20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to Rs.10,000. How would the above changes in estimates be made by B Ltd.?

Question 36 – X Ltd.

X Ltd. has a machine which got damaged due to fire as on January 31, 20X1. The carrying amount of machine was Rs.1,00,000 on that date. X Ltd. sold the damaged asset as scrap for Rs.10,000. X Ltd. has insured the same asset against damage. As on March 31, 2011, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of Rs.50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?

Question 37 – A Ltd.

A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	Rs. 15,000,000	15 years
Plant and machinery	Rs. 10,000,000	10 years
Furniture and fixtures	Rs. 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

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

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5.

Question 38 – Mr. X

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:-

The notes to the financial statements state that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. How should the finance controller respond to the query from the managing director?

Question 39 – Company X

Company X performed a revaluation of all of its plant and machinery at the beginning of 20X1. The following information relates to one of the machinery:

	Amount ('000)
Gross carrying amount	Rs. 200
Accumulated depreciation (straight-line method)	(Rs. 80)
Net carrying amount	Rs. 120
Fair value	Rs. 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of 4 years.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.

Question 40 – An entity

An entity has the following items of property, plant and equipment:

- Property A — a vacant plot of land on which it intends to construct its new administration headquarters;
- Property B — a plot of land that it operates as a landfill site;

- Property C — a plot of land on which its existing administration headquarters are built;
- Property D — a plot of land on which its direct sales office is built;
- Properties E1–E10 — ten separate retail outlets and the land on which they are built;
- Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;
- Equipment B — point of sale computer systems in each of its retail outlets;
- Furniture and fittings in its administrative headquarters and its sales office;
- Shop fixtures and fittings in its retail outlets.

How many classes of property, plant and equipment must the entity disclose?

Question 41 – Heaven Ltd.

Heaven Ltd. had purchased a machinery on 1.4.2X01 for Rs. 30,00,000, which is reflected in its books at written down value of Rs. 17,50,000 on 1.4.2X06. The company has estimated an upward revaluation of 10% on 1.4.2X06 to arrive at the fair value of the asset. Heaven Ltd. availed the option given by Ind AS of transferring some of the surplus as the asset is used by an enterprise.

On 1.4.2X08, the machinery was revalued downward by 15% and the company also re-estimated the machinery's remaining life to be 8 years. On 31.3.2X10 the machinery was sold for Rs. 9,35,000. The company charges depreciation on straight line method. Prepare machinery account in the books of Heaven Ltd. over its useful life to record the above transactions.

Thanks ....

CHAPTER

5

IND AS 40 – INVESTMENT PROPERTY

CONCEPTS COVERED

1. DEFINITIONS
2. CLASSIFICATION OF PROPERTY AS INVESTMENT PROPERTY & OWNER OCCUPIED PROPERTY
3. RECOGNITION
4. MEASUREMENT
5. MEASUREMENT AFTER RECOGNITION
6. TRANSFERS
7. DISPOSALS
8. SELF PRACTICE QUESTIONS

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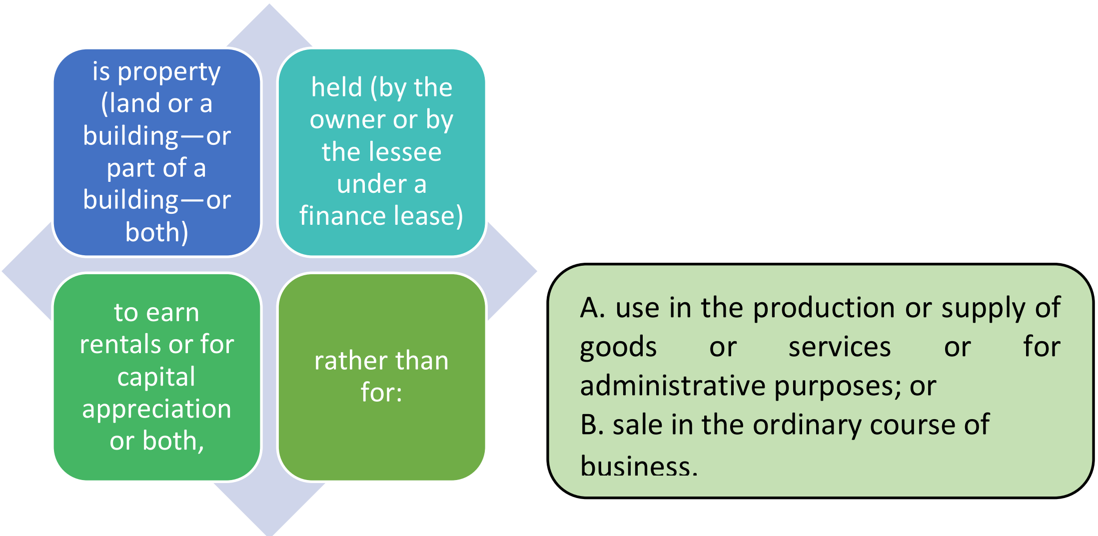
1. DEFINITIONS :

1. INVESTMENT PROPERTY :

Investment property

- is property (land or a building—or part of a building—or both)
- held (by the owner or by the lessee under a finance lease)
- to earn rentals or for capital appreciation or both,
- rather than for:
  - a) use in the production or supply of goods or services or for administrative purposes; or
  - b) sale in the ordinary course of business.



2. PROPERTY, PLANT AND EQUIPMENT :

A. are the tangible items that

B. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

C. are expected to be used during more than one period

3. OWNER-OCCUPIED PROPERTY :

Owner occupied property is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

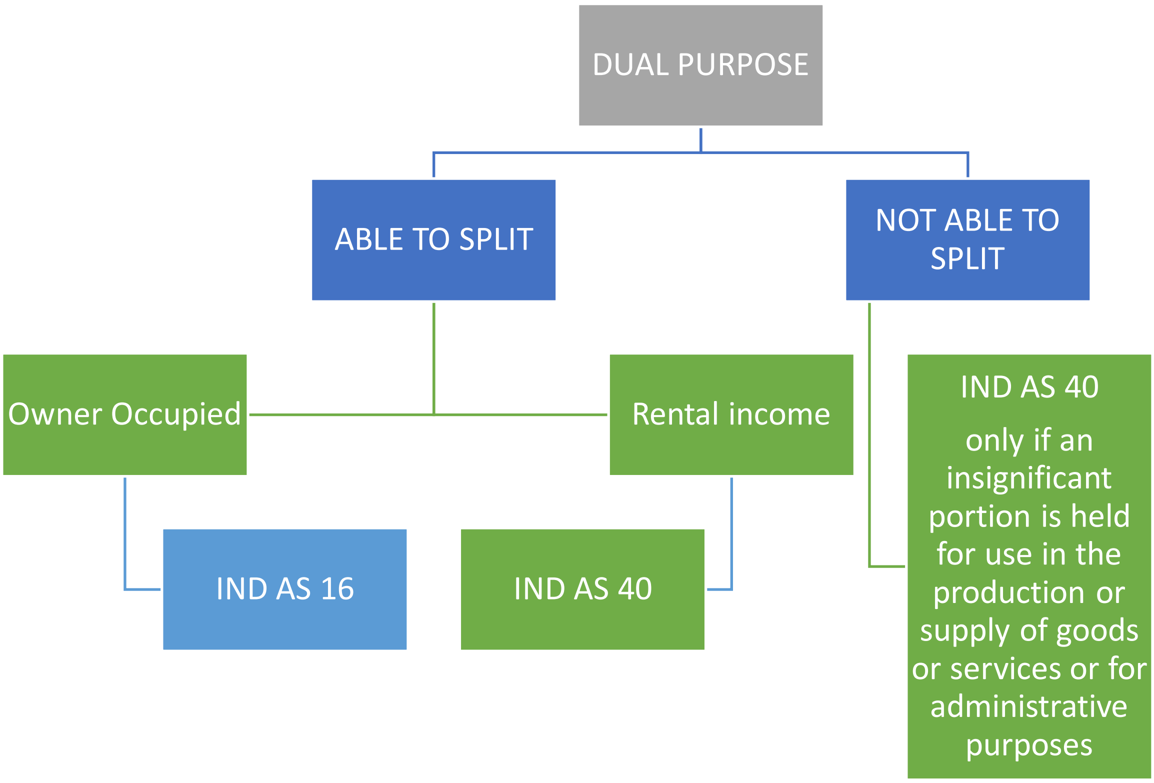
4. FAIR VALUE :

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

2. CLASSIFICATION OF PROPERTY AS INVESTMENT PROPERTY & OWNER OCCUPIEDPROPERTY :

INVESTMENT PROPERTY	NOT AN INVESTMENT PROPERTY
Land held for long-term capital appreciation	Property intended for sale in the ordinary course of business (IND AS 2)
Land held for a currently undetermined future use.(if the entity is undecided it is assumed that its currently held for capital appreciation)	Property in the process of construction or development for sale in ordinary course of business (IND AS 2)
A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.	Owner-occupied property, including property held for future use as owner occupied property. (IND AS 16)
A building that is vacant but is held to be leased out under one or more operating leases.	Property held for future development and subsequent use as owner occupied property (IND AS 16)
Property that is being constructed or developed for future use as investment property.	Property occupied by employees (whether or not the employees pay rent at market rates) (IND AS 16)
	Property leased to another entity under a finance lease (IND AS 17)

PROPERTY HELD FOR ONE OR MORE PURPOSE :



Question 1 – Sun Ltd.

Sun Ltd. owns a building having 15 floors of which it uses 5 floors for its office; the remaining 10 floors are leased out to tenants under operating leases. According to law company could sell legal title to the 10 floors while retaining legal title to the other 5 floors.
Explain how shall the property be classified?

Question 2 – Moon Ltd.

Moon Ltd. uses 35% of the office floor space of the building as its head office. It leases the remaining 65% to tenants, but it is unable to sell the tenant's space or to enter into finance leases related solely to it. Head office can't be shifted and is significant to the overall operation of the firm.
Can the above property be classified as Investment Property as per IND AS 40?

Question 3 – An entity

An entity owns a hotel, which includes a health and fitness centre, housed in a separate building that is part of the premises of the entire hotel. The owner operates the hotel and other facilities on the hotel with the exception of the health and fitness centre, which can be sold or leased out under a finance lease. The health and fitness centre will be leased to an independent operator. The entity has no further involvement in the health and fitness centre.
Explain how the above assets can be classified as per IND AS 40.

ANCILLARY SERVICES :

In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole.
If the services provided are significant than the entity should treat the property as owner occupied property and account for it as per IND AS 16

Question 4 – The owner

The owner of an office building provides security and maintenance services to the lessees who occupy the building. Can this be treated as Investment property?

Question 5

If an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Can this be treated as Investment property?

Question 6

No.	Property	Does it meet definition of Investment Property	Which Ind AS is Applicable
1	Owned by a Co and leased out under an Operating Lease		
2	Held Under Finance Lease and Leased out under an Operating Lease		
3	Held under Finance Lease and Leased out under Finance Lease		
4	Property acquired with a view for development and resale		
5	Property partly owner occupied and partly leased out under Operating Lease		
6	Land held for currently undetermined use		
7	Property occupied by Employees paying rent at less than market rate		
8	Investment Property held for sale		
9	Existing Investment Property that is being redeveloped for continued use as Investment Property		

3. RECOGNITION :

GENERAL RECOGNITION :

Investment property shall be recognised as an asset when, and only when:

a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and

b) the cost of the investment property can be measured reliably.

This general principle is used to consider whether capitalisation is appropriate both in respect of the cost incurred initially to acquire or construct an investment property and costs incurred subsequently to add to, replace part of, or service a property

Question 7 – X Limited

X Limited owns a building which is used to earn rentals. The building has a carrying amount of Rs.50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is Rs.5,00,000. The original walls have a carrying amount of Rs.1,00,000. How X Limited should account for the above costs?

4. MEASUREMENT :

4.1 MEASUREMENT AT RECOGNITION – GENERAL :

An investment property should be measured initially at its cost. Transaction costs are included in the initial measurement.

Question 8 – Netravati Ltd.

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for Rs. 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying Rs. 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at Rs. 5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?

Question 9 – X Limited

X Limited purchased a building for Rs. 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of Rs. 1,00,000 and Rs. 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

(a) Rs. 2,00,000 planning permission.

(b) Rs. 7,00,000 construction costs (including Rs. 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?

4.2 DEFERRED PAYMENTS :

If payment for an investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit.

Question 10 – X Limited

X Limited purchased a land worth of Rs. 1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of Rs.

1,20,00,000. What should be the cost of the building under both the payment methods?

4.3 EXCHANGE OF ASSETS :

The cost of such an investment property is measured at fair value unless:

a) the exchange transaction lacks commercial substance or

b) the fair value of neither the asset received nor the asset given up is reliably measurable.

Question 11 – Sun Ltd.

Sun Ltd. acquired a building in exchange of a warehouse whose fair value is Rs.5,00,000 and payment of cash is Rs.2,00,000. The fair value of the building received by the Company is Rs.8,00,000. The company decided to keep that building for rental purposes. Pass the journal Entry for the above transaction

Question 12 – Y Limited

Y Limited purchased a building for Rs.30,00,000 in May 1, 2011.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of Rs.1,00,000 and Rs.20,000 respectively were incurred in acquiring the building. In 2011-2012, Y Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

Rs.2,00,000 planning permission.

Rs.7,00,000 construction costs (including Rs.40,000 refundable purchases taxes).

The redevelopment was completed and the retail shops were ready for rental on September 2, 2011. What is the cost of building at initial recognition?

Question 13 – Z Limited

Z Limited purchased a land worth of Rs.1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of Rs.1,20,00,000. What should be the cost of the building under both the payment methods?

Question 14 – S Limited

S Limited (as the lessee) has taken a building under finance lease from the owner. It classifies its interest in the leasehold building as investment property and after initial recognition measures the property interest at fair value. The fair value is Rs.50,000. The present value of the minimum lease payment is Rs.40,000. At what value, S Limited will recognise its investment property?

5. MEASUREMENT AFTER RECOGNITION :

ACCOUNTING POLICY :

a. After initial recognition, an entity is required to measures all of its investment property in accordance with Ind AS 16's requirement for cost model

b. If it meets the criteria to be classified as held for sale or are included in a disposal group that is classified as held for sale in accordance with Ind AS 105

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

6. TRANSFERS :

An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use.

a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;

Ind AS 40 $\longrightarrow$ Ind AS 16

b) commencement of development with a view to sale, for a transfer from investment property to inventories;

Ind AS 40 $\longrightarrow$ Ind AS 2

c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

Ind AS 16 $\longrightarrow$ Ind AS 40

d) inception of an operating lease to another party, for a transfer from inventories to investment property.

Ind AS 2 $\longrightarrow$ Ind AS 40

Transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.

Question 15 – Moon Ltd.

Moon Ltd. has purchased a building on 1st April, 2011 at a cost of Rs.10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10 years. Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April, 2015. On this date the fair value of the building is Rs.8 million. Moon ltd uses cost model for accounting of its investment property.

7. DISPOSALS :

1) An investment property should be derecognised (eliminated from the balance sheet)
   a. on disposal or
   b. when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.
2) The disposal of an investment property may be achieved by:
   a. sale or
   b. entering into a finance lease.
3) Gains or losses arising from the retirement or disposal of investment property should be calculated as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in profit or loss (unless Ind AS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

Question 16 – Sun Ltd.

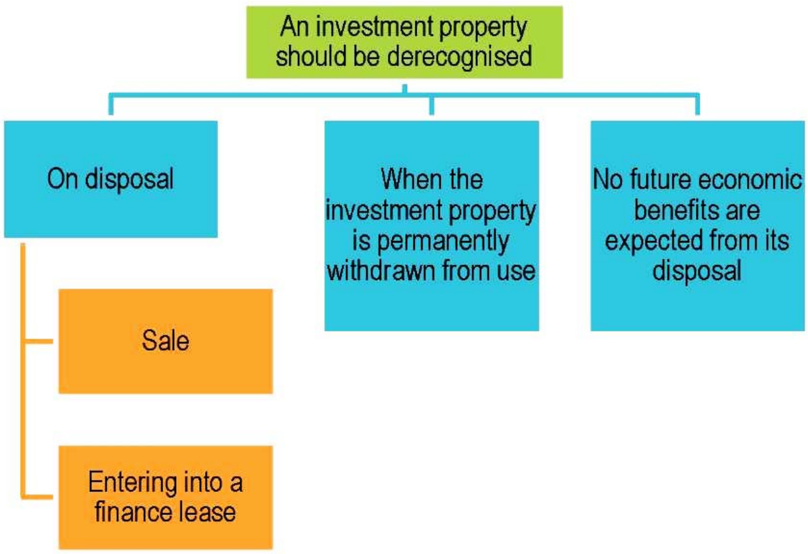
Sun Ltd., an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is Rs.2,00,000.

Case -A

Pluto Ltd. offers to buy the building at Rs.4,00,000.

Case – B

Pluto Ltd. offers to take the building on finance lease for 10 years at a lease rental of Rs.80,000 p.a. The present value of minimum lease payments is Rs.3,20,000.



8. SELF PRACTICE QUESTIONS :

Question 17 – On April 1, 2011

On April 1, 2011 an entity acquired an investment property (building) for Rs.40,00,000. Management estimates the useful life of the building as 20 years measured from the date of acquisition. The residual value of the building is Rs.2,00,000. Management believes that the straight-line depreciation method reflects the pattern in which it expects to consume the building's future economic benefits. What is the carrying amount of the building on March 31, 2012?

Question 18 – T Limited

T Limited has an investment property (building) which is carried in Balance Sheet on March 31, 2011 at Rs.15,00,000. During the year T Limited has stopped letting out the building and used it as its office premise. On March 31, 2011, management estimates the recoverable amount of the building as Rs.10,00,000 and its remaining useful life as 20 years and residual value is nil. How should T Limited account for the above investment property as on March 31, 2011?

Question 19 – X Limited

In financial year 2011-2012, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

On April 1, 2011 - Purchase cost of the property Rs.1,80,00,000.

On April 1, 2011 – Non-refundable transfer taxes Rs.20,00,000 (not included in the purchase cost).

On April 2, 2011- Legal cost related to property acquisition Rs.5,00,000.

On April 6, 2011- Advertisement campaign to attract tenants Rs.3,00,000.

On April 8, 2011 - Opening ceremony function for starting business Rs.1,50,000.

Throughout 2011-2012, incurred Rs.1,00,000 towards day-to-day repair maintenance and other administrative expenses.

X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

How X Limited will account for all the above mentioned expenses in the books of account?

Question 20 – X Ltd

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs. 20,00,000. On 31st March, 20X5, the fair value of the property was Rs. 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was Rs. 2,90,00,000. On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X

Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further Rs. 40,00,000 to complete the project, after which each flat could be sold for Rs. 50,00,000.
Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS.

Question 21 – Shaurya Limited

Shaurya Limited owns a Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.
Following information is relevant for Building A for the year ending 31st March, 20X2:
Building A was initially purchased at the cost of Rs. 10 crores. At that time, the useful life of the building was estimated to be 20 years; out of which 5 years have been expired as on 1st April, 20X1. The company follows straight line method for depreciation.
During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs. 2 crores. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.
Further, during the year 20X1-20X2 the company earned/incurred following direct operating expenditure relating to Building A and Building B:

Rental income from Building A	= Rs. 75 lakhs
Rental income from Building B	= Rs. 25 lakhs
Sales promotion expenses	= Rs. 5 lakhs
Fees & Taxes	= Rs. 1 lakhs
Ground rent	= Rs. 2.5 lakhs
Repairs & Maintenance	= Rs. 1.5 lakhs
Legal & Professional	= Rs. 2 lakhs
Commission and brokerage	= Rs. 1 lakhs

The company does not have any restrictions and contractual obligations against Property - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.
The other key inputs for valuation are as follows:
The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet.

Question 22 – X Ltd.

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1? During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

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

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

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2?

Thanks ….

CHAPTER

6

IND AS 38 – INTANGIBLE ASSETS

CONCEPTS COVERED

1. IDENTIFICATION OF INTANGIBLE ASSETS
    - MEANING OF INTANGIBLE ASSETS
    - IDENTIFICATION
    - ASSETS
2. RECOGNITION OF INTANGIBLE ASSETS
3. MEASUREMENT OF INTANGIBLE ASSETS
4. SUBSEQUENT MEASUREMENT
5. USEFULL LIFE
6. AMORTIZATION METHOD
7. INTANGIBLE ASSET WITH INFINITE USEFUL LIVES
8. IMPAIRMENT
9. RETIREMENT AND DISPOSAL
10. SELF PRACTICE QUESTIONS

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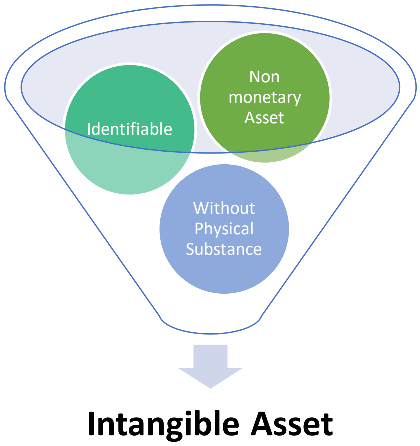
1. IDENTIFICATION OF INTANGIBLE ASSETS :

1.1. MEANING OF INTANGIBLE ASSETS :

An intangible asset is an

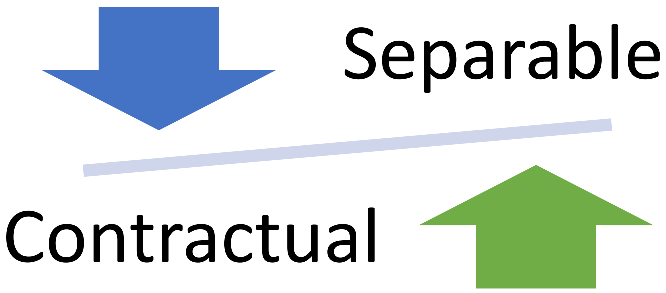
- identifiable
- non-monetary asset without physical substance



Common examples of items encompassed by these broad headings are:

- Computer software
- Patents
- Copyrights
- Motion picture films
- Customer lists
- Mortgage servicing rights
- Fishing licenses
- Import quotas
- Franchises
- Customer or supplier relationships
- Customer loyalty
- Market share and marketing rights.
- Intangible

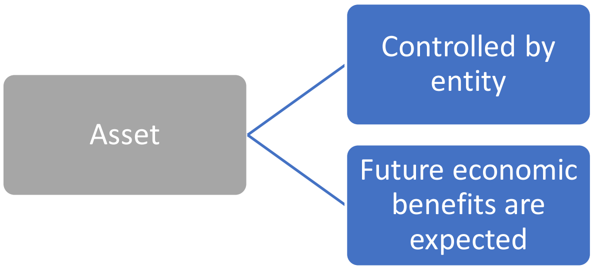
1.2 IDENTIFICATION :



Question 1 – Sun Ltd.

Sun Ltd has an expertise in consulting business. In past years, company has gained a market share for its services of 30 percent and considers recognizing it as an intangible asset. Is the action by company is justified?

1.3 ASSETS :



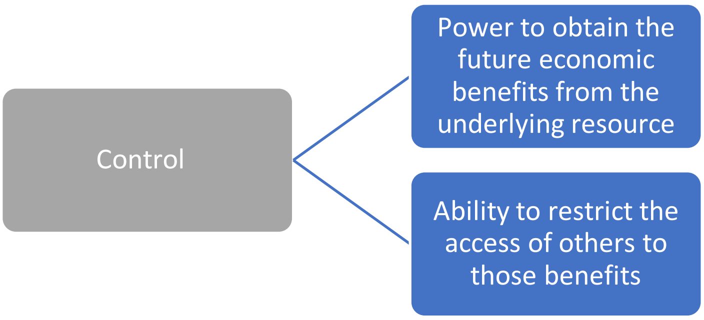
An asset is a

(a) resource:

(b) controlled by an entity

(c) as a result of past events; and

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



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

Question 2 – Company XYZ Ltd.

Company XYZ Ltd. has provided training to its staff on various new topics like GST, Ind AS etc. to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?

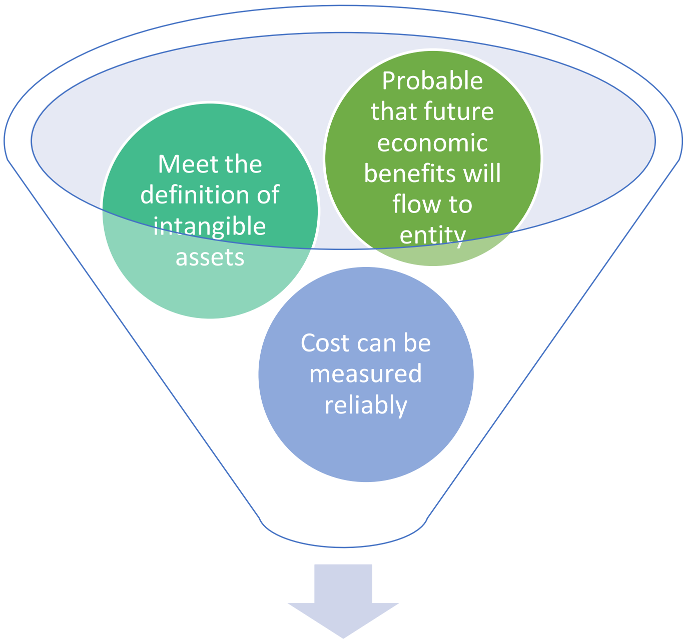
The future economic benefits flowing from an intangible asset may include:

(a) Revenue from the sale of products or services;

(b) Cost savings; or

Other benefits resulting from the use of the asset by the entity.

2. RECOGNITION OF INTANGIBLE ASSETS :



Intangible Asset - Recognition Criteria

Question 3 – Pluto Ltd.

Pluto Ltd. intends to open a new retail store in a new location in the next few weeks. Pluto Ltd has spent a substantial sum on a series of television advertisements to promote this new store. The Company has paid an amount of Rs.800,000 for advertisements before 31st March, 2011. Rs.700,000 of this sum relates to advertisements shown before 31st March, 2011 and Rs.100,000 to advertisements shown in April, 2011. Since 31st March, 2011. The Company has paid for further advertisements costing Rs.400,000. Pluto Ltd is of view that such costs can be carried forward as intangible assets. Since market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of the above costs in the financial statements for the year ended 31st March, 2011

Question 4 – Mercury Ltd.

Mercury Ltd. is preparing its accounts for the year ended 31st March, 2012 and is unsure about how to treat the following items.

(a) The company completed a grand marketing and advertising campaign costing Rs.4.8 lakh. The finance director had authorised this campaign on the basis that it would create Rs.8 lakh of additional profits over the next three years.

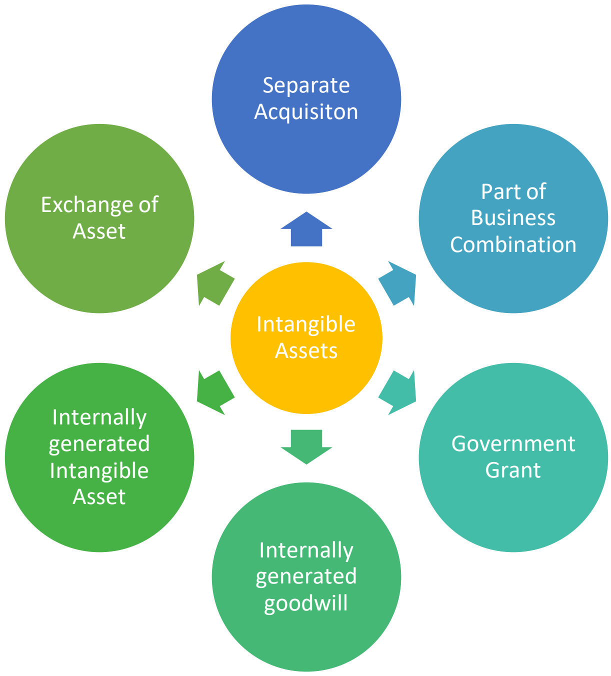
(b) A new product was developed during the year. The expenditure totaled Rs.3 lakh of which Rs.1.5 lakh was incurred prior to 30th September, 2011, the date on which it became clear that the product was technically viable. The new

	product will be launched in the next four months and its recoverable amount is estimated at Rs.1.4 lakh.
(c)	Staff participated in a training programme which cost the company Rs.5 lakh. The training organisation had made a presentation to the directors of the company outlining that incremental profits to the business over the next twelve months would be Rs.7 lakh.

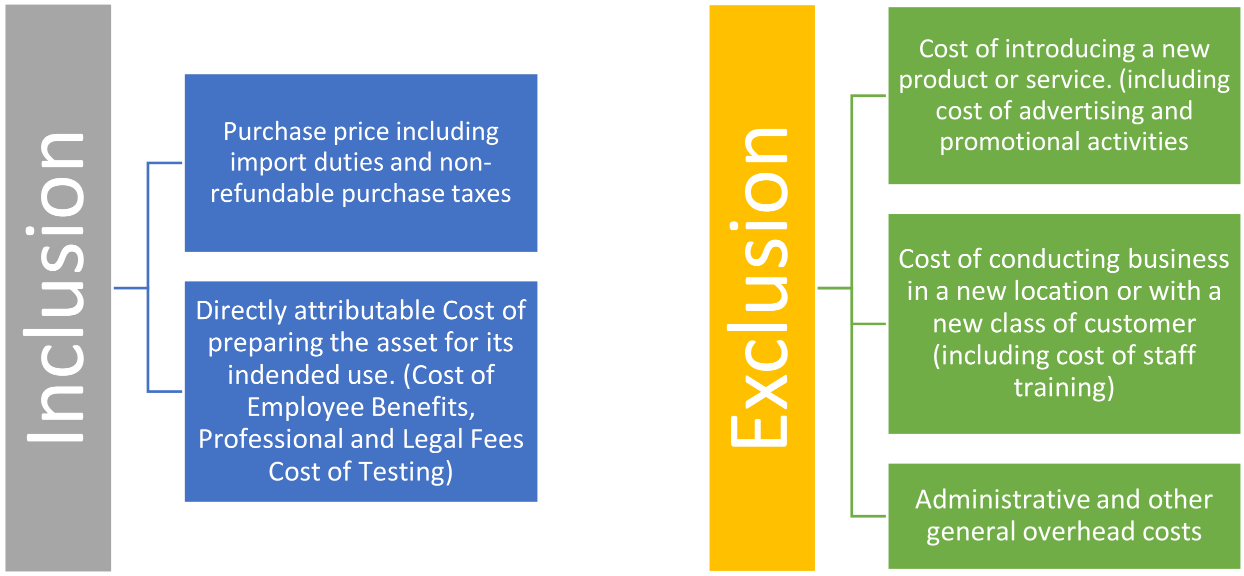
What amounts should appear as intangible assets in accordance with Ind AS 38 and Ind AS 36 in Mercury's balance sheet as on 31st March, 2012?

3. MEASUREMENT OF INTANGIBLE ASSETS :

An intangible asset should be measured initially at cost.



SEPARATE ACQUISITION :



Question 5 – Jupiter Ltd.

Jupiter Ltd. Acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing

1. Costs of new solar technology – 10,00,000
2. Trade discount provided – (1,00,000)
3. Training course for staff in new technology – 50,000
4. Initial testing of new technology – 35,000
5. Losses incurred while other parts of plant shut down during testing and training – 25,000

Calculate the amount of Intangible Asset.

Question 6 – Venus India Private Ltd.

Venus India Private Ltd acquired a software for its internal use costing Rs.10,00,000. The amount payable for the software was Rs.600,000 immediately and Rs.400,000 in one year time. The other expenditure incurred were:-

- Purchase tax : Rs.1,00,000
- Entry Tax : 10% (recoverable later from tax department)
- Legal fees: Rs.87,000
- Consultancy fees for implementation : Rs.1,20,000
- Cost of capital of the company is 10%.

Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

PART OF BUSINESS COMBINATION :

An acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination

If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset.

Question 7 – Business Combination

Business Combination On 31st March, 20X1, Earth India Ltd paid Rs.50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd's. net assets had a fair value of Rs.30,00,000.

In addition, Sun Ltd also held the following rights:

Trade Mark named "GRAND" – valued at Rs.180,000 using a discounted cash flow technique.

Sole distribution rights to an electronic product. Future cash flows from which are estimated to be Rs.150,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.
The 6 year, 10% annuity factor is 4.36.
Calculate goodwill and other Intangible assets arising on acquisition.

GOVERNMENT GRANT :

In accordance with Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, an entity should recognise both the intangible asset and the grant initially at fair value.

EXCHANGE OF ASSETS :

One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets.

1. The cost of such an intangible asset is measured at fair value
2. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

No intangible asset can be recognised unless its cost can be measured reliably. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost. However, if the fair value of the asset received is more clearly evident, then fair value of the asset received is taken up as cost.

Question 8 – Sun Ltd.

Sun Ltd. acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at Rs.5,00,000 in the books of Sun Ltd. The Software is carried at Rs.10,000 in the books of the Earth Ltd which is not the fair value.

Advise journal entries in the following situations in the books of Sun Ltd and Earth Ltd:-

1) Fair value of software is Rs.5,20,000 and fair value of telecommunication license is Rs.5,00,000.
2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at Rs.4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

INTERNALLY GENERATED GOODWILL :

This standard prohibits the recognition of internally generated goodwill as an asset.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

INTERNALLY GENERATED INTANGIBLE ASSET :

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

1. a research phase; and

2. a development phase.

If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research phase :

Expenses should be charged to Profit and Loss A/c

Development Phase :

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:

1. Technical feasibility of completion of Intangible asset to make it available for use or sale
2. Intention to complete the intangible asset and use or sell it
3. Ability to use or sell the intangible asset.
4. How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
5. Adequate resources (like technical, financial or others) to complete the development.
6. Ability to measure reliably the expenditure attributable to the intangible asset during its development.

Question 9 – Venus Ltd.

Venus Ltd. is preparing its accounts for the year ended 31st March, 2012 and is unsure how to treat the following items.

- Company has completed a big marketing and advertising campaign costing Rs.2,40,000. The finance director had authorized this campaign on the basis that it would create Rs.5,00,000 of additional profits over the next three years.
- A new product was developed during the year. The expenditure totaled Rs.1,50,000 of which Rs.1,00,000 was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs.70,000.
- Staff participated in a training programme which cost the company Rs.300,000. The training organization had made a presentation to the directors of Baxter outlining that incremental profits to the business over the next twelve months would be Rs.500,000.

What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 2012?

Question 10 – Venus Ltd.

Development Phase Expenditure on a new production process in 2011-2012:

	Rs.
1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January, 2012. The amount estimated to be recoverable from the process is Rs.1,000.

What is the carrying amount of the intangible asset at 31st March, 2012 and the charge to profit or loss for 2011-2012?

Expenditure incurred in FY 2012-2013 is Rs.6,000.

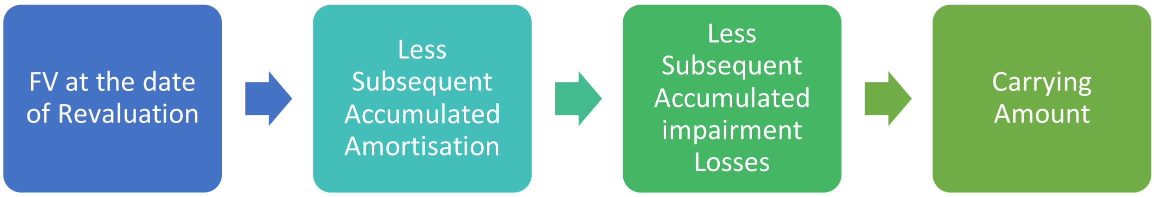
At 31st March, 2013, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs.5,000.

What is the carrying amount of the intangible asset at 31st March, 2013 and the charge to profit or loss for 2012-2013?

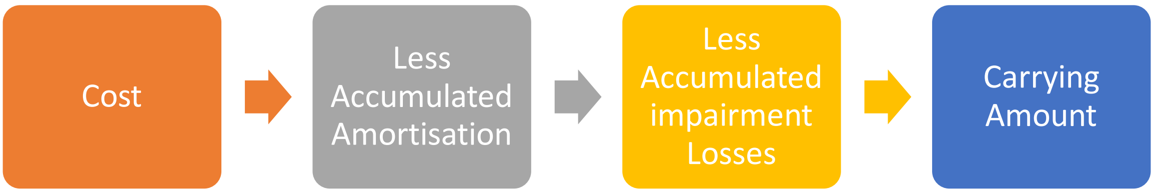
4. SUBSEQUENT MEASUREMENT :

An entity should choose either the **cost model** or the **revaluation model** as its accounting policy.

Revaluation Model : After initial recognition, an intangible asset is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.



Cost Model : After initial recognition, an intangible asset is carried at its cost less any accumulated amortization and any accumulated impairment losses.



Frequency of revaluations :

1. Revaluations should be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

2. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

Question 11 – Saturn Ltd.

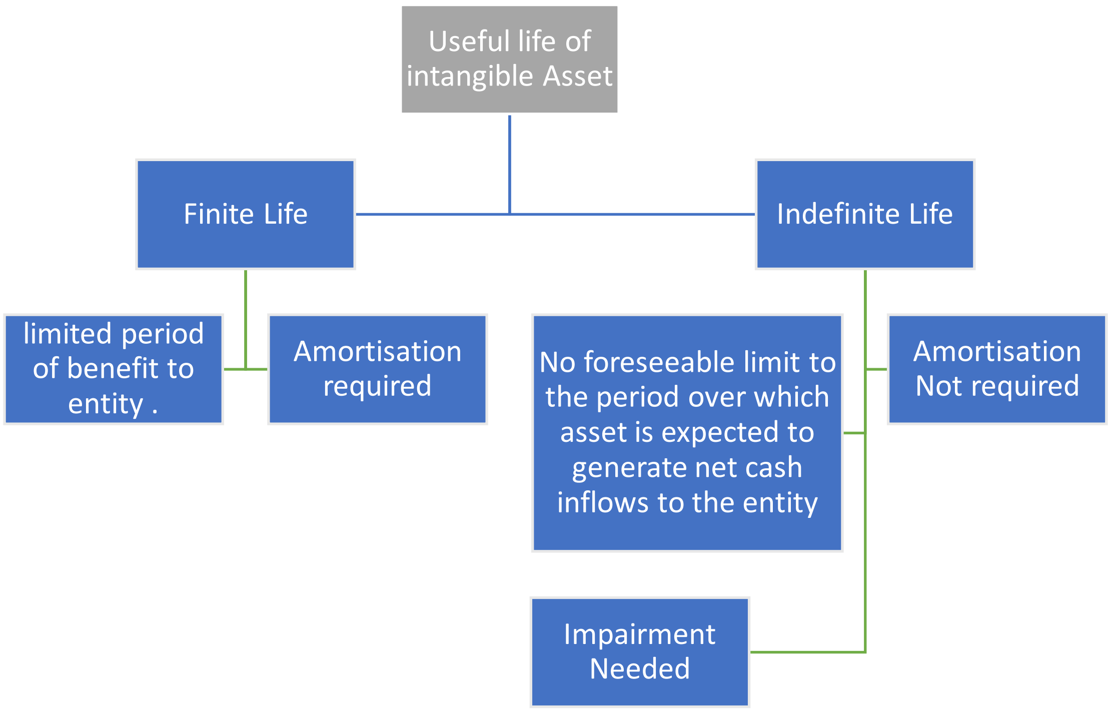
1. Saturn Ltd. acquired an intangible asset on 31st March, 2011 for Rs.1,00,000. The asset was revalued at Rs.1,20,000 on 31st March, 2012and Rs.85,000 on 31st March, 2013.
2. Jupiter Ltd. acquired an intangible asset on 31st March, 2011 for Rs.1,00,000. The asset was revalued at Rs.85,000 on 31st March, 2012 and at Rs.1,05,000 on 31st March, 2013.

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them for ease of understanding.

At 31st March, 2013, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs.5,000.

What is the carrying amount of the intangible asset at 31st March, 2013 and the charge to profit or loss for 2012-2013?

5. USEFULL LIFE :



The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised, and an intangible asset with an indefinite useful life is not amortised and tested for impairment.

6. AMORTIZATION METHOD :

The amortisation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method should be used.

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method.

7. INTANGIBLE ASSET WITH INFINITE USEFULL LIVES :

1. An intangible asset with an indefinite useful life should not be amortised.
2. In accordance with Ind AS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount
   a. annually; and
   b. whenever there is an indication that the intangible asset may be impaired.

8. IMPAIRMENT :

1. To determine whether an intangible asset is impaired, an entity applies Ind AS 36. That Standard explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.
2. For an intangible asset with indefinite useful lives, an impairment review is required at least annually.

9. RETIREMENTS AND DISPOSALS :

1. An intangible asset should be derecognised:
   a. on disposal; or
   b. when no future economic benefits are expected from its use or disposal The disposal of an intangible asset may occur in a variety of ways (e.g. by sale, by entering into a finance lease, or by donation)
2. The gain or loss arising from the derecognition of an intangible asset should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It is to be recognised in profit or loss when the asset is derecognized (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains should not be classified as revenue.

10. SELF PRACTICE QUESTIONS :

Question 12 – X Limited

X Limited engaged in the business of manufacturing fertilisers entered into a technical collaboration agreement with a foreign company Y Limited. As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid Rs.10,00,00,000 for the use of know-how for a period of 5 years. X Limted estimates the production of fertiliser as follows:

Year	(In metric tons)
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.

How will X Limited amortise the technical know-how fees as per Ind AS 38?

Question 13 – Y Ltd.

Y Ltd. purchased a patent right on April 1, 2011, for Rs.3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method. As at April 1, 2012, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of Rs.1,50,000 and decides to amortise over 2 years. As at April 1, 2013, having perfected the related production process, the asset is now appraised at a value of Rs.3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year.

Question 14 – X Pharmaceutical Ltd.

X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4 year license to manufacture a specialised drug at a cost of Rs.1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition the company acquired a brand with a FV of Rs.3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent Rs.1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be Rs.10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.
   Cost incurred (accumulated) till March 31, 2011 is Rs.5,00,00,000.
   Balance cost incurred during the financial year 2011-2012 is Rs.5,00,00,000.

5. It has also commenced developing another drug 'Drug B'. It has incurred Rs.50,00,000 towards research expenses till March 31, 2012. The technological feasibility has not yet been established. How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

Question 15 – X Ltd.

X Ltd. is engaged in the business of publishing Journals. They acquired 50% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of Rs.10,00,00,000 and fair value of net asset acquired is Rs.8,50,00,000. The above purchase consideration includes:

A. Rs.30,00,000 for obtaining the skilled staff of Y Ltd.

B. Rs.50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5 years.

How should the above transactions be accounted for by X Ltd?

Question 16 – Z Ltd.

Z Ltd. purchased a franchise from a restaurant chain at a cost of Rs.1,00,00,000 and the franchise has 10 years life. In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made. Can the franchise rights be treated as an intangible asset under Ind AS 38?

Question 17 – An entity

An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.

Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS 38?

Question 18 – A software company X Ltd.

A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software. X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset. What would be your advice to X Ltd?

Question 19 – S Ltd.

S Ltd. has acquired a telecom license from Government to operate mobile telephony in two states of India. Can the cost of acquisition be capitalised as an intangible asset under Ind AS 38?

Question 20 – X Ltd.

X Ltd. purchased a standardised finance software at a list price of Rs.30,00,000 and paid Rs.50,000 towards purchase tax which is non refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs.7,00,000 towards customisation of the software for its intended use. X Ltd. purchased a 5 year maintenance contract with the vendor company of Rs.2,00,000. At what cost the intangible asset will be recognised?

Question 21 – P Ltd.

P Limited in a business combination, purchased the net assets of Q Limited for Rs.4,00,000 on March 31, 2011. The assets and liabilities position of Q Limited just before the acquisition is as follows:

Assets	**Cost (in Rs)**
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are Rs.1,50,000, Rs.30,000 and Rs.70,000 respectively.
How would P Limited account for the net assets acquired from Q Limited?

Question 22 – R Ltd.

R Ltd. acquired S Ltd. on April 30, 2011. The purchase consideration is Rs.50,00,000. The fair value of the tangible assets is Rs.45,00,000. The company estimates the fair value of "in-process research projects" at Rs.10,00,000. No other Intangible asset is acquired by R Ltd. in the transaction. Further, cost incurred by R Ltd. in relation to that research project is as follows:

A. Rs.5,00,000 – as research expenses
B. Rs.2,00,000 – to establish technological feasibility

C. Rs.7,00,000 – for further development cost after technological feasibility is established.

At what amount the intangible asset should be measured under Ind AS 38?

Question 23 – X Ltd.

X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs.20,00,000 and Rs.18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

A. X Ltd. did not pay any cash to Y Ltd.

B. X Ltd. pays Rs.2,00,000 to Y Ltd.

Question 24 – X Garments Ltd.

X Garments Ltd. spent Rs.1,00,00,000 towards promotions for a fashion show by way of various on-road shows, contests etc.

After that event, it realised that the brand name of the entity got popular and resultantly, subsequent sales have shown a significant improvement. It is further expected that this hike will have an effect over the next 2-3 years.

How the entity should account for the above cost incurred on promoting such show?

Question 25 – An entity

An entity is developing a new production process. During 2011-2012, expenditure incurred was Rs.1,000, of which Rs.900 was incurred before March 1, 2012 and Rs.100 was incurred between March 1, 2012 and March 31, 2012. The entity is able to demonstrate that at March 1, 2012, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.500.

During 2012-2013, expenditure incurred is Rs.2,000. At the end of 2013, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.1,900.

Question 26 – T Ltd.

T Ltd. is engaged is developing computer software. The expenditures incurred by T Ltd. in pursuance of its development of software is given below:

A. Paid Rs.2,00,000 towards salaries of the program designers.

B. Incurred Rs.5,00,000 towards other cost of completion of program design.

C. Incurred Rs.2,00,000 towards cost of coding and establishing technical feasibility.

D. Paid Rs.7,00,000 for other direct cost after establishment of technical feasibility.

E. Incurred Rs.2,00,000 towards other testing costs.

F. A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs.70,000.

G. On March 15, 20X1, the development phase was completed and a cash flow budget was prepared.

Net profit for the year was estimated to be equal Rs.40,00,000. How T Ltd. should account for the above mentioned cost?

Question 27 – A Ltd.

A Ltd. has started developing a new production process in financial year 2011-2012. Total expenditure incurred till September 30, 2013, was Rs.1,00,00,000 . The expenditure on the development of the production process meets the recognition criteria on July 1, 2011. The records of A Ltd. show that, out of total Rs.1,00,00,000, Rs.70,00,000 were incurred during July to September, 2011. A Ltd. publishes its financial results quarterly. How A Ltd. should account for the development expenditure?

Question 28 – X Ltd.

X Ltd. decides to revalue its intangible assets on April 1, 2011. On the date of revaluation, the intangible assets stand at a cost of Rs.1,00,00,000 and accumulated amortization is Rs.40,00,000. The intangible assets are revalued at Rs.1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account?

Question 29 – XYZ

One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of Rs. 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company Rs. 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue?'

Thanks ….

CHAPTER

7

IND AS 105 – NON CURRENT ASSETS HELD FOR SALE & DISCONTINUED OPERATIONS

CONCEPTS COVERED

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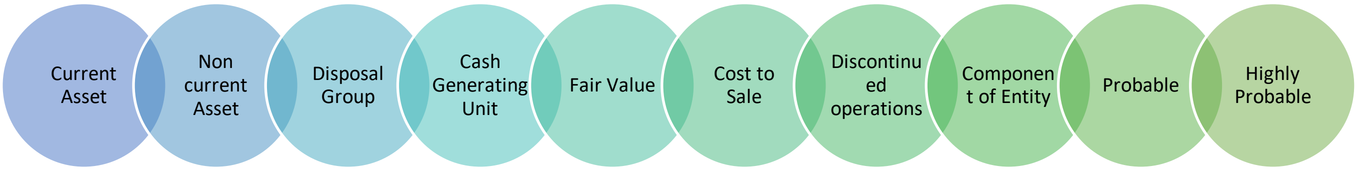
1. DEFINITIONS :



1. **Current Asset :**

   An entity classifies an asset as current when:

   - it expects to realise the asset, or intends to sell or c onsume it, in its normal operating cycle;
   - it holds the asset primarily for the purpose of trading;
   - it expects to realise the asset within twelve months after the reporting period; or
   - the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

2. **Non current Asset :**

   Non-current assets are assets that do not meet the definition of current assets.

3. **Disposal Group :**

   Disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. A disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.

4. **Cash Generating Unit :**

   Cash-generating unit is a smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

5. **Fair Value :**

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

6. **Cost to Sale :**

   Costs to sell are the incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense.

7. **Discontinued operations :**

   A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and:

   (a) represents a separate major line of business or geographical area of operations; or

   (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or

   (c) is a subsidiary acquired exclusively with a view to resale.

8. **Component of Entity :**

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

9. **Probable :**

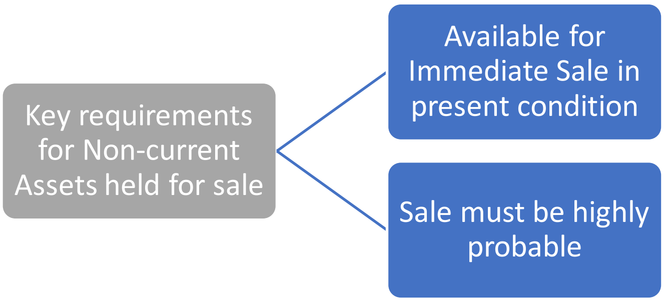
It means more likely than not.

10. **Highly Probable :**

Significantly more likely than probable.

2. CLASSIFICATION :

An entity is required to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.



Available for Immediate Sale :

- The asset (or disposal group) must be available for immediate sale in its present condition. The terms that are usual and customary for sale of similar assets (or disposal group) doesn't disqualify to being classified as held for sale.
- An asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future.

Question 1 – Available for Immediate Sale

1. A property being used as a headquarters by the entity needs to be vacated before it can be sold. The time required to vacate the building is usual and customary for sale of such assets. Hence the criteria for classification as held for sale would be met.
2. In above example, if property can be vacated only after a replacement is available then this may indicate that the property is not available for immediate sale, but only after the replacement becomes available.
3. An entity can't classify a manufacturing facility as held for sale if prior to selling the facility it needs to clear a backlog of uncompleted order.
4. In above example, if entity intends to sell the manufacturing facility along with the uncompleted orders it can be classified as held for sale.

5. An entity plans to renovate some of its property to increase its value prior to selling it to a third party. The entity is already searching for a buyer at current market values. But due to the plans to renovate the property prior to sale, the property may not be meeting condition of available for immediate sale.
6. A company has put a property on the market and expects that all the conditions of classification as held for sale is meeting. Any buyer will undertake searches and valuations before making an offer and exchanging contracts : Such conditions are normal for properties and any delays that might arise from such legal processes do not preclude the property from being classified as held for sale.

Sale must be highly probable :

This Standard defines 'highly probable' as 'significantly more likely than probable' where probable means more likely than not.

1.The appropriate level of management must be committed to a plan to sell the asset (or disposal group).

2. An active programme to trace a buyer and complete the selling plan must have been initiated.

3. The asset (or disposal group) must be marketed for sale at a price that is reasonable in relation to its current fair value.

4. The sale transaction is expected to be completed within one year from the date of classification.

5. Significant changes to or withdrawal from the plan to sell the asset are unlikely.

Question 2 – An entity

An entity is committed to its selling plan of a manufacturing facility in its present condition and so classifies it as held for sale. After a firm purchase commitment, the buyer's inspection identifies environmental damages not previously known to exist. The entity is required by the buyer to make good the damage, which will extend the timeframe of one year to complete the sale within one year. However, the entity has initiated actions to make good the damage and satisfactory rectification is highly probable. In this situation exception to one year requirement will met.

Question 3 – An entity

An entity has acquired a building exclusively with a view of its subsequent disposal. The management is highly confident that the property can be sold in one year. The property requires refurbishing it to enhance its value which is highly probable to be completed in less than a period of three months. The building will be classified as held for sale on the date of acquisition itself even though it is not immediately available for sale.

Question 4 – Entity

Entity ceases to use a manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it is expected to be brought back into use in future when demand picks up. It is neither to be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use, therefore the entity will not stop charging depreciation or treat it as held for sale. This is because its carrying amount will be recovered principally through continuing use to the end of its economic life.

3. MEASUREMENT OF ASSETS CLASSIFIED AS HELD FOR SALE :

1. An entity should measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.
2. Depreciation and amortization shall be immediately stopped from the moment the asset has been classified as held for sale.
3. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.
4. When the sale is expected to occur beyond one year, the entity should measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.
5. Non-current asset (or disposal group) classified as held for distribution are also measured on same line as non-current asset (or disposal group) classified as held for sale.

Question 5 – An item of property

An item of property, plant and equipment that is measured on the cost basis should be measured in accordance with Ind AS 16.

Entity ABC owns an item of property and it was stated at the following amounts in its last financial statements:

31st December, 2011	**Rs.**
Cost	12,00,000
Depreciation	(6,00,000)
Net book value	6,00,000

The asset is depreciated at an annual rate of 10% ie. Rs.1,20,000 p.a.

During July, 2012, entity ABC decides to sell the asset and on 1st August it meets the conditions to be classified as held for sale. Analyse.

Question 6 – A Ltd.

A Ltd. acquired a property for Rs.2,00,000. After few years the cumulative depreciation on the property is of Rs.80,000 has been recognised and subsequently the property is classified as held for sale under Ind AS 105.

The Fair Value less cost of Sale = Rs.100,000

On the next reporting date, the Fair Value less cost of sale is Estimated at Rs 85,000

Subsequently the property was sold at Rs.90,000

Show the Asset shall be measured at various measurement dates.

Question 7

Disposal Group	Carrying Amount at the reporting Date before classification as held for Sale	Carrying Amount as remeasured immediately before classification as held for sale
Goodwill	1500	1500
PPE	4600	4000
Building	5700	5700
Inventory	2400	2200
Investment in Equity	1800	1500
Total	**16000**	**14900**

The entity estimated that fair value less costs to sell of the disposal group amounts to Rs 13,000 on the date the disposal group is classified as Held for Sale. On the subsequent measurement date the fair value less cost of sale is measured at 15,500. How would you account for the same.

Changes to Plan of Sale ;

- If an entity has classified an asset (or disposal group) as held for sale, but the held for sale criteria no longer met, the entity should cease to classify the asset (or disposal group) as held for sale.
- The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of: (a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortization or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale; and (b) its recoverable amount at the date of the subsequent decision not to sell.

Question 8 – S Ltd.

S Ltd purchased a property for Rs.6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 2013, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of Rs.4,70,000.

The fair value less cost to sell on 31st March, 2013 was Rs.4,60,000. On 31st March, 2014 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 2014 is Rs.5,00,000.

Value the property at the end of 2013 and 2014.

4. PRESENTATION AND DISCLOSURE OF A NON CURRENT ASSET (OR DISPOSAL GROUP) CLASSFIED AS HELD FOR SALE :

Presentation :

- An entity is required to present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet.
- The liabilities of a disposal group classified as held for sale should be presented separately from other liabilities in the balance sheet. Those assets and liabilities should not be offset and presented as a single amount.

5. PRESENTATION AND DISCLOSURE OF DISCONTINUED OPERATIONS :

Ind AS 105 defines Discontinued Operation as: A component of an entity that either has been disposed of or is classified as held for sale and:

a) represents a separate major line of business or geographical area of operations; or

b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

c) is a subsidiary acquired exclusively with a view to resale.

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash generating units while being held for use.

Question 9 – Company XYZ

Company XYZ has 5 different operating segments, one of which solely produces consumer goods. All of the consumer goods production facilities are situated in Central Europe. XYZ also has other operations in Central Europe for other operating segments. In April 20X1, XYZ disposed of its consumer goods segment which meets the definition of a component of a business and represents a separate major line of business and would therefore be considered as a discontinued operation.

Question 10 – A group

A group has announced that it is closing an engineering contracting segment. Although no new contracts are being undertaken, all existing contracts will be completed and the business will be run down accordingly. In this situation, the operation will have ceased to be used when the contracting activity has been completed (that is, at the end of the last contract). In the period during which existing contracts are completed, the group is continuing to carry out a revenue-earning activity, albeit that the activity is being wound down, and so it does not qualify as a discontinued operation.

Question 11 – A Company

A company carried out a merchandise wholesaling business that it operated from several leasehold premises throughout the country. The business has been closed, all stocks have been disposed of, and employees have been made redundant before the end of three months into the next financial year. At that time, some debtors remain to be collected, and costs will continue to be incurred in respect of the vacated premises until the leases are disposed of. In this case, the former activity of merchandise wholesaling has ceased. The outstanding future transactions do not constitute the continuation of the activity and, consequently, the operation has been discontinued.

Question 12 – XYZ Company

XYZ Company has one business segment, and it operates in the UK, the US and Australia. Each of these operations represents a component of XYZ and a major geographical area of operations. Management has decided to sell the US operation, which met the criteria to be classified as held for sale during the year. The US operation should be disclosed in the XYZ's financial statements as a discontinued operation, despite the fact that there has been no change to the number of business segments.

Question 13

Identify whether each of the following scenarios gives rise to a discontinued operation and/or classification of assets as held for sale:

S. No	Particulars	Discontinued operation Yes/No	Assets held for sale Yes/No
1	MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.		

2	PQR has ceased activities that meet the definition of a discontinued operation without selling any assets.		
3	STU ceases activities and has already completed the sale of the underlying assets at the reporting date.		
4	VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations.		

Question 14 – Sun Ltd.

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in chandni chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.

All Ind AS 105 criteria for held for sale classification were first met at 1st October, 2011. The outlet will be sold in June, 2012.

Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analysis

6. SELF PRACTICE QUESTIONS :

Question 15 – Entity X

On November 30, 2011, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months. Can the property be classified as held for sale at the reporting date i.e. December 31, 2011?

Question 16 – Entity R

On March 1, 2011, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on March 31, 2011, it is expected that the factory will be sold by February 28, 2012. However, in May 2011, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on June 26, 2011. Should the factory be shown as held for sale as on March 31, 2011?

Question 17 – Entity X

On June 1, 2011, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 2011, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 2011 and the sale is expected to be completed by March 31, 2012. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

Disposal Group	**Carrying Value as on December 31, 2010**	**Carrying value as on July 31, 2011**
Goodwill	500	500
PPE	1000	900
Building	2000	1850
Debtors	850	1050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2000)	(1850)
Total	2750	2600

The fair value of the manufacturing unit as on December 31, 2010 is Rs.2,000 and as on July 31, 2011 is Rs.1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., December 31, 2011. The fair value as on December 31, 2011 is lower than the carrying value of the disposal group as on that date.

Required:

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. The measurement of the manufacturing unit as on the date of classification as held for sale.
3. The measurement of the manufacturing unit as at the end of the year.

Question 18 – A Ltd.

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/ (liability)	**Carrying amount as on 31st March, 20X1 (In Rs.'000)**
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250

Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	**2,250**

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.

The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	**Carry amount as on 15th September 20X1 (In Rs. '000)**
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	1,020
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	520
Current liabilities	(870)
Non-current liabilities – provisions	(250)
Total	**2,160**

Entity A proposed to sell the disposal group at Rs.19,00,000. It estimates that the costs to sell will be Rs.70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	**(In Rs. '000)**
Financial assets	410
Deferred tax assets	230
Current assets- Inventory, receivables and cash balances	400
Current liabilities	900
Non- current liabilities- provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to Rs. 16,50,000.

Required:

What would be the value of all assets/ labilities within the disposal group as on the following dates in accordance with Ind AS 105?

(a) 15 September, 20X1 and
(b) 31st March, 20X2

Question 19 – CK Ltd.

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 20X1. During the 3 months ended 30th June, 20X1 following events occurred:

On 1st April, 20X1, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1st April, 20X1, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill – Rs. 60,000
- Property, Plant & Equipment (average remaining estimated useful life two years) - Rs. 20,00,000
- Inventories - Rs. 10,00,000

From 1st April, 20X1, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 20X1 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 20X1, market condition has improved and as on 1st August, 20X1 the Company received and accepted a firm offer to purchase the division for Rs. 33,00,000.

The sale is expected to be completed on 30th September, 20X1 and Rs. 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 20X1. During the period from 1st April to 30th June inventories of the division costing Rs. 8,00,000 were sold for Rs. 12,00,000. At 30th June, 20X1, the total cost of the inventories of the division was Rs. 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale of the division will be reported in the interim financial statements for the quarter ended 30th June, 20X1 giving relevant explanations.

Question 20 – Identify

Identify which of the following is a disposal group at 31 March 20X1:

(1) On 21 March 20X1, XYZ announced the Board’s intention to sell its shares in a subsidiary company, Alpha, contingent upon the approval of Alpha’s shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.

(2) PQR has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC, on 14 March 20X1. The assets will be transferred on 28 April 20X1 from which date the Group will outsource its delivery activities to another company, LMN.

(3) On 16 January 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31 March 20X1 heads of agreement had been signed although due diligence and the negotiation of final terms are still in process. The transaction is expected to be completed in April 20X1.

Thanks ….

CHAPTER

8

IND AS 23 – BORROWING COST

CONCEPTS COVERED

1. INTRODUCTION
2. BORROWING COST
3. QUALIFYING ASSET
4. RECOGNITION
5. PERIOD OF CAPITALISATION
   - COMMENCEMENT
   - SUSPENSION
   - CESSATION
6. DISCLOSURE
7. SELF PRACTICE QUESTIONS

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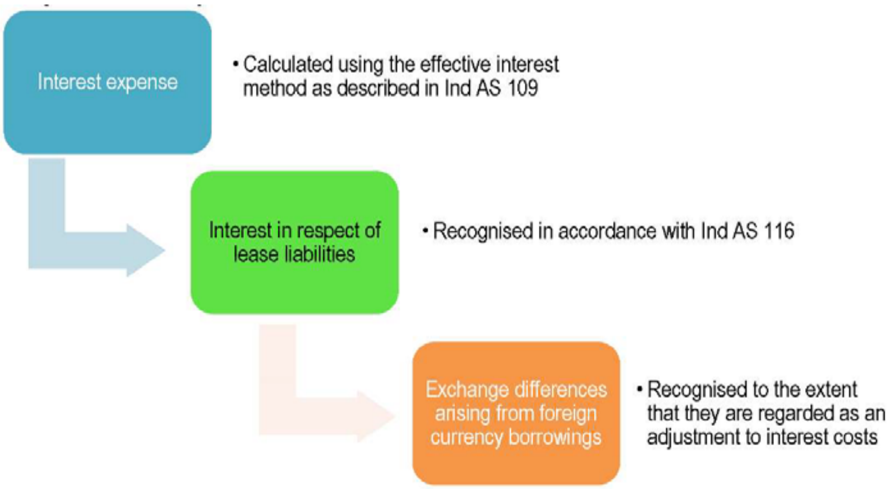
1. INTRODUCTION :

This standard requires borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Other borrowing costs are recognized as an expense.

2. BORROWING COST :

These are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs may include:

- interest expense calculated using the effective interest rate method as described in Ind AS 109 *Financial Instruments;*
- interest in respect of lease liabilities recognised in accordance with Ind AS 116, Leases; and
- exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs



Question 1 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.

Calculate the amount of total borrowing cost.

Question 2 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.41. The loan is not due for repayment.

Calculate the amount of total borrowing cost.

Question 3 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.

Calculate the amount of total borrowing cost.

If the exchange rate on March 31, 2013, is $ 1 = Rs.48. Discuss what shall be the accounting treatment at the end of year 2013.

Question 4 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.

Calculate the amount of total borrowing cost.

If the exchange rate on March 31, 2013, is $ 1 = Rs.44. Discuss what shall be the accounting treatment at the end of year 2013.

Question 5 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.

Calculate the amount of total borrowing cost.

If the exchange rate on March 31, 2013, is $ 1 = Rs.44. Discuss what shall be the accounting treatment at the end of year 2013 assuming $ 600 of the borrowings was paid on March 31, 2012.

Question 6 – ABC Ltd.

ABC Ltd. has taken a loan of USD 20,000 on April 1, 2011 for constructing a plant at an interest rate of 5% per annum payable on annual basis.

On April 1, 2011, the exchange rate between the currencies i.e USD vs Rupees was Rs.45 per USD. The exchange rate on the reporting date i.e. March 31, 2012 is Rs.48 per USD.

The corresponding amount could have been borrowed by ABC Ltd from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1.

Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd.

3. QUALIFYING ASSET :

- An Asset that takes substaintial period of time to be ready for its intended use.
- It should substantial period of time to get ready for its intended use or sale
- Substantial period of time is not defined in IND AS. It is to be understood on case to case basis. Generally a period of more than 12 months is considered substantial. However any shorter period, if justifiable can also be taken as substantial period.
- Generally inventory are not considered as Qualifying Asset as they are produced on repetitive basis over a short period of time. However if the nature of inventory is such that it takes substantial period of time to get ready for its intended use or sale then inventory can be classified as Qualifying Asset.
  Foe e.g. – Wine, Rice, Cheese Etc.
- If an Asset is ready for its intended use then it cannot be classified as Qualifying Asset. However if an Asset is a part of larger asset or project then it is not independent and therefore should be looked along with bigger asset than it should be capitalised.

Depending on the circumstances, any of the following may be qualifying assets:
(a) inventories
(b) manufacturing plants
(c) power generation facilities
(d) intangible assets
(e) investment properties
(f) bearer plants.

Financial assets and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

Question 7 – A Company deals

A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.
State whether borrowing costs incurred to finance the production of inventories (cheese) that have a long production period, be capitalised?

Question 8 – A company

A company is in the process of developing computer software. The asset has been qualified for recognition purposes. However, the development of computer software will take substantial period of time to complete.
(i) Can computer software be termed as a 'qualifying asset' under Ind AS 23?
(ii) Is management intention considered when assessing whether an asset is a qualifying asset?

Question 9 – A telecom company

A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

Should borrowing costs on the acquisition of the 3G license be capitalised until the network is ready for its intended use?

Question 10 – A real estate

A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.

Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete?

4. RECOGNITION :

when it is probable it will result in future economic benefits to the entity; and

the costs can be measured reliably.

- Other borrowing costs are recognised as an expense in the period in which they are incurred.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period

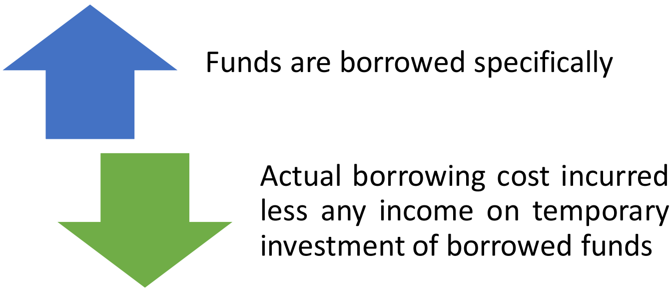
General Borrowing Cost :

When a qualifying asset is funded from a pool of general borrowings, the amount of the borrowing costs eligible for capitalisation is not so obvious.

Total general borrowing costs for the period (excluding specific borrowings) ÷ Weighted Average total general borrowings (excluding specific = Capitalization Rate

Specific Borrowing Cost :

When an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.



Question 11 – ABC Ltd.

Alpha Ltd. on 1st April, 2011 borrowed 9% Rs.30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April, 2011. The loan facility was availed on 1st April, 2011 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory Building	**Office Building**
1^{st} April 2011	5,00,000	10,00,000
1^{st} Oct 2011	5,00,000	10,00,000

Calculate the cost of the asset and the borrowing cost to be capitalized.

Question 12 – ABC Ltd.

On 1st April, 20X1, A Ltd. took a 8% loan of Rs. 50,00,000 for construction of building A which is repayable after 6 years ie on 31st March 20X7. The construction of building was completed on 31st March 20X3. A Ltd. started constructing a new building B in the year 20X3-20X4, for which he used his existing borrowings. He has outstanding general purpose loan of Rs. 25,00,000, interest on which is payable @ 9% and Rs. 15,00,000, interest on which is payable @ 7%.

Is the specific borrowing transferred to the general borrowings pool once the respective qualifying asset is completed? Why?

Question 13 – Beta Ltd.

Beta Ltd. had the following loans in place at the end of 31st March, 2012:

Loan	**1^{st} April, 2011**	**31^{st} March 2012**
18 % Bank Loan	1000	1000
16 % Term Loan	3000	3000
14% Debentures	-	2000

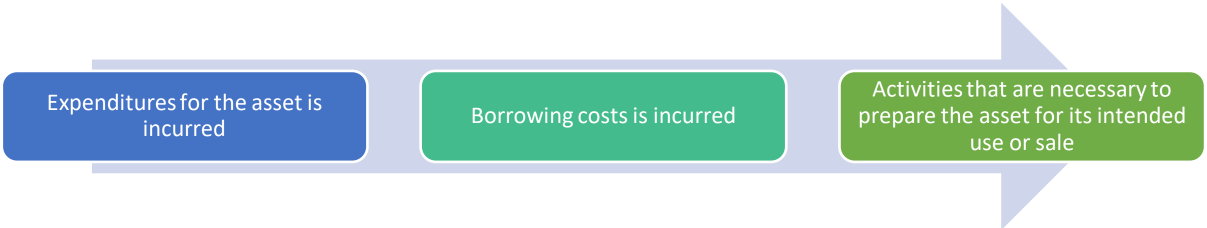
14% debenture was issued to fund the construction of Office building on 1st July, 2011 but the development activities has yet to be started.
On 1st April, 2011, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: Rs.500,000 on 1st April, 20X1 and Rs.2,500,000 on 1st January, 2012.
Required : Calculate the borrowing cost that can be capitalized for the plant.

5. PERIOD OF CAPITALIZATION :

1. COMMENCEMENT :

An entity is required to begin the capitalizing of borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions cumulatively on a particular date:

- It incurs expenditure for the Asset.
- It incurs borrowing cost.
- It undertakes activities that are necessary to prepare the asset for its intended use or sale.



Question 14 – X Ltd.

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:
(i) 15th May, 2011: Loan interest relating to the project starts to be incurred
(ii) 2nd June, 2011 : Technical site planning commences
(iii) 19th June, 2011 : Expenditure on the project started to be incurred
(iv) 18th July, 2011 : Construction work commences Identify commencement date.

2. SUSPENSION :

- An entity is required to suspend the capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.
- An entity does not required to suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

3. **CESSATION :**

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

6. DISCLOSURE :

Entities are required to disclose:

(a) The amount of borrowing costs capitalized during the period; and

(b) The capitalization rate used to determine the amount of borrowing costs eligible for capitalization.

7. SELF PRACTICE QUESTIONS :

Question 15 – Marine Transport Limited

Marine Transport Limited ordered 3 ships for its fleet on April 1, 2010. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 2017. On March 1, 2012, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.

Is it permissible for Marine Transport Limited to capitalize any borrowing costs for the financial year ended March 31, 2011 or March 31, 2012.

Question 16 – X Limited

X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 2012, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	**Amount (Rs)**
July 1, 2011	2,50,000
December 1, 2011	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	**Average Balance (Rs.)**	**Interest (Rs.)**
Long Term Loan @ 10%	10,00,000	1,00,000
Working Capital	5,00,000	65,000
Total	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

Question 17 – An entity constructs

An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are Rs. 100,000 in September 20X1 and Rs. 250,000 in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of Rs. 20 lacs and had an overdraft of Rs. 500,000, which increased to Rs. 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.

Question 18 – K Ltd.

K Ltd. began construction of a new building at an estimated cost of Rs. 7 lakh on 1st April, 20X1. To finance construction of the building it obtained a specific loan of Rs. 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	Rate of Interest per annum
Rs. 7,00,000	12%
Rs. 9,00,000	11%

The expenditure incurred on the construction was:

April, 20X1	Rs. 1,50,000
August, 20X1	Rs. 2,00,000
October, 20X1	Rs. 3,50,000
January, 20X2	Rs. 1,00,000

The construction of building was completed by 31st January, 20X2. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 20X2.

Question 19 – Entity A

On 1st April, 20X1, entity A contracted for the construction of a building for Rs. 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor :

Payment date	Amount (Rs. '000)
1st April, 20X1	200
30th June, 20X1	600

31st December, 20X1	1,200
31st March, 20X2	200
Total	**2,200**

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs. 1,000,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs. 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Question 20 – Parent Company "P"

In a group with Parent Company "P" there are 3 subsidiaries with following business:

"A" – Real Estate Company

"B" – Construction Company

"C" – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

Real Estate Company

- Borrowings of Rs. 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to Rs. 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

Construction Company

- No borrowings during the period.
- Financed Rs. 10,00,000 of expenditures on qualifying assets using its own cash resources.

Finance Company

- Raised Rs. 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for generalcorporate purposes at the rate of 8%.

Parent Company

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Question 21 – Y Ltd.

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?
Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of Rs. 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.
Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Question 22 – Nikka Limited

Nikka Limited has obtained a term loan of Rs. 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of Rs. 510 lacs was incurred on installation of Plant and Machinery, Rs. 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of Rs. 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.
The company has paid total interest of Rs. 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

Thanks ....

CHAPTER

9

IND AS 36 – IMPAIRMENT OF ASSETS

CONCEPTS COVERED

1. INTRODUCTION
2. DEFINITIONS
3. IDENTIFYING AN ASSET THAT MAY BE IMPAIRED
   - IDENTIFYING AN ASSET THAT MAY BE IMPAIRED – GENERAL
   - INDICATIONS OF IMPAIRMENT
4. REQUIREMENT OF ANNUAL REVIEW
   - ITEMS REQUIRED TO BE TESTED FOR IMPAIRMENT AT LEAST ANNUALLY
5. VALUE IN USE
6. RECOGNISING IMPAIRMENT LOSS
7. CASH GENERATING UNIT
8. GOODWILL (AS 28)
9. REVERSAL OF IMPAIRMENT LOSS
10. SELF PRACTICE QUESTIONS

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1. INTRODUCTION :

Assets as defined by Framework for preparation and Presentation of Financial Statements means "Any resource controlled by an enterprise and from which future economic benefit are expected by that enterprise from that resource.

As per the above definition assets represents future economic benefit and hence should be measured according to benefit expected out of it. However if there is decline in amount of benefit expected than the asset should be revalued to reflect the amount i.e expected benefit.

If the carrying amount of asset is more than its recoverable amount, the excess of carrying amount over its recoverable amount is called as Impairment Loss.

"Impairment Loss = Carrying Amount – Recoverable Amount"

2. DEFINITIONS :

The following are the key terms used in this standard:

1. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
2. The **recoverable amount** of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.
3. A **cash-generating unit** is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

3. IDENTIFYING AN ASSET THAT MAY BE IMPAIRED :

3.1 IDENTIFYING AN ASSET THAT MAY BE IMPAIRED – GENERAL :

- An asset is impaired when its carrying amount exceeds its recoverable amount.

- Irrespective of whether there is any indication of impairment, an entity is required to test following items for impairment at least annually:

For above three assets, the entity should not have wait for Impairment indicators, rather there is mandate of impairment testing. We will discuss this aspect in detail in the next section.

Question 1 – Rainbow Limited

Jupiter Ltd, a leading manufacturer of steel is having a furnace, which is carried in the balance sheet on 31.03.2011 at Rs.250 lakh. As at that date the value in use and Fair value is Rs.200 lakh. The cost of disposal is Rs.13 lakh.

Calculate the Impairment Loss to be recognised in the books of the Company?

Question 2 – Venus Ltd.

Venus Ltd. has an asset, which is carried in the Balance Sheet on March 31, 2011 at Rs.500 lakh. As at that date the value in use is Rs.400 lakh and the fair value less costs to sells is Rs.375 lakh.

From the above data:

(a) Calculate impairment loss.

(b) Prepare journal entries for adjustment of impairment loss.

(c) Show, how impairment loss will be shown in the Balance Sheet.

Question 3 – X Ltd.

X Ltd. is having a plant (asset) carrying amount of which is Rs.100 lacs on 31.03.2015. Its balance useful life in 5 years and residual value at the end of five years is Rs.5 lacs. Estimated future cash flows from using the plant in next five years are :

For the year ended on	Estimated Cash flows (Rupees in lacs)
31.03.2016	50
31.03.2017	30
31.03.2018	30
31.03.2019	20
31.03.2020	20

Calculate "value in use" for plant if the applicable discounts rate is 10% and also calculate the recoverable amount if the net selling price of plant on 31.03.2015 is Rs.60.00 lacs.

Question 4 – Uttaranchal Industries Ltd.

Uttaranchal Industries Ltd. gives the following estimates of cash flows relating to fixed asset on 31.12.2015. The discount rate is 15%

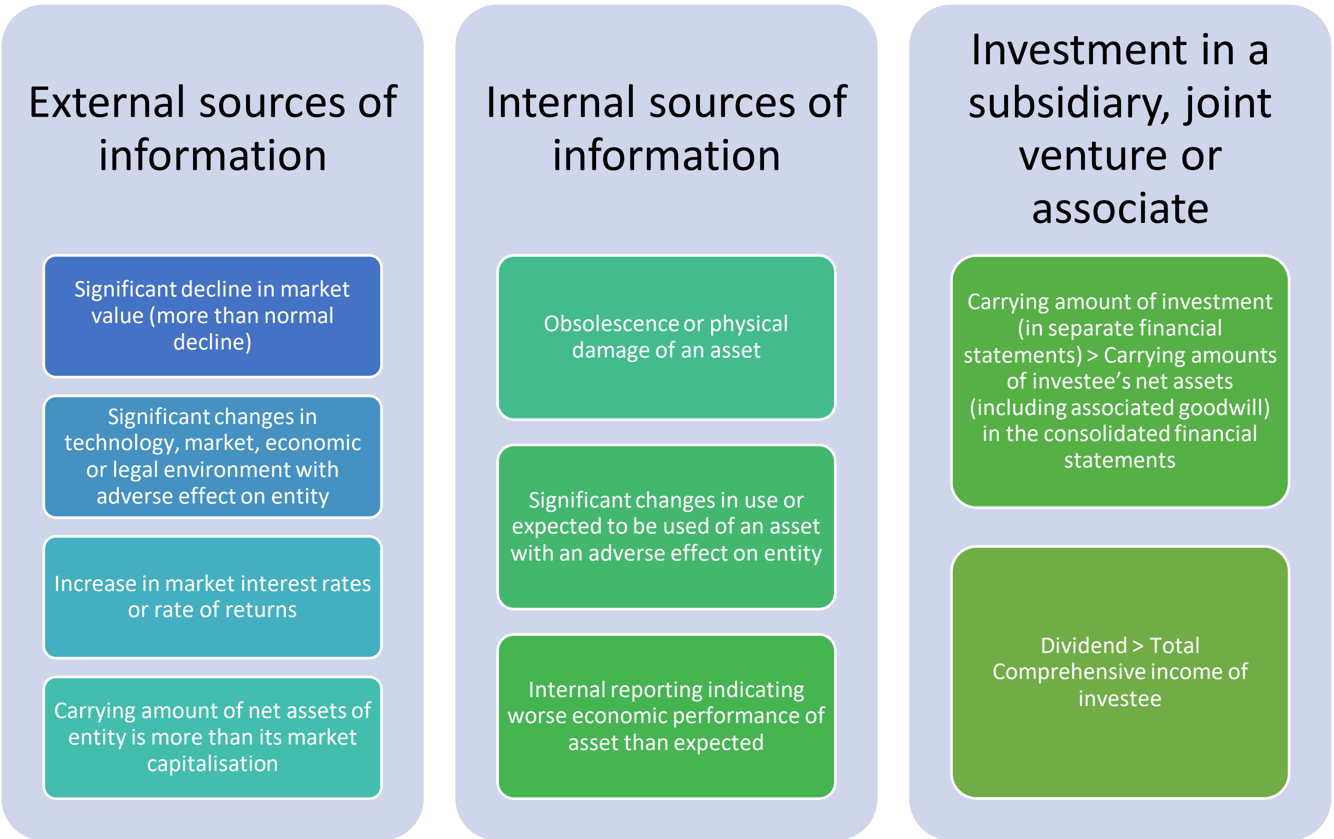
Year	Cash Flows (Rs. In lacs)
2016	2000
2017	3000
2018	3000
2019	4000

2020	2000

Residual value at the end of 2020 is Rs.500 lacs
Fixed asset purchased on 01.01.2013 for Rs.20000 lacs
Useful life is 8 years
Residual value estimated Rs.500 lakhs at the end of 8 years
Net Selling price Rs.10,000 lacs
Calculate on 31.12.2015

a. Carrying amount at the end of 2015
b. Value is use on 31.12.2015
c. Recoverable amount on 31.12.2015
d. Impairment loss to be recognized for the year ended 31.12.2015
e. Revised carrying amount
f. Depreciation charges for 2016.

3.2 INDICATIONS OF IMPAIRMENT



4. REQUIREMENT OF ANNUAL REVIEW :

ITEMS REQUIRED TO BE TESTED FOR IMPAIRMENT AT LEAST ANNUALLY :

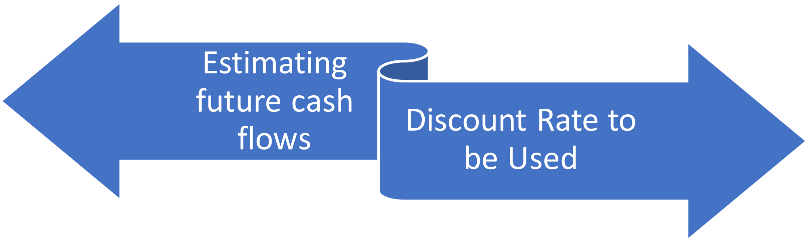
Irrespective of whether there is any indication of impairment, an entity is required to test following items for impairment at least annually:

a) intangible asset with an indefinite useful life;
b) intangible asset not yet available for use; and
c) goodwill acquired in a business combination for impairment.

5. VALUE IN USE :

Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Primarily two key decisions are involved in determining value in use:

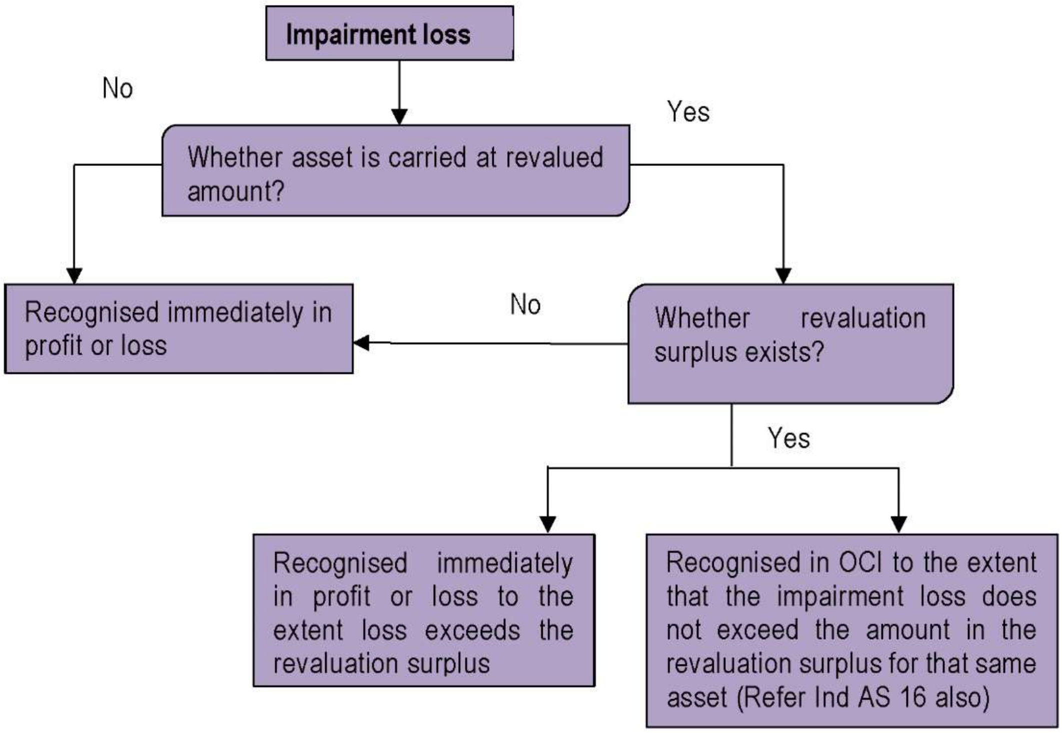


Question 5 – Saturn Ltd.

Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of Rs. 36 million excludes the benefit to be derived from a future reorganization, but the second value of Rs. 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments.

Whether the business segment needs to be Impaired?

6. RECOGNISING IMPAIRMENT LOSS :



Question 6

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of Asset	Rs 56 lakhs
Usefull Life	10 years
Salvage Value	Nil
Carrying Value at the beginning of the year	Rs 27.30 lakhs
Remaining useful life	3 years
Recoverable amount at the beginning of the year	12 lakhs
Upward revaluation done in last year	14 lakhs

Question 7 – NDA Ltd.

NDA Ltd. acquired plant on 01.04.2008 for Rs.50.00 lakhs having 10 years useful life and provides depreciation on SLM with nil residual value. On 01.04.2013. NDA Ltd revalued the plant at Rs.29 lakhs against its book value of Rs.25 lakhs and credited Rs.4 lakhs to revaluation reserve.

On 31.03.2015 the plant was impaired and its recoverable amount on this date was Rs.14 lakhs. Calculate the Impairment loss and how this loss should be treated in the accounts.

Question 8 – G Ltd.

G Ltd., acquired a machine on 1st April, 2010 for Rs.7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2014, the carrying value of the machine was reassessed at Rs.5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 2016, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs.79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Question 9 – X Ltd.

X Ltd. purchased a Property, Plant and Equipment four years ago for Rs.150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at Rs.75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs.67.50 lakhs and expected disposal costs are Rs.3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs.60 lakhs?

7. CASH GENERATING UNIT :

A ***cash-generating unit*** is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Question 10 – A publisher

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Question 11 – A mining entity

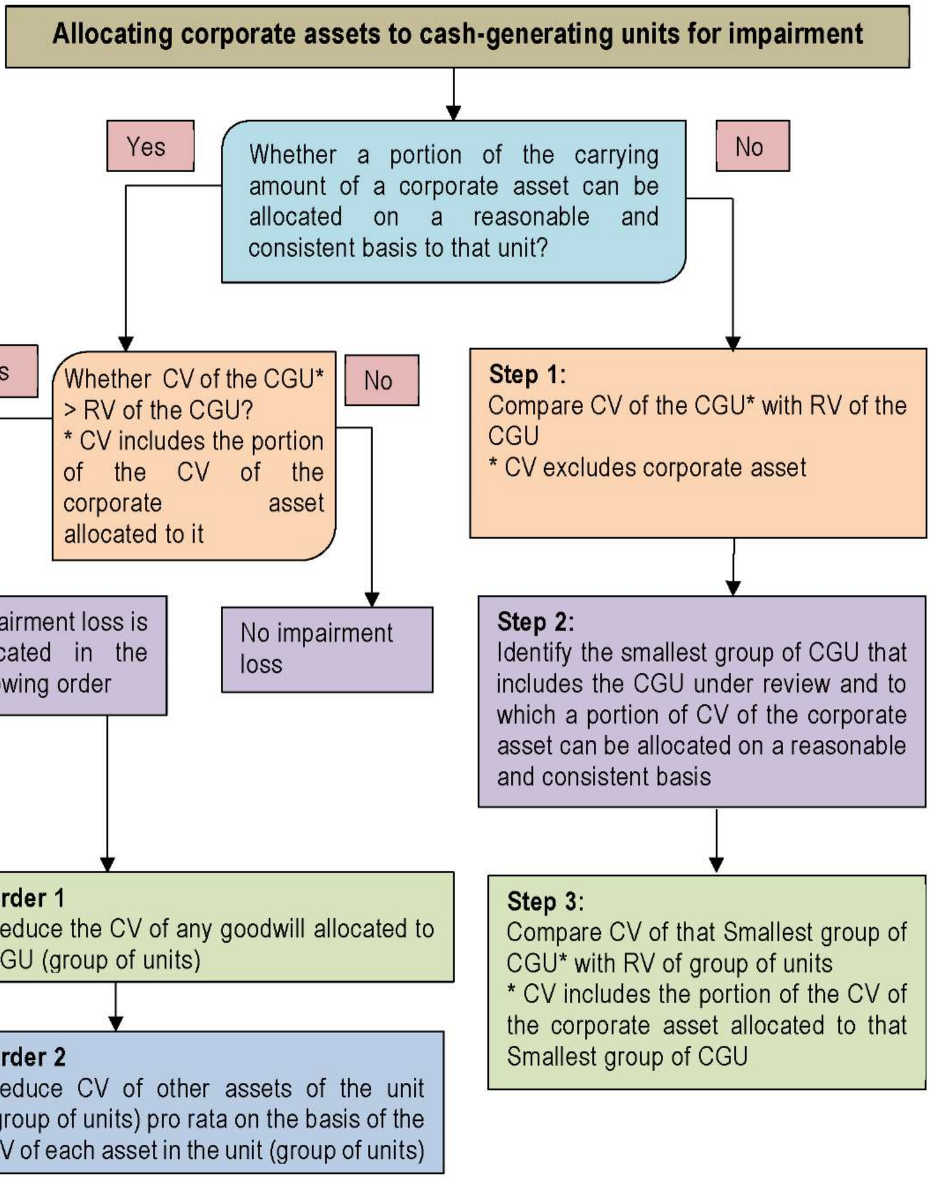
A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine. Should the entity determine the recoverable amount for the private railway or for the mining business as a whole?

Question 12 – In north campus

In north campus there are ten college under Delhi University having their own canteens, which provides food and beverage to be students and staff. Under a policy of the University the contract of running all the ten college canteens will be given to only one contractor. Out of these 7 canteens are profitable but 3 are loss making. Identify cash generating units.

8. GOODWILL :

Goodwill does not generate cash flows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognized. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test



Question 13 – Entity A acquires Entity B

Entity A acquires Entity B for Rs. 50 million, of which Rs. 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two

Rs. in million

	CGU 1	CGU 2	Total
Fair value of acquired identifiable tangible and intangible assets	25	10	35

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.

Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as Rs. 33 million and Rs. 17 million respectively.

Determine the allocation of goodwill to each CGU?

Question 14 – Earth Infra Ltd.

Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for Rs. 20 million and CGU B for Rs. 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of Rs. 10 million. The recoverable amounts are based on value-in-use of Rs. 18 million for CGU A and Rs. 38 million for CGU B.

Determine whether the carrying values of CGU A and B are impaired.

Question 15 – A Ltd.

A Ltd. has 3 CGU with the fair value of Assets of these units in the ratio of 3 : 2 : 1 for unit A, B and C respectively.

B Ltd. acquired all the three cash generating units of A Ltd. at a price of Rs.2,500 lacs and recognised a goodwill of Rs.600 lacs at the time of acquisition. After a few years, it is found that unit A is incurring losses and the recoverable amount of unit A is 750 lacs. Presently the carrying amount of these units are Rs.725 lacs, Rs.500 lacs and Rs.220 lacs. The goodwill is appearing at Rs.420 lacs in the financial statements. Find the impairment loss to be recognised for CGU A, if

A. Goodwill can be allocated to cash generating units on a reasonable basis, and

B. Goodwill cannot be allocated to cash generating units and the recoverable amount of the three units taken together is

   (i) Rs. 1700 or

   (ii) Rs. 1400

Question 16

A cash generating unit has these net assets

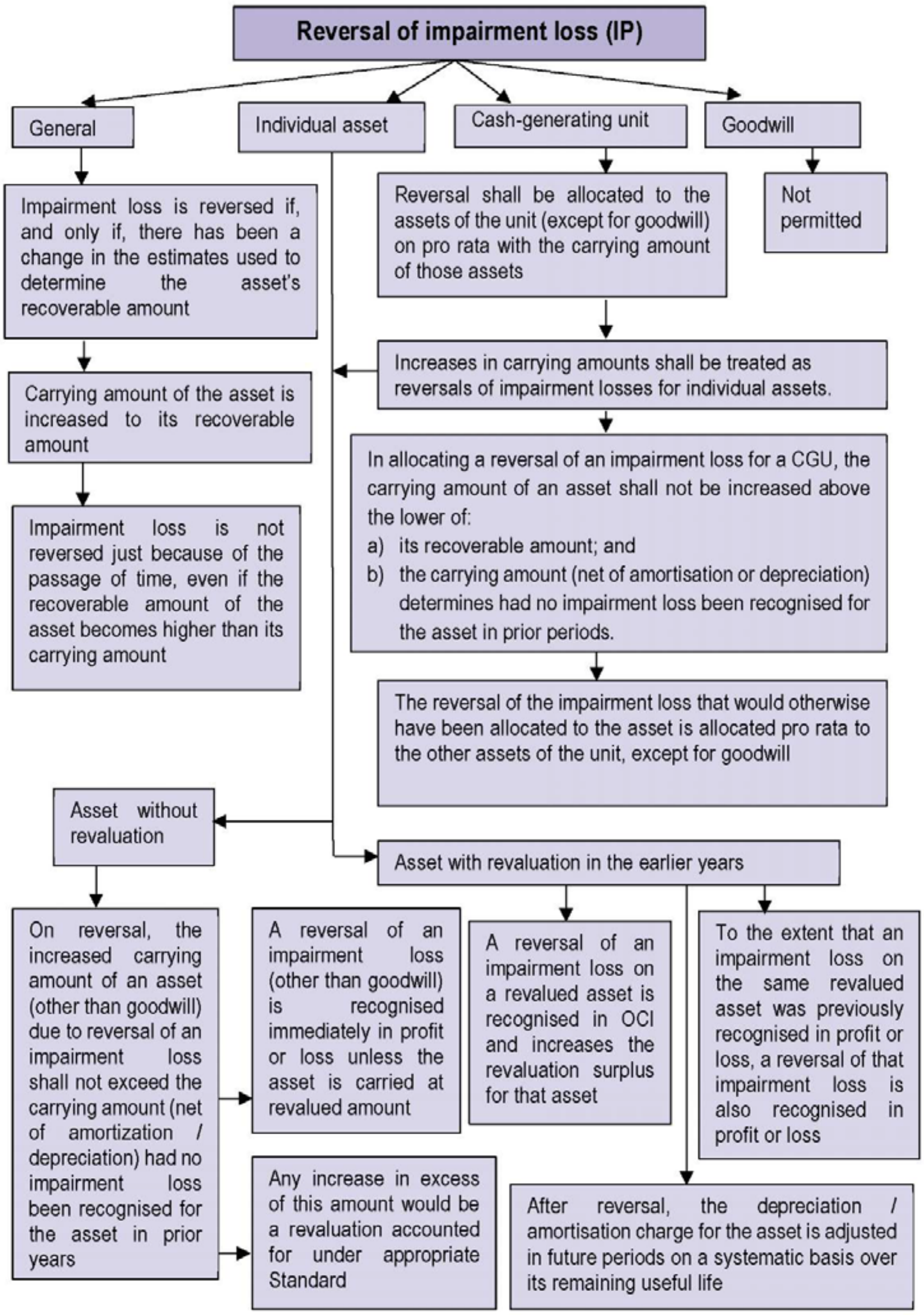
	Rs in million
Goodwill	10
Property	20
Plant and Equipment	30
Total	**60**

The recoverable Amount has been determined at Rs.45 million.

Required :

Allocate the impairment loss to net assets of the entity.

9. REVERSAL OF IMPAIRMENT LOSS :



Question 17 – Venus Ltd.

On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for Rs. 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was Rs. 3,20,000 and goodwill was Rs. 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.

As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.

Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So, the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at Rs. 2,12,000.

Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is reestimated. The value in use is expected to be Rs. 3,04,000 and fair value less cost to disposal is expected to be Rs. 2,90,000.

Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

10. SELF PRACTICE QUESTIONS :

Question 18

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of asset	Rs. 56 lakh
Useful life	10 years
Salvage value	Nil
Carrying value at the beginning of the year	Rs. 27.30 lakh
Remaining useful life	3 years
Recoverable amount at the beginning of the year	Rs. 12 lakh
Upward revaluation done in last year	Rs. 14 lakh

Question 19 – Venus Ltd.

Venus Ltd. has an asset, which is carried in the Balance Sheet on 31st March, 20X1 at Rs. 500 lakh. As at that date the value in use is Rs. 400 lakh and the fair value less costs to sells is Rs. 375 lakh.

From the above data:

(a) Calculate impairment loss.

(b) Prepare journal entries for adjustment of impairment loss.

Question 20 – A significant raw

A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same entity. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the entity.

60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the entity. For each of the following cases, what are the cash-generating units for X and Y?

(a) If X could sell the products it sells to Y in an active market and internal transfer prices are higher than market prices, what are the cash-generating units for X and Y?

(b) If there is no active market for the products X sells to Y, what are the cash-generating units for X and Y?

Question 21 – XYZ Limited

XYZ Limited produces a single product and owns plants 1, 2 and 3. Each plant is located in a different country. Plant 1 produces a component that is assembled in either Plant 2 or Plant 3. The combined capacity of Plant 2 and Plant 3 is not fully utilised. XYZ Limited's products are sold worldwide from either Plant 2 or Plant 3, e.g., Plant 2's production can be sold in Plant 3's country if the products can be delivered faster from Plant 2 than from Plant 3. Utilisation levels of Plant 2 and Plant 3 depend on the allocation of sales between the two sites. If there is no active market for Plant 1's products, what are the cash-generating units for Plant 1, Plant 2 and Plant 3?

Question 22 – XYZ Limited

XYZ Limited has a cash-generating unit 'Plant A' as on 1st April, 20X1 having a carrying amount of Rs. 1,000 crore. Plant A was acquired under a business combination and goodwill of Rs. 200 crore was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no residual value. On 31st March, 20X2, Plant A has a recoverable amount of Rs. 600 crore. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Question 23 – Apex Ltd.

Apex Ltd. is engaged in manufacturing of steel utensils. It owns a building for its headquarters. The building used to be fully occupied for internal use. However, recently the company has undertaken a massive downsizing exercise as a result of which 1/3rd of the building became vacant. This vacant portion has now been given for on lease for 6 years. Determine the CGU of the building.

Question 24 – ABC Ltd.

ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

(Rs. in crore)

Cash-generating units	Carrying amount	Remaining useful life
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years

(Rs. in crore)

Corporate asset	Carrying amount	Remarks
X	600	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.
Y	200	The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash generating units.

Recoverable amount as on 31st March, 20X1 is as follows:

Cash-generating units	Recoverable amount (Rs. in crore)
A	600
B	900
C	1,400
ABC Ltd.	3,200

Calculate the impairment loss, if any. Ignore decimals.

Question 25 – A Ltd.

A Ltd. purchased a machinery of Rs. 100 crore on 1st April, 20X1. The machinery has a useful life of 5 years. It has nil residual value. A Ltd. adopts straight line method of depreciation for depreciating the machinery. Following information has been provided as on 31st March, 20X2 :

Financial year	Estimated future cash flows (Rs. in crore)
20X2-20X3	15
20X3-20X4	30
20X4-20X5	40
20X5-20X6	10

Discount rate applicable : 10%

Fair value less costs to sell as on 31st March, 20X2 : Rs. 70 crore

Calculate the impairment loss, if any.

Question 26

Assuming in the above question, as on 31st March, 20X3, there is no change in the estimated future cash flows and discount rate. Fair value less costs to sell as on 31st March, 20X3 is Rs. 40 crore. How should it be dealt with under Ind AS 36?

Question 27 – A Ltd.

A Ltd. purchased an asset of Rs. 100 lakh on 1st April, 20X0. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
31st March, 20X1	Rs. 60 lakh
31st March, 20X2	Rs. 40 lakh
31st March, 20X3	Rs. 28 lakh

Calculate the amount of impairment loss or its reversal, if any, on 31st March, 20X1, 31st March, 20X2 and 31st March, 20X3.

Question 28 – A Ltd.

On 1 January Year 1, Entity Q purchased a machine costing Rs. 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to Rs. 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be Rs. 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

a) The carrying amount of the machine on 31 December Year 2 and the revaluation surplus arising on 1 January Year 3.

b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31 December Year 4 and its treatment thereon

d) The depreciation charge in the year to 31 December Year 4.

Note: During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings.

Thanks ....

CHAPTER

10

IND AS 116 – LEASES

CONCEPTS COVERED

1. WHAT IS A LEASE ?
   - 1.1 RECOGNITION EXEMPTIONS
   - 1.2 IDENTIFIED ASSET
   - 1.3 SUBSTANTIVE SUBSTITUTION RIGHTS:
   - 1.4 IDENTIFIED ASSET – PHYSICALLY DISTINCT:
   - 1.5 RIGHT TO CONTROL
   - 1.6 SEPARATION OF LEASE AND NON LEASE COMPONENTS
   - 1.7 SEPARATING LEASE COMPONENTS FROM NON – LEASE COMPONENTS
   - 1.8 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSEE
   - 1.9 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSORS
   - 1.10 CONTRACT COMBINATIONS
   - 1.11 PORTFOLIO APPLICATION
2. KEY CONCEPTS
   - 2.1 INCEPTION AND COMMENCEMENT OF LEASE
   - 2.2 LEASE TERM
   - 2.3 CANCELLABLE LEASES
   - 2.4 LEASE PAYMENTS
   - 2.5 LESSEE INVOLVEMENT BEFORE COMMENCEMENT DATE
   - 2.6 INITIAL DIRECT COSTS
   - 2.7 DISCOUNT RATES
   - 2.8 ECONOMIC LIFE

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1. WHAT IS A LEASE?

A lease is defined as

Lease

- a contract, or part of a contract
- that conveys the right
- to control the use
- of an identified asset
- for a period of time
- in exchange for consideration

The inception date is defined as the earlier of the following dates:

date of a lease agreement

↓

date of commitment by the parties to the principal terms and conditions of the lease

1.1 RECOGNITION EXEMPTIONS :

In addition to above scope exclusions, a lessee can elect not to apply Ind AS 116's recognition requirements to:

1. Short-term leases; and
2. Leases for which the underlying asset is of low-value

If a lessee elects to apply the above recognition exemption, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis, if that basis is more representative of the pattern of the lessee's benefit.

1. Short term leases:

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset. As the determination is made at the commencement date, a lease cannot be classified as short-term if the lease term is subsequently reduced to less than 12 months.

Question 1 – Scenario A

Scenario A :

A lessee enters into a lease with a nine-month non-cancellable term with an option to extend the lease for four months. The lease does not have a purchase option. At the lease commencement date, the lessee is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates. Whether the lessee can take a short-term exemption in accordance with Ind AS 116?

Scenario B :

Assume the same facts as Scenario A except, at the lease commencement date, the lessee is not reasonably certain to exercise the extension option because the monthly lease payments during the optional extension period are at what the lessee expects to be market rates and there are no other factors that would make exercise of the renewal option reasonably certain. Will your answer be different in this case?

2. Leases of low-value assets :

Though Ind AS 116 does not explicitly define the leases of low-value assets, it provides the conditions based on which an asset can be treated as of low-value

An underlying asset can be of low value ONLY IF BOTH the following conditions are satisfied

- The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee
- The underlying asset is not highly dependent on, or highly interrelated with, other assets

The election for leases for which the underlying asset is of low value can be made on a lease-bylease basis. For example, an entity enters into a rental contract for a large number of laptops. Each laptop within the contract constitutes an identified asset. Entity has considered that the value of individual laptop would be low, even though the contract for all the laptops is not.

Examples of low-value underlying assets can include :

- tablet
- personal computers
- small items of office furniture
- telephones

1.2 IDENTIFIED ASSET :

An arrangement only contains a lease if there is an identified asset. Under Ind AS 116, an identified asset can be explicitly specified in a contract or implicitly specified at the time that the asset is made available for use by the customer.

Question 2 – Customer XYZ

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of rolling stock specifically designed for Customer XYZ.
The rolling stock is designed to transport materials used in Customer XYZ's production process and is not suitable for use by other customers. The rolling stock is not explicitly specified in the contract but, Supplier ABC owns only one rolling stock that is suitable for Customer XYZ's use. If the rolling stock does not operate properly, the contract requires Supplier ABC to repair or replace the rolling stock.
Whether there is an identified asset?

Question 3 – Customer XYZ

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of a car. The specification of the car is specified in the contract (i.e., brand, type, colour, options, etc.). At inception of the contract, the car is not yet built.
Whether there is an identified asset?

1.3 SUBSTANTIVE SUBSTITUTION RIGHTS :

A supplier's right to substitute an asset is SUBSTANTIVE when BOTH of the following conditions are met:

1. The supplier has the **PRACTICAL ABILITY** to substitute alternative assets throughout the period of use
2. The supplier would **BENEFIT ECONOMICALLY** from the exercise of its right to substitute the asset

Question 4 – Scenario A

Scenario A:

An electronic data storage provider (supplier) provides services through a centralised data centre that involve the use of a specified server (Server No. 10). The supplier maintains many identical servers in a single accessible location and determines, at inception of the contract, that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use. Further, the supplier would benefit economically from substituting an alternative asset, because doing this would allow the supplier to optimise the performance of its network at only a nominal cost. In addition, the supplier has made clear that it has negotiated this right of substitution as an important right in the arrangement, and the substitution right affected the pricing of the arrangement. Whether the substitution rights are substantive and whether there is an identified asset?

Scenario B:

Assume the same facts as in Scenario A except that Server No. 10 is customised, and the supplier does not have the practical ability to substitute the customised asset throughout the period of use. Additionally, it is unclear whether the supplier would benefit economically from sourcing a similar alternative asset.

Whether the substitution rights are substantive and whether there is an identified asset?

1.4 IDENTIFIED ASSET – PHYSICALLY DISTINCT :

An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of an asset. For example, a building is generally considered physically distinct, but one floor within the building may also be considered physically distinct if it can be used independent of the other floors. Similarly, a capacity or other portion of an asset that is not physically distinct (for e.g., a capacity portion of a fibre optic cable) is not an identified asset unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Question 5 – Customer XYZ

Customer XYZ enters into a 15-year contract with Supplier ABC for the right to use five fibres within a fibre optic cable between Mumbai and Pune. The contract identifies five of the cable's 25 fibres for use by Customer XYZ. The five fibres are dedicated solely to Customer XYZ's data for the duration of the contract term. Assume that Supplier ABC does not have a substantive substitution right.

Whether there is an identified asset?

Question 6 – Customer XYZ

Scenario A:

Customer XYZ enters into a ten-year contract with Supplier ABC for the right to transport oil from India to Bangladesh through Supplier ABC's pipeline. The contract provides that Customer XYZ will have the right to use of 95% of the pipeline's capacity throughout the term of the arrangement. Whether there is an identified asset?

Scenario B:

Assume the same facts as in Scenario A, except that Customer XYZ has the right to use 65% of the pipeline's capacity throughout the term of the arrangement. Whether there is an identified asset?

1.5 RIGHT TO CONTROL :

To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

1. The right to obtain substantially all of the economic benefits from use of the identified asset; and
2. The right to direct the use of the identified asset

Question 7 – ABC Ltd.

ABC Ltd enters into a contract with XYZ Ltd, which grants ABC Ltd exclusive rights to use a specific grain storage facility over a five-year period in the months of May and June. During these months, ABC Ltd has the right to decide which crops are placed in storage and when to remove them. XYZ Ltd provides the loading and unloading services for the warehouse activities. During the other ten months each year, XYZ Ltd has the right to determine how the warehouse will be used.

Which party has the right to control the use of the identified asset during the period of use?

1. Right to Obtain Substantially All of the Economic Benefits:

Economic benefits from use of an asset include:

- the asset's primary outputs (i.e., goods or services)
- any by-products (for e.g., renewable energy credits that are generated through the use of the asset), including potential cash flows derived from these items.
- benefits from using the asset that could be realised from a commercial transaction with a third party (for e.g., subleasing the asset)

Question 8 – Company MNO

Company MNO enters into a 15-year contract with Power Company PQR to purchase all of the electricity produced by a new solar farm. PQR owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and MNO will receive renewable energy credits that accrue from use of the solar farm.).

Who has the right to substantial benefits from the solar farm?

2. Right to Direct the Use of the Identified Asset

A customer has the right to direct the use of an identified asset whenever it has the right to direct how and for what purpose the asset is used throughout the period of use (i.e., it can change how and for what purpose the asset is used throughout the period of use).

Ind AS 116 provides the following examples of decision-making rights that grant the right to change how and for what purpose an asset is used:

Particulars	Examples
The right to change the type of output that is produced by the asset	(i) Deciding whether to use a shipping container to transport goods or for storage (ii) Deciding on the mix of products sold from a retail unit
The right to change when the output is produced	Deciding when an item of machinery or a power plant will be used
The right to change where the output is produced	(i) Deciding on the destination of a truck or a ship (ii) Deciding where a piece of equipment is used or deployed
The right to change whether the output is produced and the quantity of that output	Deciding whether to produce energy from a power plant and how much energy to produce from that power plant

Question 9 – Customer X

Customer X enters into a contract with Supplier Y to use a vehicle for a five-year period. The vehicle is identified in the contract. Supplier Y cannot substitute another vehicle unless the specified vehicle is not operational (for e.g., if it breaks down). Under the contract:

- Customer X operates the vehicle (i.e., drives the vehicle) or directs others to operate the vehicle (for e.g., hires a driver).
- Customer X decides how to use the vehicle (within contractual limitations). For example, throughout the period of use, Customer X decides where the vehicle goes, as well as when or whether it is used and what it is used for. Customer X can also change these decisions throughout the period of use.
- Supplier Y prohibits certain uses of the vehicle (for e.g., moving it overseas) and modifications to the vehicle to protect its interest in the asset.

Whether Customer X has the right to direct the use of the vehicle throughout the period of lease?

Question 10 – Supplier H

Entity A contracts with Supplier H to manufacture parts in a facility. Entity A designed the facility and provided its specifications. Supplier H owns the facility and the land. Entity A specifies how many parts it needs and when it needs the parts to be available. Supplier H operates the machinery and makes all operating decisions including how and when the parts are to be produced, as long as it meets the contractual requirements to deliver the specified number on the specified date. Assuming supplier H cannot substitute the facility and hence is an identified asset.

Which party has the right to control the use of the identified asset (i.e., equipment) during the period of use?

Question 11 – Entity L

Entity L enters into a five—year contract with Company A, a ship owner, for the use of an identified ship. Entity L decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent Entity L from sailing the ship into waters at a high risk of piracy or carrying explosive materials as cargo. Company A operates and maintains the ship, and is responsible for safe passage.
Who has the right to direct the use of the ship during the period of use?

1.6 SEPARATION OF LEASE AND NON LEASE COMPONENTS :

Sometimes, there are contracts that contain rights to use multiple assets (for e.g., a building and an equipment, multiple pieces of equipment, etc.). The right to use each such asset is considered as a 'separate' lease component **ONLY IF BOTH** the following conditions are satisfied:

- The lessee can benefit from the use of the asset either on its own **OR** together with other resources that are readily available to the lessee (i.e., goods or services that are sold or leased separately, by the lessor or other suppliers, or that the lessee has already obtained from the lessor or in other transactions or events) **AND**
- The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

If one or both of these criteria are not met then, the right to use multiple assets is considered a 'single' lease component, i.e., not a 'separate' lease component.

Question 12 – Scenario A

Scenario A:

A lessee enters a lease of an excavator and the related accessories (for e.g., excavator attachments) that are used for mining purposes. The lessee is a local mining company that intends to use the excavator at a copper mine. How many lease and non-lease components are there?

Scenario B:

Assume the same facts as in Scenario A, except that the contract also conveys the right to use an additional loading truck. This loading truck could be deployed by the lessee for other uses (for e.g., to transport iron ores at another mine).

1.7 SEPARATING LEASE COMPONENTS FROM NON – LEASE COMPONENTS :

There may be many contracts containing a lease coupled with an agreement to purchase or sell other goods or services (i.e., the non-lease components under Ind AS 116). For example, a supplier may lease a truck and also operate the leased asset on behalf of a customer (i.e., provide a driver). This service is not related to securing the use of the truck. Only items that contribute to securing the output of the asset are lease components. In this example, only the use of the truck is considered a lease component.

Question 13 – Entity L

Entity L rents an office building from Landlord M for a term of 10 years. The rental contract stipulates that the office is fully furnished and has a newly installed and tailored HVAC system. It also requires Landlord M to perform all common area maintenance (CAM) during the term of the arrangement. Entity L makes single monthly rental payment and does not pay for the maintenance separately. The office building has a useful life of 40 years and the HVAC system and office furniture each has a life of 15 years.

What are the units of account in the lease?

Ind AS 116 provides a practical expedient that permits lessees to make an accounting policy election, by CLASS OF UNDERLYING ASSET, to account for each separate lease component of a contract and any associated non-lease components as a SINGLE LEASE COMPONENT. It is important to note the such practical expedient is not permissible for lessor.

1.8 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSEE :

Lessees that do not make an accounting policy election (by class of underlying asset) to use the practical expedient, as discussed above, to account for each separate lease component of a contract and any associated non-lease components as a single lease component, are required to allocate the consideration in the contract to the lease and non-lease components on a RELATIVE STAND-ALONE PRICE BASIS.

Question 14 – Scenario A

Scenario A :

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs.10,000. The contract contains fixed annual payments as follows: Rs.8,000 for rent, Rs.1,500 for maintenance and Rs.500 of administrative tasks. How the consideration would be allocated?

Scenario B :

Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?

Question 15 – A lessee enters

A lessee enters into a lease of an equipment. The contract stipulates the lessor will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

Lease	Rs. 80,000
Maintenance	Rs. 10,000
Total	Rs. 90,000

Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:

Lease	Rs. 85,000
Maintenance	Rs. 15,000
Total	Rs. 90,000

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?

1.9 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSORS :

Lessor are required to allocate the consideration in the contract to the lease and any associated non-lease components by applying Ind AS 115 Revenue from Contracts with Customers.

1.10 CONTRACT COMBINATIONS :

Ind AS 116 requires that two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty) be considered a 'single' contract IF ANY ONE of the following criteria is met:

1. The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together **OR**
2. The amount of consideration to be paid in one contract depends on the price or performance of the other contract **OR**

The rights to use the underlying assets conveyed in the contracts (or some of the rights to use underlying assets conveyed in each of the contracts) are a single lease component.

1.11 PORTFOLIO APPLICATION :

Ind AS 116 applies to individual leases. However, entities that have a large number of leases of similar assets (for e.g., leases of a fleet of similar rolling stock) may face practical challenges in applying the leases model on a lease-by-lease basis.

Thus, Ind AS 116 includes a practical expedient that allows entities to use a portfolio approach for leases with similar characteristics if the entity reasonably expects that the effects on the financial statements would not differ materially from the application of the standard to the individual leases in that portfolio.

2. KEY CONCEPTS :

2.1 INCEPTION AND COMMENCEMENT OF LEASE :

Ind AS 116 requires customers and suppliers to determine whether a contract is or contains a lease at the inception of the contract.

The inception date is defined as the earlier of the following dates:

- date of a lease agreement
- date of commitment by the parties to the principal terms and conditions of the lease

The commencement date is defined as the date on which a lessor makes an underlying asset available for use by a lessee.

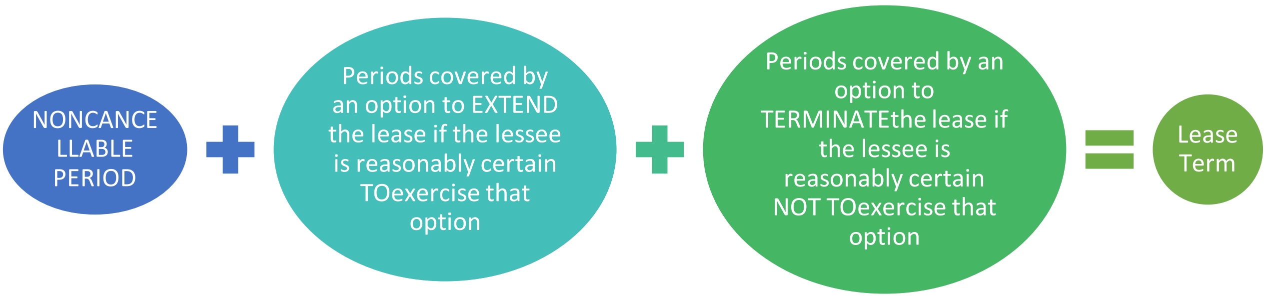
As discussed earlier, inception date is the date when an entity shall assess if the contract is or contains lease. While the commencement date is relevant because on that date:

(i) a lessee (except where the exemption of short-term lease or low-value asset is taken) initially recognises a lease liability and related Right of Use Asset (hereinafter referred to as "ROU Asset") on the commencement date

(ii) a lessor (for finance leases) initially recognises its net investment in the lease on the commencement date.

2.2 LEASE TERM :

In simple terms, lease term is the summation of the following



Question 16 – Scenario A

Scenario A:

Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

Scenario B:

Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C:

Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term?

2.3 CANCELLABLE LEASES :

In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A 'contract' is defined as an agreement between two or more parties that creates enforceable rights and obligations.

An arrangement is not enforceable if:

(i) both the lessor and lessee each have the right to terminate the lease without permission from the other party; AND

(ii) with no more than an insignificant penalty

Question 17 – Retailer M

Retailer M enters into a five-year lease for a building floor, followed by two successive five-year renewal options. On the commencement date, Retailer M is not reasonably certain to exercise the extension option. At the end of third year, Retailer M extended to include another floor from year 4 due to a business acquisition. For this purpose, the lessee concludes a separate seven-year lease for an additional floor in the building already leased. Is Retailer M required to reassess the lease term in this case?

Question 18 – Company N

Company N has taken 10 vehicles on lease for an initial period of 5 years with an extension option at the option of the lessee for a further period of 5 years at the same rental amount. The remaining useful life of the vehicles as on the commencement date of the lease is 15 years. Company N has determined at the commencement date that it is reasonably certain to exercise the extension option and hence it has taken a period of 10 years for the lease. At the end of 4th year, there is an announcement by the government that all the cars of this particular model have to be discontinued from the road within 1 year due to the change in the pollution norms in the country. Will the lease term be reassessed in this case?

2.4 LEASE PAYMENTS :

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) fixed payments (including in-substance fixed payments), less any lease incentives

(b) variable lease payments that depend on an index or a rate

(c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option

(d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

(e) Expected Residual Value Guarantee

1. **Fixed Lease Payment :**

'Fixed payments' are defined as payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Question 19 – Entity M

Entity M and Lessor A enter into a 10-year lease of an office building for fixed annual lease payments of Rs.200,000. Per the terms of the lease agreement, annual fixed lease payments comprise Rs.170,000 for rent and Rs.30,000 for real estate taxes. What are the fixed lease payments for purposes of classifying the lease?

In-substance Lease Payment :

As mentioned above, lease payments also include any in-substance fixed lease payments which are the payments that may, in form, contain variability but that, in substance, are unavoidable.

Question 20 – Entity Q

Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.

– If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month. What is considered as lease payment in this case?

Question 21 – Entity P

Entity P enters into a five-year lease for office space with Entity Q. The initial base rent is Rs 1 lakh per month. Rents increase by the greater of 1% of Entity P's generated sales or 2% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring lease liability?

Question 22 – Entity P

Company N leases a production line. The lease payments depends on the number of operating hours of the production line – i.e., N has to pay Rs.1,000 per hour of use. The annual minimum payment is Rs.10,00,000. The expected usage per year is 1,500 hours.

2. <u>Variable Payments :</u>

'Variable lease payments' are defined as the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

These may include, for e.g., payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. Such payments are included in the lease payments and are measured using the prevailing index or rate at the measurement date (e.g., lease commencement date for initial measurement).

Question 23 – An entity

An entity enters into a 10-year lease of property. The lease payment for the first year is Rs 1,000. The lease payments are linked to the consumer price index (CPI), i.e., not a floating interest rate. The CPI at the beginning of the first year is 100. Lease payments are updated at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108. What should be included in lease payments?

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed (as discussed above – In-substance fixed lease payments). Examples may include payments such as those based on performance (for e.g., a percentage of sales) or usage of the underlying asset (for e.g., the number of hours flown, the number of units produced), are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Question 24 – Entity XYZ

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at Rs 100 each.

The consumables can only be used for that equipment and Customer ABC cannot use other consumables as substitutes. There is no minimum purchase amount required in the contract.

Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

Question 25 – Entity XYZ

Entity A enters into a five-year lease of an office building. The lease payments are ` 5,00,000 per year and the contract includes an additional water charge calculated as ` 0.50 per litre consumed. Payments are due at the end of year. Entity A elects to apply the practical expedient to combine lease and non-lease components

3. Exercise price of a purchase option :

If the lessee is reasonably certain to exercise a purchase option, the exercise price is included as a lease payment, i.e., entities consider the exercise price of asset purchase options included in lease contracts consistently with the evaluation of lease renewal and termination options (as discussed earlier).

4. Penalties for terminating a lease :

If it is reasonably certain that the lessee will not terminate a lease, the lease term is determined assuming that the termination option would not be exercised, and any termination penalty is excluded from the lease payments. Otherwise, the lease termination penalty is included as a lease payment. The determination of whether to include lease termination penalties as lease payments is similar to the evaluation of lease renewal options (as discussed earlier).

5. Residual value guarantees (lessees) :

'Residual value guarantee' is defined as a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

Question 26 – An entity

An entity (a lessee) enters into a lease and guarantees that the lessor will realise Rs.20,000 from selling the asset to another party at the end of the lease. At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe Rs.8,000 at the end of the lease. Whether the lessee should include the said payment of Rs.8,000 as a lease payment?

2.5 LESSEE INVOLVEMENT BEFORE COMMENCEMENT DATE :

An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Thus, based on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.

2.6 INITIAL DIRECT COSTS :

'Initial direct costs' are defined as the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

Examples of costs included and excluded from initial direct costs is provided below.

	Included	Excluded
1	Commission (including payments to employees acting as selling agents)	Employee salaries
2	Legal fees resulting from the execution of the lease	Legal fees for services rendered before the execution of the lease
3	Lease document preparation costs incurred after the execution of the lease	Negotiating lease term and conditions
4	Certain payments to existing tenants to move out	Advertising
5	Consideration paid for a guarantee of a residual asset by an unrelated third party	Depreciation and amortization

2.7 DISCOUNT RATES :

Discount rates are used to determine the present value of the lease payments, which are used to determine Right of Use asset and Lease liability in case of a lessee and to measure a lessor's net investment in the lease.

For a Lessee :

As per Ind AS 116, the Discount Rate to be used should be:

THE INTEREST RATE IMPLICIT IN THE LEASE, if that rate can be readily determined.

OR

If not, then the lessee shall use THE LESSEE'S INCREMENTAL BORROWING RATE.

Where,
'Interest rate implicit in the lease' is defined as the rate of interest that causes the following

The present value of lease payments made by the lessee for the right to use the underlying asset + The unguaranteed residual value = The fair value of the underlying asset + Any initial direct costs of the lessor

the lessee's incremental borrowing rate is the rate of interest that

- the lessee would have to pay to borrow over a similar term,
- and with a similar security,
- the funds necessary to obtain an asset of a similar value to the Right of use Asset
- in a similar economic environment.

2.8 ECONOMIC LIFE :

'Economic Life' is defined as either

- the period over which an asset is expected to be economically usable by one or more users or
- the number of production or similar units expected to be obtained from an asset by one or more users.

3. LESSEE ACCOUNTING :

A 'lessee' is defined as an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

3.1 INITIAL RECOGNITION AND MEASUREMENT :

At the commencement date, a lessee shall recognise a ROU Asset and a Lease Liability. Ind AS 116 requires lessees to recognise a liability to make lease payments and an asset representing the right to use the underlying asset (i.e., the ROU Asset) during the lease term for ALL leases (except for short-term leases and leases of low-value assets, if they choose to apply such exemptions).

Measurement :

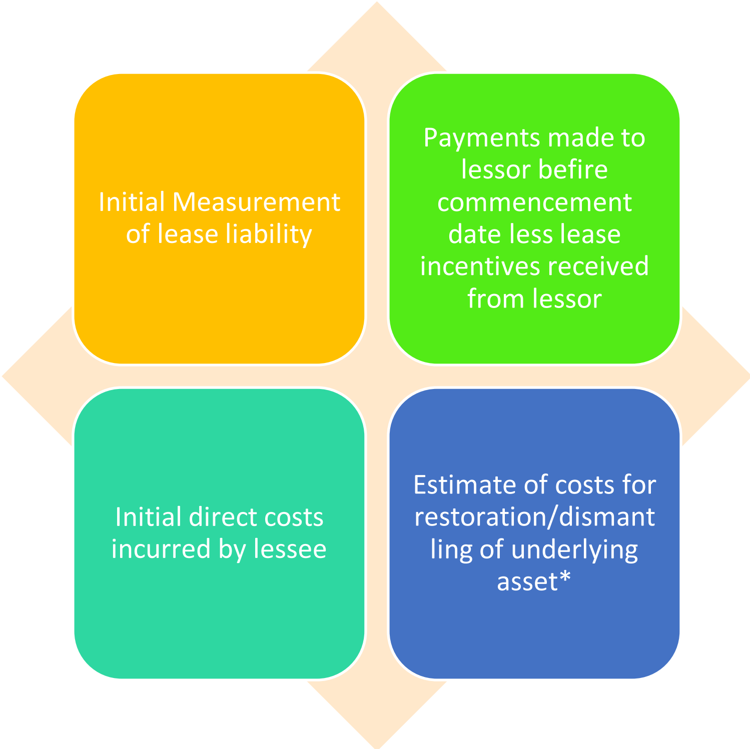
At the commencement date, a lessee initially measures the Lease Liability at the present value of the remaining lease payments to be made over the lease term, discounted using the rate implicit in the lease (or if that rate cannot be readily determined, the lessee's incremental borrowing rate). Lease payments used in measuring the lease liability are amounts due to the lessor excluding any payments that a lessee makes before lease commencement.

Question 27 – Entity L

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is Rs 100,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent. Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Measuring the right-of-use asset :

A lessee initially measures the ROU Asset at COST, which consists of ALL of the following:



Question 28 – Entity Y and Entity Z

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on January 1, 2016:

- The lease commencement date is February 1, 2016.
- Entity Y must pay Entity Z the first monthly rental payment of Rs.10,000 upon execution of the lease.
- Entity Z will pay Entity Y Rs.50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred Rs.1,000 of initial direct costs, which are payable on February 1, 2016. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is Rs.850,000. How would Lessee Company measure and record this lease?

Question 29 – Company H

Company H leases an aircraft for a period of 5 years. The aircraft must undergo a planned check after every 100,000 flight hours. At the end of the lease, company H must have a check performed (or refund the costs to the lessor), irrespective of the actual number of flight hours. What are the lease payments for purposes of calculating ROU asset?

3.2 SUBSEQUENT MEASUREMENT - RIGHT-OF-USE ASSETS (ROU ASSET) :

After the commencement date, the right-of-use asset should be measured using a cost model, unless it applies the revaluation model as specified under Ind AS 16.

Cost model for right-of-use assets :

To follow the cost model, an entity measures a right-of-use asset at cost:

(a) Less accumulated depreciation and accumulated impairment losses (recognised in accordance with Ind AS 36, Impairment of Assets); and

(b) Adjusted for re-measurements of the lease liability

Depreciation for right-of-use assets :

ROU Assets measured under the cost model should be depreciated in accordance with the depreciation requirements given in Ind AS 16, subject to the following:

- If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, or if the cost of the ROU Asset reflects that the lessee will exercise a purchase option, the ROU Asset should be depreciated from the commencement date to the end of the useful life of the underlying asset;
- otherwise, the right-of-use asset should be depreciated from the commencement date to the earlier of the end of the useful life of the ROU Asset and the end of the lease term.

Lease liability :

A Lease Liability should be accounted for in a manner similar to other financial liabilities (i.e., on an amortised cost basis).

Expense recognition :

Lessees recognise the following items in expense for leases:

- Depreciation of the ROU Asset
- Interest expense on the Lease Liability
- Variable lease payments that are not included in the lease liability (for e.g., variable lease payments that do not depend on an index or rate)
- Impairment of the ROU Asset

Question 30 – Entity ABC

Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:
Rs.20,000 in year one
Rs.30,000 in year two
Rs.50,000 in year three.
For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.
How would Entity ABC would account for the said lease under Ind AS 116?

Question 31 – Company EFG

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5- year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs 50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for Rs 30 lacs. The first annual payment is Rs 5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of Rs 2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement. Company EFG is reasonably certain to exercise that purchase option.
How would EFG measure the right-of-use asset and lease liability over the lease term?

3.3 REMEASUREMENT :

Ind AS 116 requires lessees to REMEASURE LEASE LIABILITIES upon a change in lease payments on account of ANY of the following:

- The reassessment of lease term on account of reasonable certainty to exercise/not exercise of extension and/or termination option
- The reassessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset
- In-substance fixed lease payment
- The amounts expected to be payable under residual value guarantees
- Future lease payments resulting from a change in an index or rate

When to use the 'original' and a 'revised' discount rate?

Revised Discount Rate	Original Discount Rate
Lessees use a revised discount rate when lease payments are updated for - reassessment of the lease term OR - a reassessment of a purchase option.	Lessees use the original discount rate when lease payments are updated for - a change in expected amounts for residual value guarantees AND

The revised discount rate is based on the interest rate implicit in the lease for the REMAINDER of the lease term. If that rate cannot be readily determined, the lessee uses its incremental borrowing rate.	-	payments dependent on an index or rate, unless the rate is a floating interest rate.
	-	the variability of payments is resolved so that they become in-substance fixed payments.

Question 32 – Entity W

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/2017. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is Rs.100,000 and Rs.110,000 respectively. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 01/01/18 will be based on the CPI available at 31/12/17.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/2020 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/2020 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. In the first quarter of 2020, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease in the first quarter of 2020?

3.4 LEASE MODIFICATION :

A 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for e.g., adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

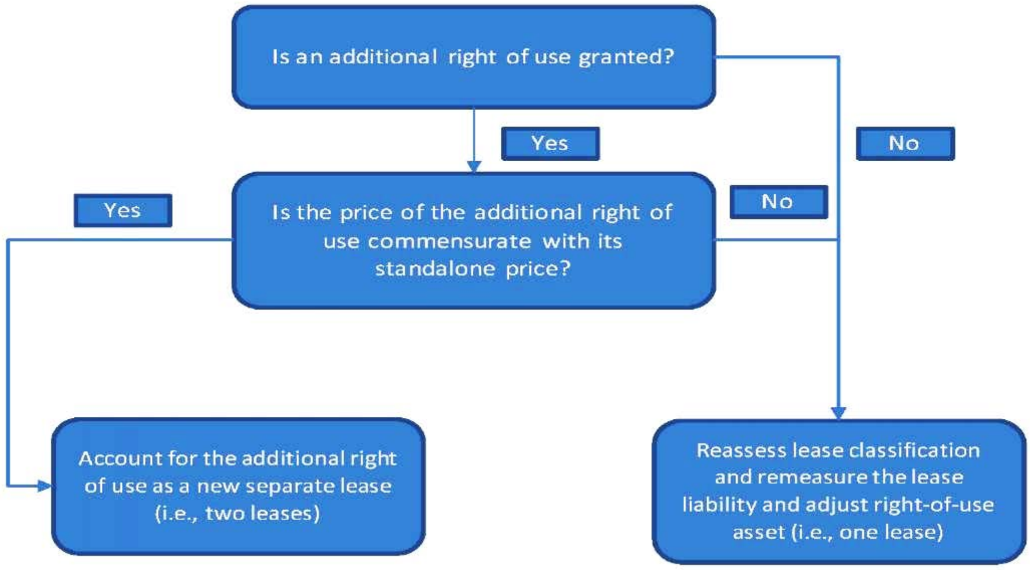
The following are examples of lease modifications that may be negotiated after the lease commencement date:

- A lease extension
- Early termination of the lease
- A change in the timing of lease payments
- Leasing additional space in the same building
- Surrendering a part of the underlying asset.

If a lease is modified (as stated above), the modified contract is evaluated to determine whether it is or contains a lease.

If a lease continues to exist, lease modification can result in:

- A separate lease OR
- A change in the accounting for the existing lease (i.e., not a separate lease).



Modification – Separate lease :

A lease modification is accounted for as a separate lease if both:

a. The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

b. The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

If both criteria are met, a lessee would follow the previous guidance on the initial recognition and measurement of lease liabilities and right-of-use assets.

Question 33 – Lessee enters

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

How should the said modification be accounted for?

Modification- Not Separate Lease:

If a lease modification fails the test above (e.g. additional right of use granted, but not at a standalone price) or the modification is of any other type (e.g. a decrease in scope from the original contract), the lessee must modify the initially recognised components of the lease contract.

The accounting treatment required for lease modifications that are not accounted for as separate leases is summarised below:

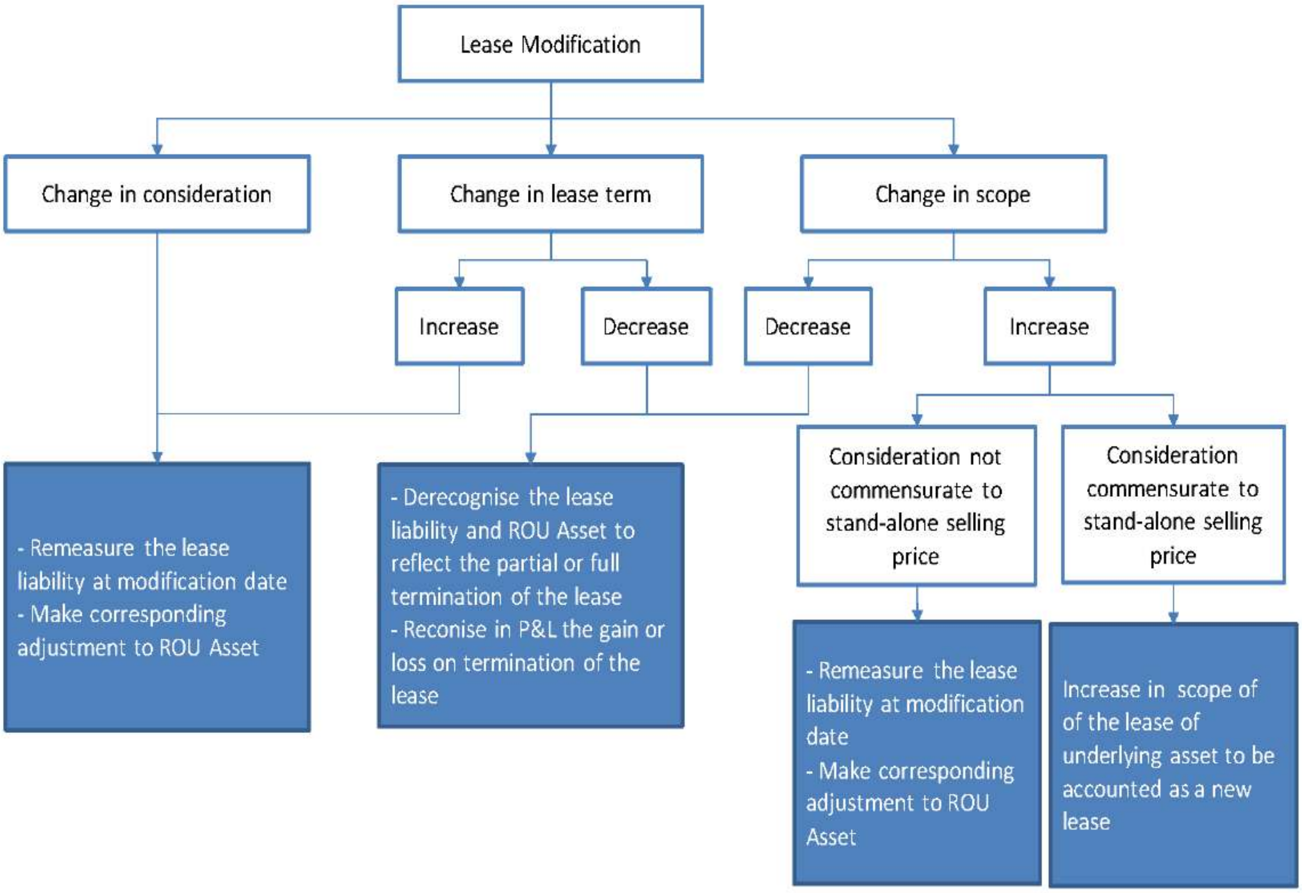
Decrease in Scope

- Remeasure lease liability using revised discount rate *(1)
- Decrease right-of-use asset by its relative scope compared to the original lease (2)
- Difference between (1) and (2) recognised in P&L

All other lease notification

- Remeasure lease liability using revised discount rate*
- Remeasure right-of-use asset by same amount

Lease modification can be summarised as follows :



Question 34 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs.1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., Rs.1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a.

How should the said modification be accounted for?

Question 35 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs.50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are Rs.30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a.

How should the said modification be accounted for?

Question 36 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from Rs.1,00,000 per year to Rs.95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year.

How should the said modification be accounted for?

Question 37 – Lessee enters

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are Rs.1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to:

A. include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and

B. reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is Rs.1,50,000 payable at the end of each year (from

Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

How should the said modification be accounted for?

4. LESSOR ACCOUNTING :

4.1 LEASE CLASSIFICATION :

A 'lessor' is defined as an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

At inception, lessors classify all leases as FINANCE LEASE or OPERATING LEASE.

- Where, a 'Finance Lease' is defined as a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.
- Where, an 'Operating Lease' is defined as a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Ind AS 116 lists a number of examples that individually, or in combination, would normally lead to a lease being classified as a FINANCE LEASE:

Ownership
- The lease transfers ownership of the asset to the lessee by the end of the lease term

Purchase option
- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised

Lease term
- The lease term is for the major part of the economic life of the asset even if title is not transferred

PV of Minimum Lease Payments
- At the inception date, the present value of the lease payments amounts to at least substantially all* of the fair value of the asset

Specialised Nature
- The asset is of such a specialised nature that only the lessee can use it without major modifications

Additionally, Ind AS 116 lists the following indicators of situations that, individually or in combination, could also lead to a lease being classified as a FINANCE LEASE:

Loss on cancellation	• If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
Risk of fair value of the residual asset	• Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (e.g., in the form of a rent rebate that is equal to most of the sale proceeds at the end of the lease)
Option to extend lease	• The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

Lease classification test for land and buildings:

For a lease that includes both land and buildings elements, the lessor separately assesses the classification of each element as a finance lease or an operating lease, having fact that land normally has an indefinite economic life.

The lessor allocates lease payments between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case, the entire lease is classified as an operating lease.

For a lease of land and buildings in which the amount for the land element is immaterial to the lease, the lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease. In such a case, the lessor regards the economic life of the buildings as the economic life of the entire underlying asset.

Key concepts applied by the lessor:

'Gross investment in the lease' is the SUM of:

(a) the lease payments receivable by a lessor under a finance lease; AND

(b) any unguaranteed residual value accruing to the lessor.

'Net investment in the lease' is the gross investment in the lease discounted at the interest rate implicit in the lease.

'Unguaranteed residual value' is that portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

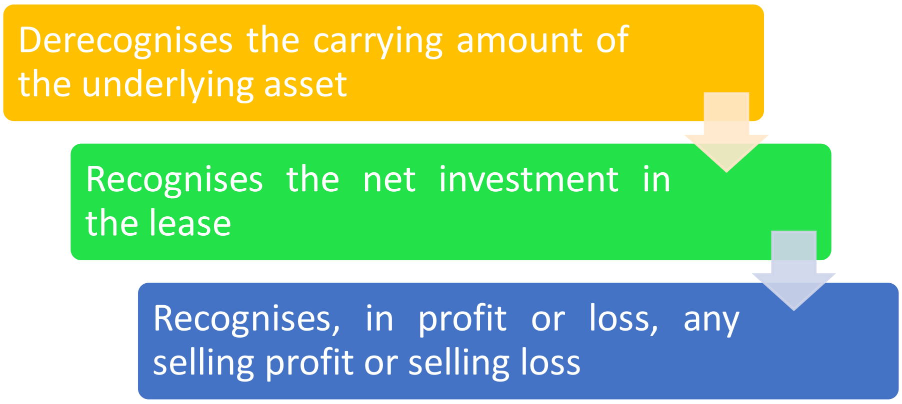
4.2 FINANCE LEASES :

Recognition :

At the commencement date, a lessor shall recognise assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease.

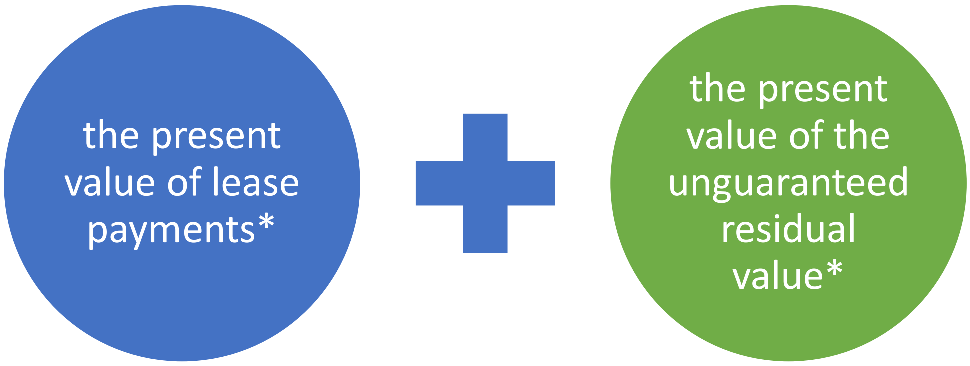
Initial Measurement :

At lease commencement, a lessor accounts for a finance lease, as follows:



For finance leases (other than those involving manufacturer and dealer lessors), initial direct costs are included in the initial measurement of the finance lease receivable. Initial direct costs are included in the lease, and are not added separately to the net investment in lease.

The net investment in the lease is initially measured as the sum of:



Any selling profit or loss is measured as the difference between the fair value of the underlying asset or the lease receivable, if lower, and the carrying amount of the underlying asset, net of any unguaranteed residual asset.

Initial Measurement – Manufacturer or Dealer Lessors :

At the commencement date, a manufacturer or dealer lessor recognises selling profit or loss in accordance with its policy for outright sales to which Ind AS 115 applies.

Therefore, at lease commencement, a manufacturer or dealer lessor recognises the following:

The fair value of the underlying asset as revenue OR the present value of the lease payments discounted using a market rate of interest, whichever is lower.

The cost (or carrying amount) of the asset (less) the present value of the unguaranteed residual value, as cost of sale.

The selling profit or loss in accordance with the policy for outright sales.

Accounting for initial direct costs shall be done in the following manner :

Finance Lease:

Ind AS 116 requires 'lessors' (other than manufacturer or dealer lessors) to include initial direct costs in the initial measurement of their net investments in finance leases and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease and they are not added separately. (Initial direct costs related to finance leases incurred by manufacturer or dealer lessors are expensed at lease commencement).

Operating Lease :

Ind AS 116 requires lessors to include initial direct costs in the carrying amount of the underlying asset in an operating lease. These initial direct costs are recognised as an expense over the lease term on the same basis as lease income.

Subsequent Measurement :

After lease commencement, a lessor accounts for a finance lease, as follows:

- Recognises finance income (in profit or loss) over the lease term in an amount that produces a constant periodic rate of return on the remaining balance of the net investment in the lease (i.e., using the interest rate implicit in the lease).
- Income is recognised on the components of the net investment in the lease, which is Interest on the lease receivables.
- Reduces the net investment in the lease for lease payments received (net of finance income calculated above)
- Separately recognises income from variable lease payments that are not included in the net investment in the lease (e.g., performance- or usage-based variable payments) in the period in which that income is earned
- Recognises any impairment of the net investment in the lease

Remeasurement of the net investment in the lease:

After lease commencement, the net investment in a lease is NOT REMEASURED UNLESS in either of the following situations:

- The lease is modified (i.e., a change in the scope of the lease, or the consideration for the lease, that was not part of the original terms and conditions of the lease) and the modified lease is not accounted for as a separate contract

OR

- The lease term is revised when there is a change in the non-cancellable period of the lease.

Question 38 – A Lessor enters

A Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- Lessor receives annual lease payments of Rs.15,000, payable at the end of the year
- Lessor expects the residual value of the equipment to be Rs.50,000 at the end of the 10-year lease term
- Lessee provides a residual value guarantee that protects Lessor from the first Rs.30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., Rs.50,000)
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of Rs.1,00,000 and a fair value of Rs.1,11,000
- The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset
- The interest rate implicit in the lease is 10.078%.

How should the Lessor account for the same in its books of accounts?

4.3 OPERATING LEASES :

Recognition and Measurement :

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis OR another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit derived from the use of the underlying asset is diminished.

4.4 LEASE MODIFICATIONS :

A 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for e.g., adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Modification- Separate lease :

A lease modification is accounted for as a separate lease if both:

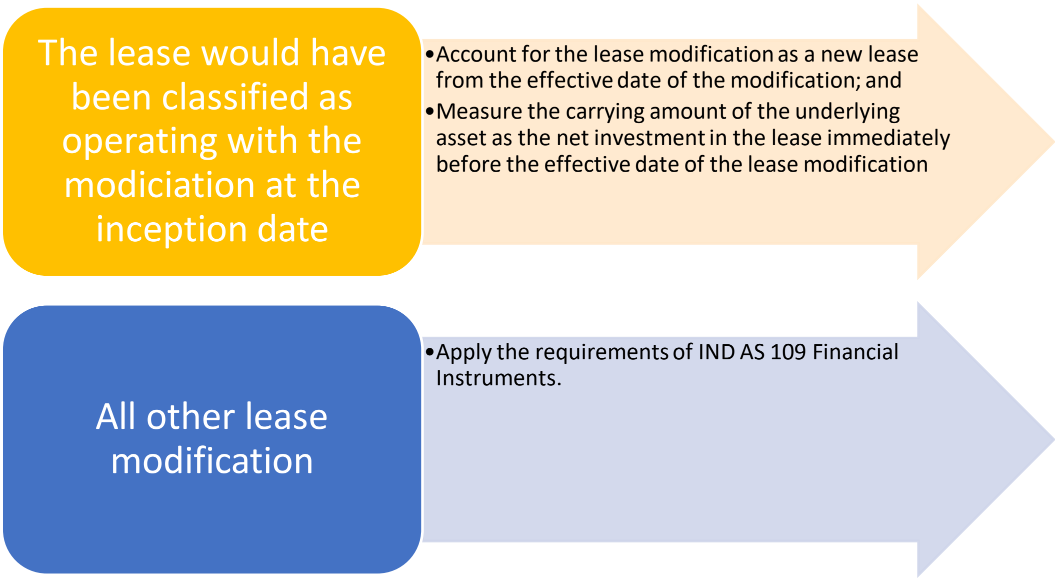
A. The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

B. The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

If both criteria are met, a lessor would follow the existing lessor guidance on initial recognition and measurement.

Modification- Not Separate lease :

If a lease modification fails the test to be considered as separate lease as mentioned above, the lessor follows the following guidance:



Operating Lease Modification:

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

5. OTHER MATTERS :

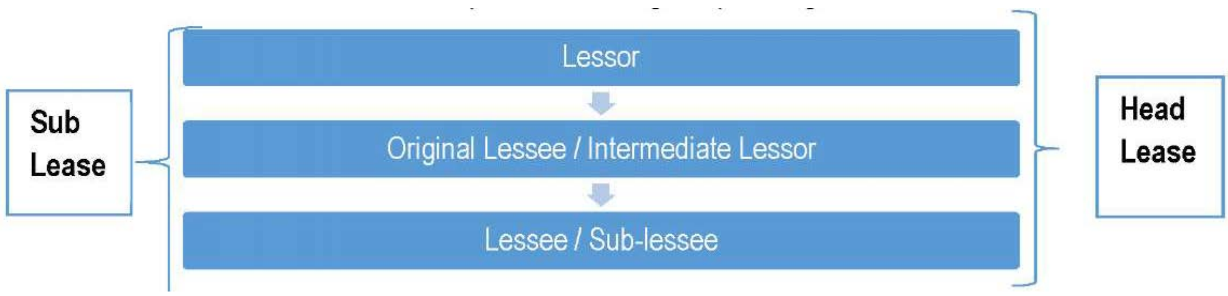
5.1 SUB LEASES :

Recognition and Measurement :

A 'Sub-lease' is defined as a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Lessees often enter into arrangements to sublease a leased asset to a third party while the original lease contract is in effect, where, one party acts as both the lessee and lessor of the same underlying asset. The original lease is often referred to as a 'head lease', the original lessee is often referred to as an 'intermediate lessor' or 'sub-lessor' and the ultimate lessee is often referred to as the 'sub-lessee'.

It can be demonstrated with the help of a following simple diagram:



Intermediate Lessor Accounting :

Where an underlying asset is re-leased by a lessee to a third party and the original lessee retains the primary obligation under the original lease, the transaction is a sublease, i.e., the original lessee generally continues to account for the original lease (the head lease) as a lessee and accounts for the sublease as the lessor (intermediate lessor).

Question 39 – Entity ABC

Entity ABC (original lessee/intermediate lessor) leases a building for five years. The building has an economic life of 40 years. Entity ABC subleases the building for four years.

How should the said sublease be classified by Entity ABC?

The intermediate lessor accounts for the sublease as follows :

If the sublease is classified as a 'Finance Lease'	If the sublease is classified as an 'Operating Lease'
The original lessee derecognises the ROU Asset on the head lease at the sublease commencement date and continues to account for the original lease liability in accordance with the lessee accounting model. The original lessee (as the intermediate lessor) recognises a net investment in the sublease and evaluates it for impairment.	The original lessee continues to account for the lease liability and ROU asset on the head lease like any other lease. If the total remaining carrying amount of the ROU asset on the head lease exceeds the anticipated sublease income, this may indicate that the ROU asset associated with the head lease is impaired (which is assessed for impairment under Ind AS 36).

An intermediate lessor who subleases, or expects to sublease an asset, CANNOT account for the head lease as a lease of a low-value asset even when the required criteria w.r.t. 'leases of lowvalue assets' (as discussed earlier) are satisfied.

Question 40 – Entity XYZ

Head lease:

An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).

Sublease:

At the beginning of Year 3, the intermediate lessor subleases the 10,000 square metres of office space for the remaining lease term i.e. three years of the head lease to a sub-lessee. How should the said sublease be classified and accounted for by the Intermediate Lessor?

Question 41 – Entity PQR

Head lease:

An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity PQR (the head lessor).

Sublease:

At the commencement of the head lease, the intermediate lessor subleases the 10,000 square metres of office space for two years to a sub-lessee. How should the said sublease be classified and accounted for by the Intermediate Lessor?

5.2 SALE AND LEASEBACK TRANSACTIONS :

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee.

Sale and leaseback transactions would no longer provide lessees with a source of off-balance sheet financing because under Ind AS 116, lessees are required to recognise most leases on the balance sheet (i.e., all leases except for leases of low-value assets and short-term leases depending on the lessee's accounting policy election).

Further, both the seller-lessee and the buyer-lessor are required to apply Ind AS 115 to determine whether to account for a sale and leaseback transaction as a sale and purchase of an asset.

How to determine whether the transfer of an asset is a sale:

As discussed above, when determining whether the transfer of an asset should be accounted for as a sale or purchase, both the seller-lessee and the buyer-lessor shall apply the requirements of Ind AS 115 on when an entity satisfies a performance obligation by transferring 'control' of an asset. Thus, there are following two possibilities in this scenario:

If Control is passed	If Control is NOT passed
If the control of an underlying asset is passed to the buyer-lessor, the transaction is accounted for as a 'sale or purchase' of the asset and a 'lease'.	If the control of an underlying asset is NOT passed to the buyer-lessor, both the seller-lessee and the buyer-lessor account for the transaction as a 'financing transaction'.

Transactions in which the transfer of an asset is a 'SALE':

If the transfer of an asset by the seller-lessee satisfies the requirements of Ind AS 115 to be accounted for as a 'sale' of the asset:

Seller-lessee	Buyer-lessor
The seller-lessee shall measure the ROU asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. Thus, the seller-lessee will: - Derecognise the underlying asset - Recognise the gain or loss, if any, that relates to the rights transferred to the buyer-lessor (adjusted for off market terms)	The buyer-lessor shall account for the purchase of the asset, applying applicable Ind ASs and for the lease, applying the lessor accounting requirements under Ind AS 116. Thus, a buyer-lessor accounts for the purchase of the asset in accordance with other Ind ASs based on the nature of the asset (for e.g., Ind AS 16 for property, plant and equipment).
When a sale occurs, both the seller-lessee and the buyer-lessor account for the leaseback in the same manner as any other lease (with adjustments for any off-market terms). Specifically, a seller-lessee recognises a lease liability and ROU asset for the leaseback (subject to the optional exemptions for short-term leases and leases of low-value assets).	

An entity shall make the following adjustments to measure the sale proceeds at fair value if:

- the fair value of the consideration for the sale of an asset does not equal the fair value of the asset

OR

- the payments for the lease are not at market rates:
  - (a) any below-market terms shall be accounted for as a prepayment of lease payments; AND
  - (b) any above-market terms shall be accounted for as an additional financing provided by the buyer-lessor to the seller-lessee.

The sale transaction and the resulting lease are generally interdependent and negotiated as a package. Consequently, some transactions could be structured with a negotiated sales price that is above or below the asset's fair value and with lease payments for the resulting lease that are above or below the market rates. These off-market terms could mislead / falsify the gain or loss on the sale and the recognition of lease expense and lease income for the lease. Thus, to ensure that the gain or loss on the sale and the lease-related assets and liabilities associated with such transactions are NEITHER understated NOR overstated, Ind AS 116 requires adjustments for any off-market terms of sale and leaseback transactions, on the more readily determinable basis (as discussed above). Thus, the two possibilities of the sale price OR the present value of the lease payments being 'less' or 'greater' than the fair value of the asset OR present value of the market lease payments, respectively, is discussed in detail :

When sale price or Present Value is LESS	When sale price or Present Value is GREATER
Using the more readily determinable basis:	Using the more readily determinable basis:
When the sale price is LESS than the underlying asset's fair value OR	When the sale price is GREATER than the underlying asset's fair value OR
the present value of the lease payments is LESS than the present value of the market lease payments,	the present value of the lease payments is GREATER than the present value of the market lease payments,
a seller-lessee recognises the difference as an increase to the sales price and the initial measurement of the ROU asset as a 'lease prepayment'.	a seller-lessee recognises the difference as a reduction in the sales price and an 'additional financing received' from the buyer-lessor.
Buyer-lessors are also required to adjust the purchase price of the underlying asset for any off-market terms. Such adjustments are recognised as:	
- 'lease prepayments' made by the seller-lessee OR	
- 'additional financing provided' to the seller-lessee.	

Question 42 – An entity

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of Rs.30,00,000. Immediately before the transaction, the building is carried at a cost of Rs.15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments of Rs.2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Sellerlessee satisfies the requirements for determining when a performance obligation is satisfied in Ind AS 115 Revenue from Contracts with Customers.

The fair value of the building at the date of sale is Rs.27,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee.

Buyer-lessor classifies the lease of the building as an operating lease.

How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?

Transactions in which the transfer of an asset is 'NOT a SALE':

If the transfer of an asset by the seller-lessee does not satisfy the requirements of Ind AS 115 to be accounted for as a 'sale' of the asset :

Seller-lessee	Buyer-lessor
The seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the	The buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer

transfer proceeds. It shall account for the financial liability applying Ind AS 109.	proceeds. It shall account for the financial asset applying Ind AS 109.
Thus, the seller-lessee accounts for the transaction as a financing transaction. The seller-lessee keeps the transferred asset subject to the sale and leaseback transaction on its balance sheet and accounts for amounts received as a financial liability in accordance with Ind AS 109. The seller-lessee decreases the financial liability by the payments made less the portion considered as interest expense.	Thus, the buyer-lessor does not recognise the transferred asset and accounts for the amounts paid as a receivable in accordance with Ind AS 109.

6. TRANSITION APPROACH :

An entity shall apply Ind AS 116 for annual reporting periods beginning on or after 01 April 2019.

For the purposes of the requirements of this 'Transition' section, the date of initial application is the beginning of the annual reporting period in which an entity first applies Ind AS 116.

Thus, Ind AS 116's transition provisions are applied at the beginning of the annual reporting period in which the entity first applies Ind AS 116 (i.e., the date of initial application). For e.g., an entity with a reporting date of 31 March 2020, applies the transition provisions on 01 April 2019.

Transition Options for Lessees :

A lessee is required to apply Ind AS 116 to its leases in either of the following ways:

Full Retrospective Approach	Modified Retrospective Approach
Retrospectively to each prior reporting period presented, applying Ind AS 8, i.e., an entity applies Ind AS 116 as if it had been applied since the inception of all lease contracts that are presented in the financial statements. If Ind AS 116 is applied at 01 April 2019, this means that, in the 31 March 2020 financial statements, the comparative period to 31 March 2019 must be restated (assuming that this is the only comparative period presented). A restated opening balance sheet at 01 April 2018 will also need to be disclosed	Retrospectively with cumulative effect of initially applying Ind AS 116 recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of the initial application. Therefore, restatement of comparatives is not required and only Balance sheets for reporting date and comparative date is required to be presented.

as required by Ind AS 1. Hence, the balance sheets for 3 period will be presented: As at 31 March 2020, 31 March 2019 & 1 April 2018	

1. <u>Modified Retrospective Approach :</u>

<u>Leases Previously Classified as Operating Leases :</u>

When applying the modified retrospective approach, a lessee does not restate comparative figures rather, a lessee recognises the cumulative effect of initially applying Ind AS 116 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

For leases previously classified as operating leases under Ind AS 17, a lessee recognises a lease liability measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application. A lessee measures the ROU asset on a lease-by-lease basis, at either:

- Its carrying amount as if Ind AS 116 had always been applied since the commencement date, but using a discount rate based on the lessee's incremental borrowing rate at the date of initial application (Alternative 1)

OR

- An amount equal to the lease liability, adjusted for previously recognised prepaid or accrued lease payments (Alternative 2)

Additionally, a lessee is also permitted to apply the following practical expedients to leases previously classified as operating leases (when applying modified retrospective approach), on a **lease-by-lease basis:**

Discount rate	• Apply a single discount rate to a portfolio of leases with reasonably similar characteristics;
Onerous contracts	• Rely on its assessment of whether leases are onerous by applying Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets as opposed to performing an impairment review;
Short term leases	• Not recognise leases whose term ends within 12 months of the date of initial application of Ind AS 116. If this election is taken, these leases are accounted for as short-term leases;
Initial direct cost	• Exclude initial direct costs from the measurement of right-of-use assets at the date of initial application;
Hindsight	• Use hindsight, such as in determining the lease term for leases that contain options

Leases Previously Classified as Finance Leases :

When applying modified retrospective approach, for leases that were classified as finance leases applying Ind AS 17, the carrying amount of the ROU asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying Ind AS 17. For such leases, a lessee shall account for the ROU asset and the lease liability applying Ind AS 116 from the date of initial application. Thus, a lessee will not change its initial carrying amounts for assets and liabilities under finance leases existing at the date of initial application of Ind AS 116.

For leases previously classified as operating leases and finance leases, the below table summarises the application of Modified retrospective approach:

Operating Lease	Lease liability	Measure at the present value of the remaining lease payments, discounted using lessee's incremental borrowing rate at the date of initial application
	Right-of-use asset	Retrospective calculation, using a discount rate based on lessee's incremental borrowing rate at the date of initial application.
		or
		Amount of lease liability (adjusted by the amount of any previously recognised prepaid or accrued lease payments relating to that lease).
		Lessee can choose one of the alternatives on a lease-by-lease basis.
Finance Lease	Lease liability	Carrying amount of the lease liability immediately before the date of initial application.
	Right-of-use asset	Carrying amount of the lease asset immediately before the date of initial application.
	Application of Ind AS 116	Apply the provisions of this standard to Right of Use asset and lease liability from the date of initial application.

The standard also prescribes certain practical expedients under Modified retrospective approach to leases previously classified as operating leases applying Ind AS 17.

Question 43 – A retailer

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of Rs 2,00,000 due on 31 March 2018, 2019 and 2020, respectively. The lease is classified as an operating lease under Ind AS 17. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1 April 2019. The incremental borrowing rate at the date of the initial application (i.e., 1 April 2019) is 10% p.a. and at the commencement of the lease (i.e., 1 April 2017) was 12% p.a. The ROU asset is subject to straight-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee using all the following transition approaches:

Full Retrospective Approach

Modified Retrospective Approach - Alternative 1 - Alternative 2 ?

7. SELF PRACTICE QUESTIONS :

Question 44 – A retailer

A lessee enters into a ten-year contract with a lessor (freight carrier) to transport a specified quantity of goods. Lessor uses rail wagons of a particular specification, and has a large pool of similar rail wagons that can be used to fulfil the requirements of the contract. The rail wagons and engines are stored at lessor's premises when they are not being used to transport goods. Costs associated with substituting the rail wagons are minimal for lessor.

Whether the lessor has substantive substitutions rights and whether the arrangement contains a lease?

Question 45 – Customer M

Customer M enters into a 20-year contract with Energy Supplier S to install, operate and maintain a solar plant for M's energy supply. M designed the solar plant before it was constructed – M hired experts in solar energy to assist in determining the location of the plant and the engineering of the equipment to be used. M has the exclusive right to receive and the obligation to take any energy produced. Whether it can be established that M is having the right to control the use of identified asset?

Question 46 – A Customer

A Customer enters into a ten-year contract with a Company (a ship owner) for the use of an identified ship. Customer decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent the company from sailing the ship into waters at a high risk of piracy or carrying explosive materials. The company operates and maintains the ship, and is responsible for safe passage.

Does the customer has the right to direct how and for what purpose the ship is to be used throughout the period of use and whether the arrangement contains a lease?

Question 47 – A Lessee

A Lessee enters into a ten-year lease contract with a Lessor to use an equipment. The contract includes maintenance services (as provided by lessor). The Lessor obtains its own insurance for the equipment. Annual payments are Rs.10,000 (Rs.1,000 relate to maintenance services and Rs.500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for Rs.2,000 and Rs.500 a year, respectively. The Lessee is unable to find an observable stand-alone rental amount for a similar equipment because none is leased without related maintenance services provided by the lessor.

How would the Lessee allocate the consideration to the lease component?

Question 48 – A Lessee

A Lessee enters into a non-cancellable lease contract with a Lessor to lease a building. Initially, the lease is for five years, and the lessee has the option to extend the lease by another five years at the same rental.

To determine the lease term, the lessee considers the following factors:

- Market rentals for a comparable building in the same area are expected to increase by 10% over the ten-year period covered by the lease. At inception of the lease, lease rentals are in accordance with current market rents.
- The lessee intends to stay in business in the same area for at least 20 years.
- The location of the building is ideal for relationships with suppliers and customers.

What should be the lease term for lease accounting under Ind AS 116?

Question 49 – A Lessee

A Lessee enters into a lease of a five-year-old machine. The non-cancellable lease term is 15 years. The lessee has the option to extend the lease after the initial 15-year period for optional periods of 12 months each at market rents.

To determine the lease term, the lessee considers the following factors:

- The machine is to be used in manufacturing parts for a type of plane that the lessee expects will remain popular with customers until development and testing of an improved model are completed in approximately 15 years.
- The cost to install the machine in lessee's manufacturing facility is significant.
- The non-cancellable term of lessee's manufacturing facility lease ends in 19 years, and the lessee has an option to renew that lease for another twelve years.
- Lessee does not expect to be able to use the machine in its manufacturing process for other types of planes without significant modifications.
- The total remaining life of the machine is 30 years.

What should be the lease term for lease accounting under Ind AS 116?

Question 50 – A Company

A Company leases a manufacturing facility. The lease payments depend on the number of operating hours of the manufacturing facility, i.e., the lessee has to pay Rs.2,000 per hour of use. The annual minimum payment is Rs.2,00,00,000. The expected usage per year is 20,000 hours.

Whether the said payments be included in the calculation of lease liability under Ind AS 116?

Thanks ....

CHAPTER

11

IND AS 41 – AGRICULTURE

CONCEPTS COVERED

1. SCOPE
2. DEFINITIONS
3. RECOGNITION OF ASSETS
4. MEASUREMENT
5. GAINS & LOSSES
6. GOVERNMENT GRANTS
7. SELF PRACTICE QUESTIONS

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1. SCOPE :

1. This Standard shall be applied to account for the following when they relate to agricultural activity:
   (a) biological assets;
   (b) agricultural produce at the point of harvest; and
   (c) government grants
2. Ind AS 41 does not apply to:
   (a) land related to agricultural activity : for example, the land on which the biological assets grow, regenerate and/or degenerate (Ind AS 16 Property, Plant and Equipment and Ind AS 40 Investment Property);
   (b) bearer plants related to agricultural activity. Such bearer plants covered within the scope of Ind AS 16, Property, plant and Equipment as accounted as per the provisions of that standard. However, this Standard applies to the produce on those bearer plants.
   (c) government grants related to bearer plants (Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).
   (d) intangible assets associated with the agricultural activity, for example licenses and rights are covered under Ind AS 38 Intangible Assets and provisions of this standard will be applicable.

This Standard is applied to agricultural produce, which is the harvested product of the entity's biological assets, only at the point of harvest. Thereafter, Ind AS 2 or another applicable Standard is applied.

Example:
Processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.

Example:
Agriculture produce after the point of harvest, for example Wool, meat, fruit, rubber, logs that are processed subsequently are not covered within purview of this standard and Ind AS 2 Inventories will apply.

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

Biological Assets	Agricultural Produce	Products that are result of processing after harvest
Sheep	Wool	Yarn, Carpet
Trees in timber plantation	Felled Trees	Logs, Lumber
Dairy Cattle	Milk	Cheese
Pigs	Carcass	Sausages, Cured hams
Cotton Plants	Harvested Cotton	Thread, Clothing

Sugarcane	Harvested Cane	Sugar
Tobacco Plants	Picked Leaves	Cured Tobacco
Tea Blushes	Picked Leaves	Tea
Grape Vines	Picked Grapes	Wine
Fruit trees	Picked fruit	Processed fruit
Rubber trees	Harvested latex	Rubber Products

Some plants, for example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are within the scope of Ind AS 16, Property, plant and Equipment. However, the produce growing on bearer plants, for example, tea leaves, grapes, oil palm fruit and latex, is within the scope of Ind AS 41.

2. DEFINITIONS :

1. Agricultural Activity :

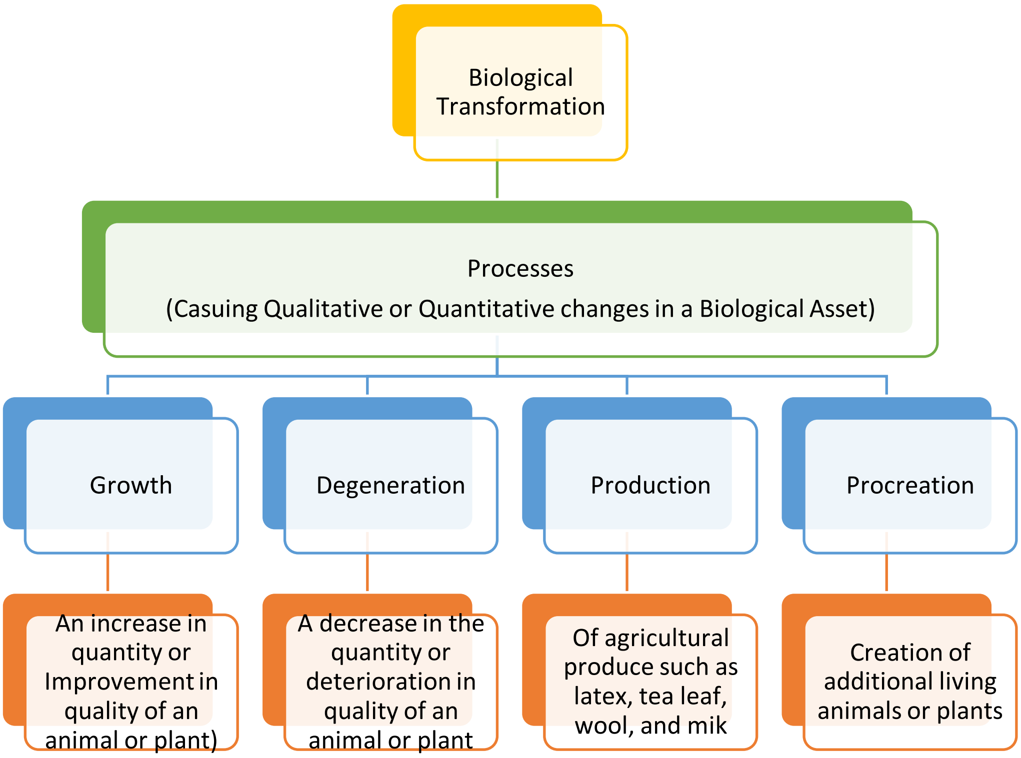
Agricultural activity refers to the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

2. Biological Asset :

Biological Asset is defined as a living animal or plant.

3. Biological Transformation :

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



4. Agricultural produce :

Agricultural produce is the harvested product of the entity's biological assets.

5. **Harvest :**

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

Question 1 – ABC Ltd.

ABC Ltd. grows vines, harvests the grapes and produces wine. Which of these activities are in the scope of Ind AS 41?

3. RECOGNITION OF ASSETS :

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

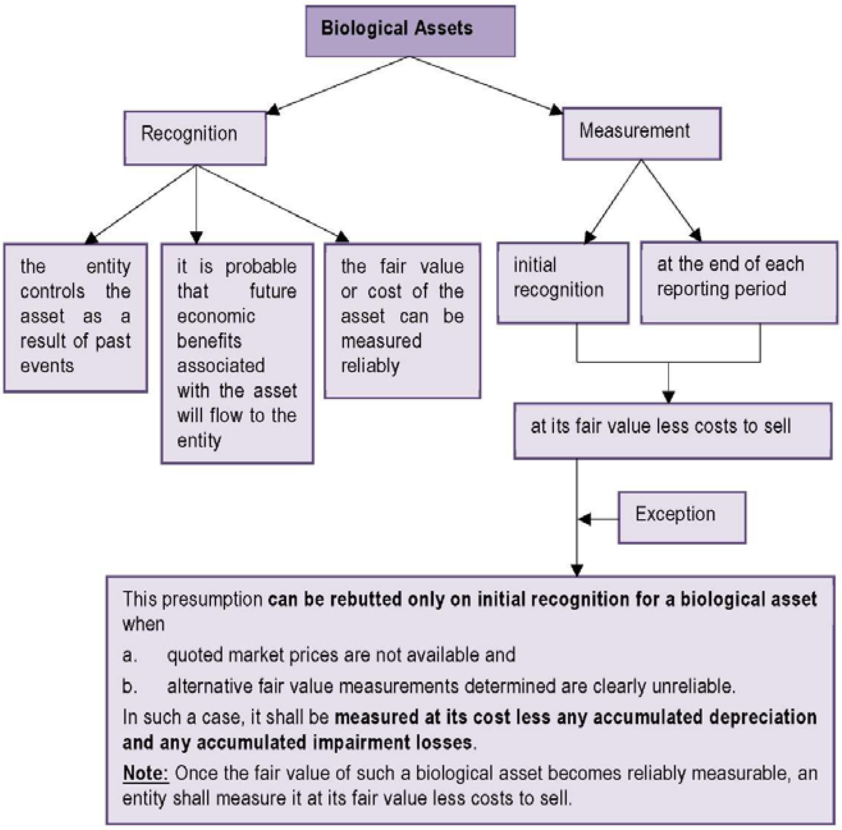
a) the entity controls the asset as a result of past events; Control over biological assets or agricultural produce may be evidenced by legal ownership or rights to control, for example legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning.

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

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

4. MEASUREMENT :

Biological Asset should be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except for the case where the fair value cannot be measured reliably.



Question 2 – A farmer

A farmer owned a dairy herd, of three years old cattle as at April 1, 2011 with a fair value of Rs.13,750 and the number of cattle in the herd was 250.
The fair value of three year cattle as at March 31, 20X2 was R. 60 per cattle. The fair value of four year cattle as at March 31, 20X2 is Rs.75 per cattle.
Calculate the measurement of group of cattle as at March 31, 2012 stating price and physical change separately.

Question 3 – XYZ Ltd.

XYZ Ltd., on 1 December 20X3, purchased 100 sheep's from a market for Rs.500,000 with a transaction cost of 2%. Sheep's fair value increased from Rs.500,000 to Rs.600,000 on 31 March 2014. Determine the fair value on the date of purchase and pass necessary journal entries.

5. GAINS AND LOSSES :

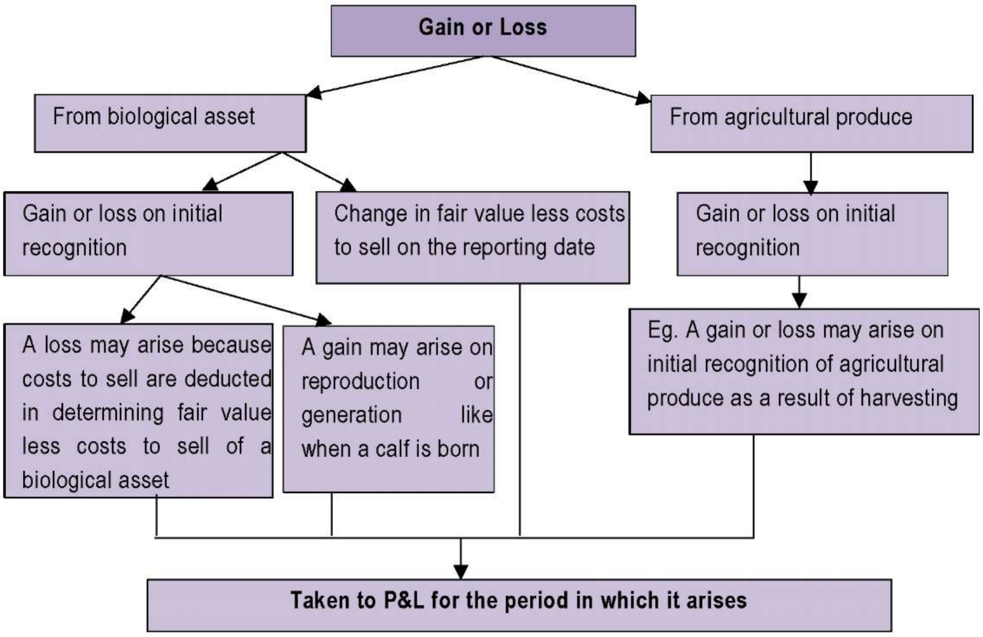
1) Biological Asset :

A gain or loss arising on initial recognition of a Biological Asset at Fair value less costs to sell and from a change in Fair value less costs to sell of a biological asset shall be included in Profit or Loss for the period in which it arises.
A loss may arise on initial recognition of a biological asset, because cost to sell are deducted in determining fair value less cost to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

Example:
During the reporting period 2011-2012, an entity is having a cow which has given birth to a calf. The fair value less estimated cost to sell for a calf is Rs.5,000. The amount of Rs.5,000 is, therefore, immediately recognised in Statement of Profit or Loss.

2) Agriculture Produce :

A gain or loss arising on initial recognition of Agricultural produce at Fair value less costs to sell shall be included in Profit or Loss for the period in which it arises.
A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting



6. GOVERNMENT GRANTS :

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

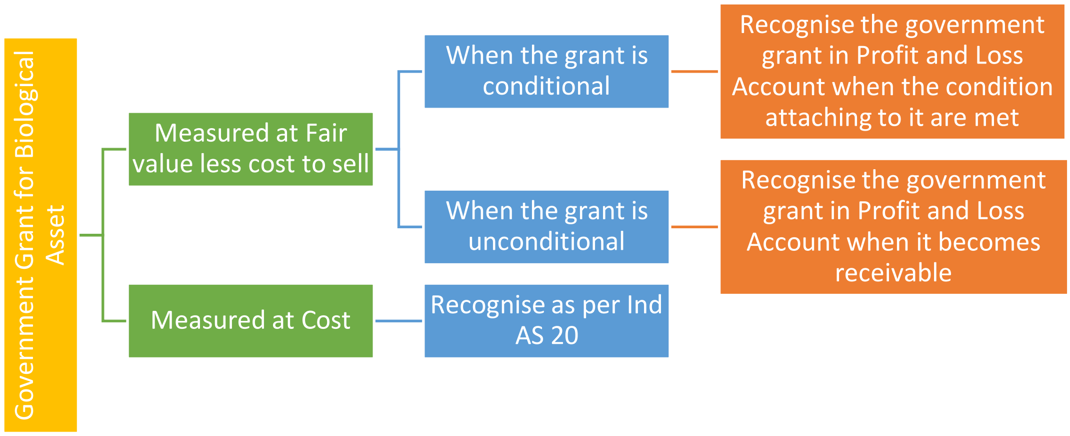
a) Unconditional Grant: An unconditional government grant related to a biological asset measured at its fair value less costs to sell shall be recognised in Profit or Loss when, and only when, the government grant becomes receivable.

b) Conditional Grant : If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met.
Terms and conditions of government grants vary. For example, a grant may require an entity to farm in a particular location for five years and require the entity to return the entire grant if it farms for a period shorter than five years. In this case, the grant is not recognised in Profit or Loss until the five years have passed. However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognises that part in profit or loss as time passes.

Example:
Sun Ltd cultivated a huge plot of land. The government offers a grant of Rs.10 crore under the condition that the land is being cultivated for 5 years. If the land will be cultivated for a shorter period, the entity is required to return the entire grant.
Therefore, the government grant will be recognised as income only after 5 years of cultivation. The situation would be different if the returning obligation referred to the years of not cultivating the land is with respect to retention of grant for the period till which the entity has cultivated the land. In this case, the amount of Rs.10 crore would be recognised as income, proportionately with the time period, meaning Rs.2 crore per annum.

2. **<u>Biological Asset measured at its cost:-</u>**

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



Question 4 – Moon Ltd.

Moon Ltd prepares financial statements to 31 March each year. On 1 April 2011 the company carried out the following transactions:

– Purchased a land for Rs.50 Lakhs.

– Purchased 200 dairy cows (average age at 1 April 2011 two years) for Rs.10 Lakhs.

– Received a grant of Rs.1 million towards the acquisition of the cows. This grant was nonrefundable.

For the year ending 31 March 20X2, the company has incurred following costs:

– Rs.6 Lakh to maintain the condition of the animals (food and protection).

– Rs.4 Lakh as breeding fee to a local farmer.

On 1 October 2011, 100 calves were born. There were no other changes in the number of animals during the year ended 31 March 2012. As of 31 March 2012, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.

Information regarding fair values is as follows:

Items	**Fair Value less cost to sales**		
	1/4/2011 (Rs.)	**1/10/2011 (Rs.)**	**31/3/2012 (Rs.)**
Land	50 lakhs	60 lakhs	70 lakhs
New born calves (per calf)	1000	1100	1200
Six month old calves (per calf)	1100	1200	1300
Two year old cows (per cow)	5000	5100	5200
Three year old cows (per cow)	5200	5300	5500
Milk (per Litre)	20	22	24

Prepare extracts from the Balance Sheet and Statement of Profit & Loss that would be reflected in the financial statements of the entity for the year ended 31 March 2012.

7. SELF PRACTICE QUESTIONS :

Question 5 – Entity A

Entity A purchased cattle at an auction on 30th June 20X1

Purchase price at 30th June 20X1	Rs. 1,00,000
Costs of transporting the cattle back to the entity's farm	Rs. 1,000
Sales price of the cattle at 31st March, 20X2	Rs. 1,10,000

The company would have to incur similar transportation costs if it were to sell the cattle at auction, in addition to an auctioneer's fee of 2% of sales price. The auctioneer charges 2% of the selling price, from both, the buyer as well as the seller.
Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March, 20X2.

Question 6 – XY Ltd.

XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. had a herd of 500 cows which were all three years old.
During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows from the market for Rs. 21,000 each. These 20 cows were all one year old when they were purchased.
On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was Rs. 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of Rs. 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.
Information relating to fair value and costs to sell is given below:

Date	Fair value of a dairy cow (aged)				Costs to sell a cow
	1 year	1.5 years	3 years	4 years	
1st April 20X1	20,000	22,000	27,000	25,000	1,000
1st October 20X1	21,000	23,000	28,000	26,000	1,000
31st March 20X2	21,500	23,500	29,000	26,500	1,100

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is Rs. 27,000.
Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.

Question 7 – Company X

Company X purchased 100 goats at an auction for Rs. 1,00,000 on 30 September 20X1. Subsequent transportation costs were Rs. 1,000 that is similar to the cost X would have to incur to sell the goat at the auction. Additionally, there would be a 2% selling fee on the market price of the goat to be incurred by the seller.

On 31 March 20X2, the market value of the goat in the most relevant market increases to Rs. 1,10,000. Transportation costs of Rs. 1,000 would have to be incurred by the seller to get the goat to the relevant market. An auctioneer's fee of 2% on the market price of the goat would be payable by the seller.

On 1 June 20X2, X sold 18 goats for Rs. 20,000 and incurred transportation charges of Rs. 150. In addition, there was a 2% auctioneer's fee on the market price of the goat paid by the seller.

On 15 September 20X2, the fair value of the remaining goat was Rs. 82,820. 42 goats were slaughtered on that day, with a total slaughter cost of Rs. 4,200. The total market price of the carcasses on that day was Rs. 48,300, and the expected transportation cost to sell the carcasses is Rs. 420. No other costs are expected.

On 30 September 20X2, the market price of the remaining 40 goat was Rs. 44,800. The expected transportation cost is Rs. 400. Also, there would be a 2% auctioneer's fee on the market price of the goat payable by the seller.

Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.

Question 8 – C Agro Ltd.

On 1st November, 20X1, C Agro Ltd. purchased 100 goats of special breed from a market for Rs. 10,00,000 with a transaction cost of 2%. Goats fair value decreased from Rs. 10,00,000 to Rs. 9,00,000 as on 31st March, 20X2.

Determine the fair value on the date of purchase and as on financial year ended 31st March, 20X2 under both the cases viz-

(i) the transaction costs are borne by the seller and

(ii) the transaction costs are incurred by the seller and purchaser both.

Also pass journal entries under both the situations on both dates.

Question 9

Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses

- Growing of plants to be used in the production of drugs
- Purchase of 25 dogs for security purpose of the company's premises.

Question 10 – Pinus Radiata trees

As at 31st March, 2011, a plantation consists of 100 Pinus Radiata trees that were planted 10 years earlier. The tree takes 30 years to mature, and will ultimately be processed into building material for houses or furniture. The enterprise's weighted average cost of capital is 6% p.a.

Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:

As at 31st March, 2011: 171

As at 31st March, 20X2: 165

Assume that there would be immaterial cash flow between now and point of harvest.

The present value factor of Rs 1 @ 6% for

19th year = 0.331

20th year = 0.312

State the value of such plantation as on 31st March, 2011 and 2012 and the gain or loss to be recognised as per Ind AS.

Thanks ....

Rahul Malkan....

CHAPTER

12

IND AS 108 – OPERATING SEGMENTS

CONCEPTS COVERED

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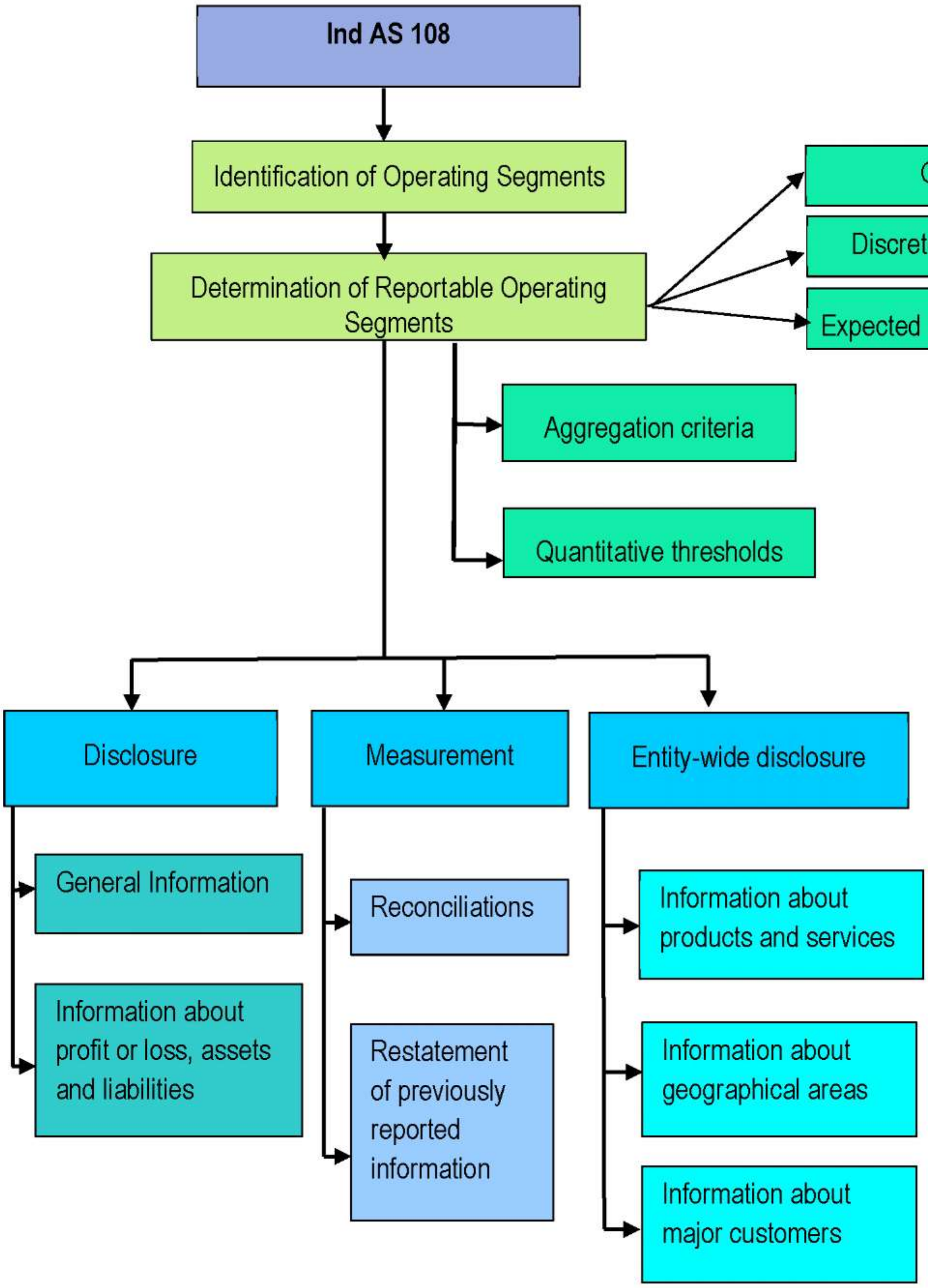
1. INTRODUCTION :



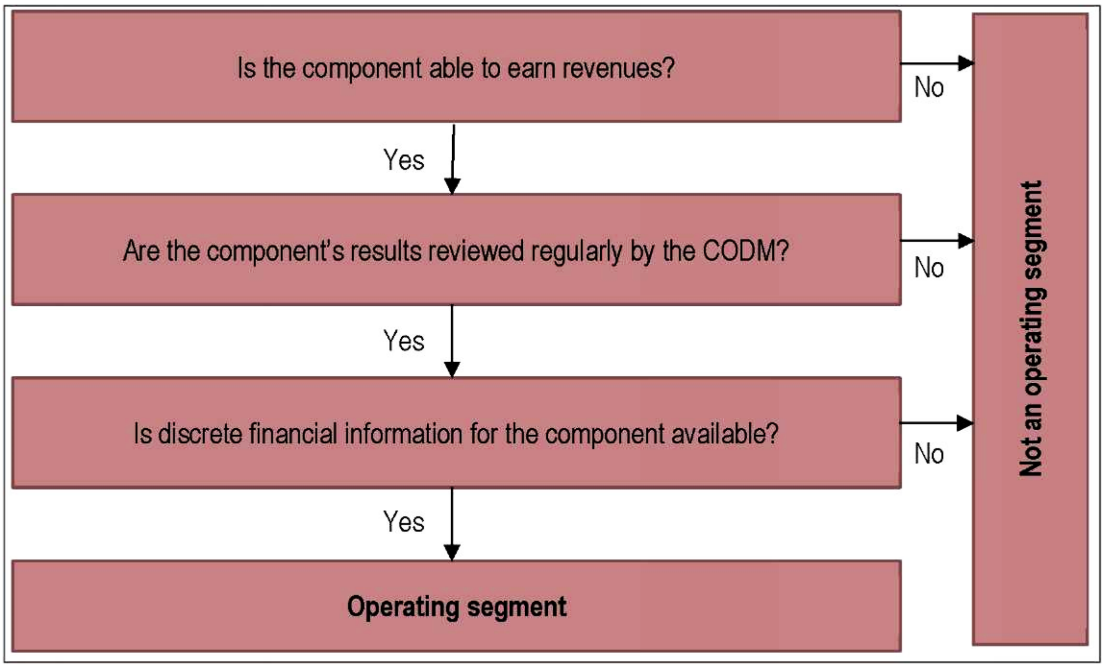
2. OPERATING SEGMENTS

An operating segment is a component of an entity:

a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity);

b) whose operating results are regularly reviewed by the entity's chief operating decision maker (CODM) to make decisions about resources to be allocated to the segment and assess its performance; and

c) for which discrete financial information is available.



An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

Question 1 – ABC Ltd.

ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages products B & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by the CODM. Identify reportable segments of ABC Ltd.

Question 2 – The CEO

The CEO along with other Board members do a review of financial information about various business segments and take decisions on the basis of discrete information available for these segments and are correctly identified as **Chief Operating Decision Maker (CODM).** Review of only revenue information is done for decision making about those segments by the CODM. As per CODM, many segments require minimal costs due to centralization of costs. Whether review of only the revenue related information is sufficient for these segments to be considered as operating segments for the purposes of Ind AS 108 'Operating Segments'?

3. CODM - "CHIEF OPERATING DECISION MAKER" :

The term 'chief operating decision maker' (CODM) identifies a function, not necessarily a manager with a specific title.

- That function is to allocate resources to
- assess the performance of the operating segments of an entity.
- Often the CODM of an entity is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others.

Question 3 – X Ltd.

X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per the geographical location of the company. The CODM regularly reviews the operating results of both sets of components. How should X Ltd. identify its operating segments?

Question 4 – CODM of XY Ltd.

CODM of XY Ltd. receives and reviews multiple sets of information when assessing the businesses' overall performance to take a decision on resources allocation. It receives the information as under:

- Level 1 Report: Summary report for all 4 regions
- Level 2 Report: Summary report for 20 Sub-regions within those regions
- Level 3 Report: Detailed report for 50 Branches within the sub-regions

What factors and level should be considered for determining an operating segment?

4. REPORTABLE SEGMENTS :

An entity should report separately information about each operating segment that:

(a) has been identified or results from aggregating two or more of those segments; and

(b) exceeds the quantitative thresholds.

Standard specifies other situations in which separate information about an operating segment should be reported.

Identify CODM → Identify operating Segments → Determine Reportable Segments → Disclose information

5. AGGREGATION CRITERIA :

Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of Ind AS 108, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) the nature of the products and services;

(b) the nature of the production processes;
(c) the type or class of customer for their products and services;
(d) the methods used to distribute their products or provide their services; and
(e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

Question 5 – XY Ltd.

XY Ltd. has operations in France, Italy, Germany, UK and India. It wishes to apply aggregation criteria on geographical basis.

How will the aggregation criteria apply for reporting segments in the given scenario?

Question 6 – X Ltd.

X Ltd. is engaged in the business of manufacturing and selling papers. Varieties of paper like adhesive paper, anti-rust paper, antique paper, art paper etc., are manufactured and sold by X Ltd. Should X Ltd. classify these papers into different segments?

Question 7 – X Ltd.

T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:

- Segment 1: Local Route
- Segment 2: Inter-city Route
- Segment 3: Contract Hiring

The characteristics of each segment are as under:

Segment 1: The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.

Segment 2: T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).

Segment 3: T Ltd also leases buses to schools under a long-term arrangement.

While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under '**Operating Segment'**

Required:

Whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'? and

Discuss, in the above context, whether disclosure of segment information is relevant to an investor's appraisal of financial statements?

6. QUANTITATIVE THRESHOLDS :

1. An entity should report separately information about an operating segment that meets any of the following quantitative thresholds:
   a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10% or more of the combined revenue, internal and external, of all operating segments.
   b) The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of
      (i) the combined reported profit of all operating segments that did not report a loss and
      (ii) the combined reported loss of all operating segments that reported a loss
   c) Its assets are 10% or more of the combined assets of all operating segments.
2. Operating segments that do not meet any of the quantitative thresholds may be considered reportable and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.
3. External revenue of reportable segments must be ≥ 75% of total external revenue of the entity.

Question 8 – RM Ltd.

From the information given for RM Ltd. identity its reportable segments

Segments	External Sales	Inter Segment Transfers	Total Revenue	Total Profit	Total Assets
A	200	60	260	-85	48
B	--	100	100	10	20
C	35	30	65	15	6
D	10	--	10	-25	4
E	15	5	20	12	2
F	55	--	55	5	6
G	50	5	55	7	5
H	45	5	50	23	9

Question 9 – X Ltd.

X Limited has identified the following business components

Segment	Revenue		Profit (Rs)	Assets (Rs)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000
FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Others	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in IND AS 108.

7. SELF PRACTICE QUESTIONS :

Question 10 – Y Ltd.

Y Ltd. has identified 4 operating segments for which revenue data is given below:

	External Sale (Rs)	Internal Sale (Rs.)	Total (Rs.)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
Total Sales	50,00,000	50,00,000	1,00,00,000

Additional information:

Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108?

Question 11 – X Ltd.

X Ltd. is operating in coating industry. Its business segment comprise coating and others consisting of chemicals, polymers and related activities. Certain information for financial year 2011-2012 is given below:

Rs.In Lakhs

Segment	External Sale	Tax	Other operating income	Result	Asset	Liabilities
Coating	2,00,000	5,000	40,000	10,000	50,000	30,000
Others	70,000	3,000	15,000	4,000	30,000	10,000

Additional information:

i. Unallocated revenue net of expenses is Rs.30,00,00,000

ii. Interest and bank charges is Rs.20,00,00,000

iii. Income tax expenses is Rs.20,00,00,000 (current tax Rs.19,50,00,000 and deferred tax Rs.50,00,000)

iv. Investments Rs.1,00,00,00,000 and unallocated assets Rs.1,00,00,00,000.

v. Unallocated liabilities, Reserve & surplus and share capital are Rs.2,00,00,00,000, Rs.3,00,00,00,000 & Rs.1,00,00,00,000 respectively.

vi. Depreciation amounts for coating & others are Rs.10,00,00,000 and Rs.3,00,00,000 respectively.

vii. Capital expenditure for coating and others are Rs.50,00,00,000 and Rs.20,00,00,000 respectively.

viii. Revenue from outside India is Rs.3,00,00,00,000 and segment asset outside India Rs.1,00,00,00,000

Based on the above information, how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 2011-2012?

Question 12 – An entity

An entity uses the weighted average cost formula to assign costs to inventories and cost of goods sold for financial reporting purposes, but the reports provided to the chief operating decision maker use the First-In, First-Out (FIFO) method for evaluating the performance of segment operations. Which cost formula should be used for Ind AS 108 disclosure purposes?

Question 13 – ABC Limited

ABC Limited has 5 operating segments namely A, B, C, D and E. The profit/ loss of respective segments for the year ended March 31, 20X1 are as follows:

Segment	**Profit/(Loss) (Rs. in crore)**
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	**1,480**

Based on the quantitative thresholds, which of the above segments A to E would be considered as reportable segments for the year ending March 31, 20X1?

Thanks ....

CHAPTER

13

IND AS 34 – INTERIM FINANCIAL REPORTING

CONCEPTS COVERED

1. INTRODUCTION
2. DEFINITIONS
3. CONTENTS OF AN INTERIM FINANCIAL REPORT
4. RECOGNITION AND MEASUREMENT
5. SELF PRACTICE QUESTIONS

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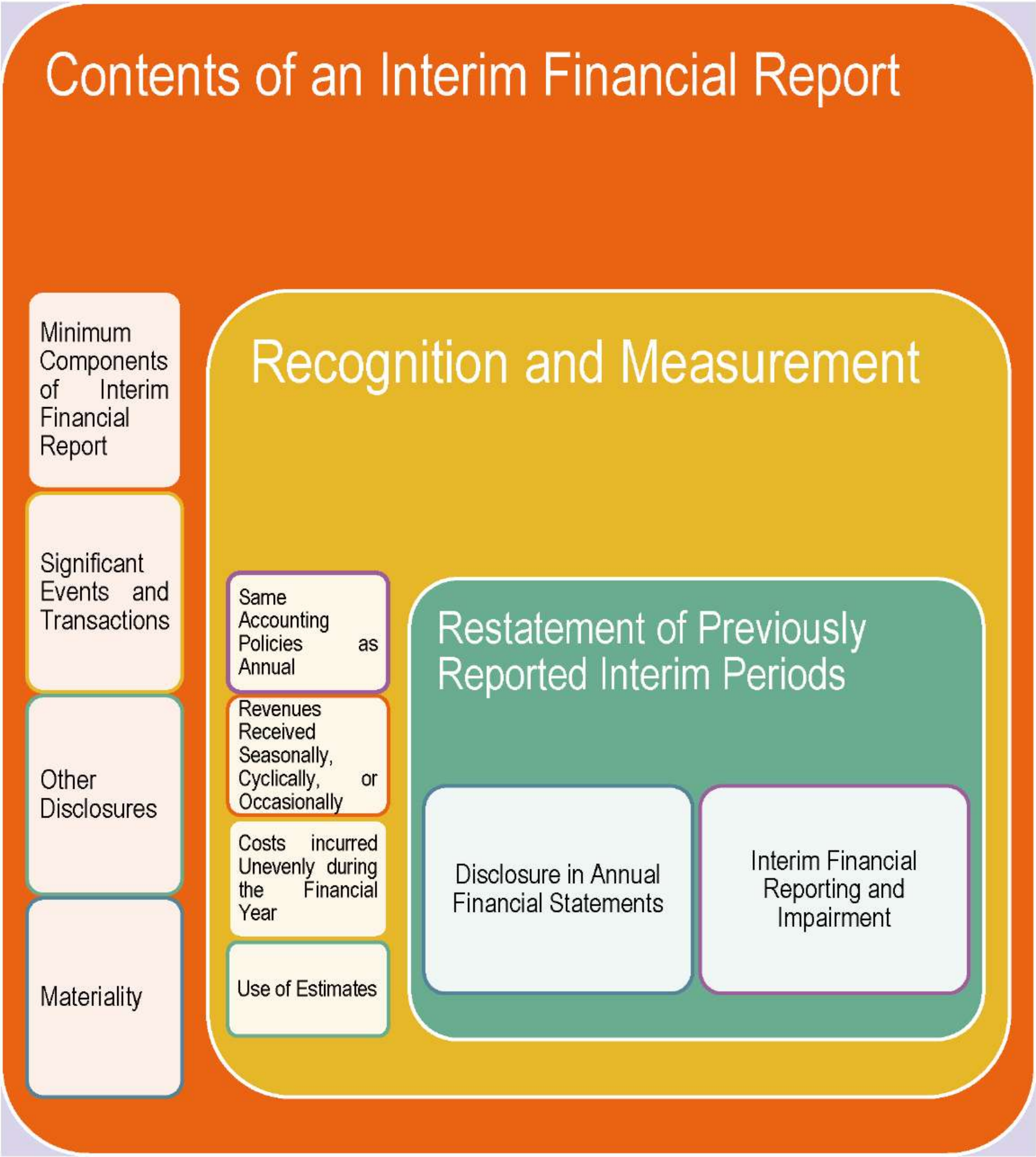
1. INTRODUCTION :



2. DEFINITIONS :

1. **Interim period** is a financial reporting period shorter than a full financial year.
2. **Interim financial report** means a financial report containing either a complete set of financial statements (as described in Ind AS 1, Presentation of Financial Statements), or a set of condensed financial statements (as described in this Standard) for an interim period.

3. CONTENTS OF INTERIM FINANCIAL :

CONTENTS

- A condensed balance sheet
- A condensed statement of profit and loss
- A condensed statement of changes in equity
- A condensed statement of cash flows
- Notes, comprising significant accounting policies and other explanatory information

Periods for which Interim Financial Statements are Required to be Presented :

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

(a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.

(b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.

(c) statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

(d) statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period may be useful.

Question 1 –

A company has to prepare interim financial statements for the period ended 31st Dec, 2016. As per IND AS 34 describes the periodicity of its interim financial statements along with comparatives.

4. RECOGNITION AND MEASUREMENT :

1. **Accounting Policies :**

   An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.

2. **Revenues received cyclically, occasionally or seasonally :**

   1. Revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year. Examples include dividend revenue, royalties, and government grants.
   2. Certain entities earn more revenue in certain interim periods of a financial year than other interim periods. Such revenues are recognised when they occur. Example seasonal revenues of retailers.

3. **Costs incurred unevenly during the financial year :**

   Costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year

4. **Use of Estimates :**

   1. To ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed.
   2. The preparation of interim financial reports requires a greater use of estimation methods than annual financial reports.

Question 2 – Company A

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

Question 3 – An enterprise

An enterprise reports quarterly. At the end of Q-1 estimate of pre-tax annual profit was Rs.6 lakhs and aggregate of deductions from GTO under tax laws was estimated at Rs.1 lakh.

At the end of Q-2, estimate of Pre-tax annual profit was Rs.6.30 lakhs and aggregate of deductions from GTI under tax law was estimated at Rs. 84,000.

The pre-tax earnings of Q-1 and Q-2 was 1.2 lakh and 1.3 lakh. Tax rate is 30%. Compute PAT for the quarters.

Question 4 – An enterprise

An enterprise that reports quarterly earned Rs.1 lakhs before tax at the end of Q1 and Rs.1.5 lakhs at the end of Q2. The annual PBT estimated at the end of Q1 was Rs.4 lakhs and that the end of Q2 was Rs.5 lakhs. The company has a carry forward loss of Rs.1 lakh. The applicable tax rate is 40%. Compute PAT for the quarters.

Question 5 – (May 2011 – 4 marks)

An enterprise reports quarterly, estimates an annual income of Rs.10 lakhs. Assume tax rates on 1st 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are Rs.75,000, Rs.2,50,000, Rs.3,75,000 and Rs.3,00,000
Calculate the tax expense to be recognised in each quarter.

Question 6 – X Ltd.

X Ltd. holds equity shares worth in Y Ltd. Y Ltd is doing well and is sure to declare dividend for the current year. While preparing the IFR, X Ltd. recognises pro-rate dividend income, which has not actually been received by it. Is the treatment right ? Discuss.

Question 7 – Innovative Corporation Private Limited

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

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

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

Particulars	Amounts (in crore)
Sales	70
Employees benefits expenses	25
Administrative and other expenses	12
Finance cost	4

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

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

Question 8 – Innovative Corporation Private Limited

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

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

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

5. SELF PRACTICE QUESTIONS :

Question 10 – A Ltd.

A Ltd has Rs.1,02,000 net income for the quarter ended 31sr December, 2017 including the following items.

Rs.16,000 cumulative effect loss resulting from change in method of inventory valuation method was recognised on Nov 2, 2017. Out of the this loss Rs.10,000 relates to the previous quarters.

Compute the profit as per IND AS – 34 for the quarter ended 31st Dec, 2017.

Question 11 – RM Ltd. (May 2005)

RM Ltd. is dealing in seasonal products

For the first quarter ending 31st March, 2017. RM gives you the following information

Sales	50 crores
Salary and other expenses	30 crores
Advertisement Expenses	2 crores
Administrative and Selling expenses	8 crores

While preparing interim financial report for the first quarter RM wants to defer Rs.21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business

Calculate the result of first quarter.

Question 12 – X Limited (May 2012 – 5 Marks)

On 30-6-2011, X Limited incurred Rs.3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid Rs.80,000 for property taxes assessed for the calendar year 2011. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30-9-2011?

Question 13 – SM Ltd.

SM Ltd shows the net profit of Rs.5,40,000 for the quarter III after incorporating the following

- Extraordinary loss of Rs.28,000 incurred during the quarter has been fully recognised in this quarter
- Additional Depreciation of Rs.36,000 resulting from the change of method of depreciation.

Do you agree with the treatments adopted by the company? If not, find out the correct quarterly income.

Question 14 – Company A

Company A expects to earn Rs. 15,000 pre-tax profit each quarter and has a corporate tax slab of 20 percent on the first Rs. 20,000 of annual earnings and 40 per cent on all additional earnings. Actual earnings match expectations. Calculate the amount of income tax to be shown in each quarter.

Question 15 – Narayan Ltd.

Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income	33,00,000
(inclusive of Estimated Capital Gains of Rs. 8,00,000)	

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

Tax Rates:	On Capital Gains	12%

On Other Income:	First Rs. 5,00,000	30%
	Balance Income·	40%

Question 16 – An entity

An entity reports quarterly, earns Rs. 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs. 50,000 in each of the three remaining quarteRs. The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%. The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

Question 17 – Happy India Ltd.

Due to decline in market price in second quarter, Happy India Ltd. incurred an inventory loss. The Market price is expected to return to previous levels by the end of the year. At the end of year, the decline had not reversed. When should the loss be reported in interim statement of profit and loss of Happy India Ltd.?

Question 18 – An entity

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

Thanks ....

CHAPTER

14

IND AS 8 – ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATED & ERRORS

CONCEPTS COVERED

1. INTRODUCTION
2. DEFINITIONS
3. ACCOUNTING POLICIES
4. CHANGES IN ACCOUNTING ESTIMATES
5. SELF PRACTICE QUESTIONS

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1. INTRODUCTION :

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

Accounting Policies

- Selection and application of accounting policies
- Consistency of accounting policies
- Changes in accounting policies
- Applying changes in accounting policies
- Retrospective application
- Limitations on retrospective application
- Disclosure

Changes in Accounting Estimates

- Apply changes in accounting estimates prospectively

Errors

- Limitations on retrospective restatement
- Disclosure of prior period errors

2. DEFINITIONS

1. **Accounting Policy :**

   Accounting policies are the
   - specific principles,
   - bases,
   - conventions,
   - rules and practices
   - applied by an entity in preparing and presenting financial statements.

2. **A change in accounting estimate :**

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

3. **Material Omissions or misstatements :**

   Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.

4. **Prior period errors :**

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

A. was available when financial statements for those periods were approved for issue; and

B. could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

5. Retrospective application :

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

6. Retrospective restatement :

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

7. Impracticable :

Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

8. Prospective application :

Prospective application of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

A. applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

B. recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

3. ACCOUNTING POLICIES :

3.1 SELECTION AND APPLICATION OF ACCOUNTING POLICIES :

1. When an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.
2. The Guidance provided in the implementation guidance of a concerned standard is also part of the standard and should be considered equally important for selection and application of accounting policies.
3. In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

   A. relevant to the economic decision-making needs of users; and

   B. reliable in that the financial statements:

      i. represent faithfully the financial position, financial performance and cash flows of the entity;

      ii. reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

iii. are neutral, i.e. free from bias;
iv. are prudent; and
v. are complete in all material respects.

(i) Whether it is relevant? The basic purpose of presenting financial statements is to facilitate the economic decision making of the stakeholders, which would be based on the information provided in the financial statements. So if the management is of the opinion that an accounting policy related to a particular transaction/ condition / event results in information that is going to help the users to make the economic decisions, then the entity must select and apply such accounting policy as it is relevant for decision making.

(ii) Whether it is reliable? The information will be said to be reliable if it makes a faithful representation, unbiased, prudent, complete in all material respects and it reflects substance of the transaction and is not presented solely with a purpose of adhering to the law.

Accordingly, Ind AS 8 provides the following list:

(i) Check if there are any other Ind AS available which are dealing with similar and related issues
(ii) Check the basic Framework of Ind AS, which provides the general principles
(iii) Check the pronouncements of International Accounting Standard Board
(iv) Check the pronouncements of other standard setting bodies having a similar conceptual framework
(v) Check the accounting literature and accepted industry practices

3.2 CONSISTENCY OF ACCOUNTING POLICIES :

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate.

3.3 CHANGES IN ACCOUNTING POLICIES :

An entity shall change an accounting policy only if the change:

A. is required by an Ind AS; or
B. results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

The following are not changes in accounting policies

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and
(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.

Question 1

Suppose an entity has been following the FIFO method of determination of cost for inventories. In the current year, it shifts from FIFO to weighted average method. The company feels that this would result into more realistic and relevant presentation. Discuss, giving proper reasons, whether it can do so.

Question 2 – A company owns

A company owns several hotels and provides significant ancillary services to occupants of rooms. These hotels are, therefore, treated as owner-occupied properties and classified as property, plant and equipment in accordance with Ind AS 16. The company acquires a new hotel but outsources entire management of the same to an outside agency and remains as a passive investor. The selection and application of an accounting policy for this new hotel in line with Ind AS 40. Is it change in accounting policy?

Question 3 – RM Ltd.

RM Ltd. manufactured bags until 2015. It had 5 motor vehicles at that time which were used for the delivery of bags. It classified all the vehicles as Non-current Assets in 2015. However in 2016 shareholders have approved a proposal to change the nature of business from manufacturing bags to sell of unused motor vehicles. It reclassified the motor vehicles as current Assets during 2016 as they will be sold as part of normal business. Should this be treated as change in accounting policy.

Question 4 – Health care foundation

Health care foundation obtains the Government grant for the first time 2015. This grant will be dealt in the financial books as per IND AS 20 – Accounting for Government grants and disclosure of Government assistance. Can this be treated as change in Accounting policy?

Question 5

Can an entity voluntarily change one or more of its accounting policies?

Question 6 – Entity ABC

Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 20X1-20X2. During the financial year 20X2-20X3, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity

ABC reclassified it from PPE to investment property in the financial year 20X2-20X3. Should Entity ABC account for the change as a change in accounting policy?

Question 7 – Entity ABC

Whether change in functional currency of an entity represents a change in accounting policy?

3.4 HOW TO APPLY THE CHANGES IN ACCOUNTING POLICIES? :

If the change in accounting policy is made voluntarily or where the Ind AS is not containing transitional provisions, then the accounting policy needs to be applied retrospectively.

4. CHANGES IN ACCOUNTING ESTIMATES :

4.1 MEANING :

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information.

For example, estimates may be required of:

- bad debts;
- inventory obsolescence;
- the fair value of financial assets or financial liabilities;
- the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
- warranty obligations.

4.2 ACCOUNTING TREATMENT FOR A CHANGE IN ESTIMATE :

- The effect of change in an accounting estimate, except to the extent that the change results in change in assets, liabilities or equity, shall be recognised prospectively

4.3 CHANGE IN THE BASIS OF MEASUREMENT – WHETHER A CHANGE IN ACCOUNTING POLICY OR CHANGE IN ESTIMATE? :

A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate.

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate

Question 8

Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

Question 9 – Nish Ltd.

Nish Ltd. prepares its financial statements by recording a purchase of Air Dryer(Machine) during 2015 worth Rs.50,000 under purchases instead of purchase of non-current asset. The error comes to light in the following accounting year. Can this be treated as the prior period error?

Question 10 – Shivani International

Shivani International is preparing financial statements as at 31/12/2015. Due to change in estimated life of the machine, the company auditor decide to change the rate of depreciation from 10% to 15%. Can this be treated as change in prior period errors?

Question 11 – Space Limited

Space Limited is preparing its financial statements for 2016. The management wishes to change the valuation of its inventory from the FIFO method to the weighted Average Method. Discuss whether the change would warrant a prior period adjustment.

Question 12 – An entity

An entity has presented certain material liabilities as non-current in its financial statements for periods upto 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 20X1). Would this reclassification of liabilities from non-current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

5. SELF PRACTICE QUESTIONS :

Question 13 – A carpet retail

A carpet retail outlet sells and fits carpets to the general public. It recognizes revenue when the carpet is fitted, which on an average is six weeks after the purchase of the carpet.

It then decides to sub-contract the fitting of carpets to self-employed fitters. It now recognizes revenue at the point-of-sale of the carpet.

Whether this change in recognising the revenue is a change in accounting policy as per the provision of Ind AS 8?

Question 14

When is an entity required to present a third balance sheet as at the beginning of the preceding period?

Question 15 – Delta Ltd.

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

In years before 20X2, Delta Ltd.'s asset records were not sufficiently detailed to apply a components approach fully. At the end of 2011, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

Delta Ltd.'s management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta Ltd.'s new policy prospectively from the start of 20X2.

Additional information:

(i)	Delta Ltd.'s tax rate is 30%	
(ii)	Property, plant and equipment at the end of 20X1:	
	Cost	Rs.25,000
	Depreciation	Rs.14,000
	Net book value	Rs.11,000
(iii)	Prospective depreciation expense for 20X2 (old basis)	Rs.1,500
(iv)	Some results of the engineering survey:	
	Valuation	Rs.17,000
	Estimated residual value	Rs.3,000
	Average remaining asset life	7 years
	Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	Rs.2,000

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

Question 16

Is change in the depreciation method for an item of property, plant and equipment a change in accounting policy or a change in accounting estimate?

Question 17 – An entity

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

Question 18

While preparing the annual financial statements for the year ended 31st March, 20X3, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 20X2 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the error was material?

Question 19

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

Question 20 – ABC Ltd.

ABC Ltd has an investment property with an original cost of Rs.1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil.

How should the error be corrected in the financial statements for the year ended 31st March, 20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

Question 21 – ABC Ltd.

ABC Ltd. changed its method adopted for inventory valuation in the year 20X2-20X3. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

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

- 31st March, 20X1 - Increase of Rs. 10 million
- 31st March, 20X2 - Increase of Rs. 15 million
- 31st March, 20X3 - Increase of Rs. 20 million

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

	20X2-20X3	20X1-20X2
Revenue	324	296
Cost of goods sold	(173)	(164)
Gross profit	**151**	**132**
Expenses	(83)	(74)
Profit	**68**	**58**

Retained earnings at 31st March, 20X1 were Rs.423 million

Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.

Question 22 – Cheery Limited

During 20X4-X5, Cheery Limited discovered that some products that had been sold during 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at Rs. 6,500. Cheery Limited's accounting records for 20X4-X5 show sales of Rs. 104,000, cost of goods sold of Rs. 86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.

In 20X3-X4, Cheery Limited reported:

	Rs.
Sales	73,500
Cost of goods sold	(53,500)
Profit before income taxes	20,000

Income taxes	(6,000)
Profit	14,000
Basic and diluted EPS	2.8

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

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

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

Question 23

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

Analyse the above situation in accordance with relevant Ind AS.

Thanks ....

CHAPTER

15

IND AS 37 – PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS

CONCEPTS COVERED

1. INTRODUCTION
2. DEFINITIONS
3. RELATIONSHIP BETWEEN PROVISIONS & CONTINGENT LIABILITIES
4. RECOGNITION
   - PROVISIONS
   - CONTINGENT LIABILITY
   - CONTINGENT ASSET
5. MEASUREMENT
6. REIMBURSEMENT
7. CHANGE IN PROVISIONS
8. USE PROVISIONS
9. APPLICATION OF THE RECOGNITION & MEASUREMENT RULES
   - FUTURE OPERATING LOSSES
   - ONEROUS CONTRACTS
   - RESTRUCTURING
10. SELF PRACTICE QUESTIONS

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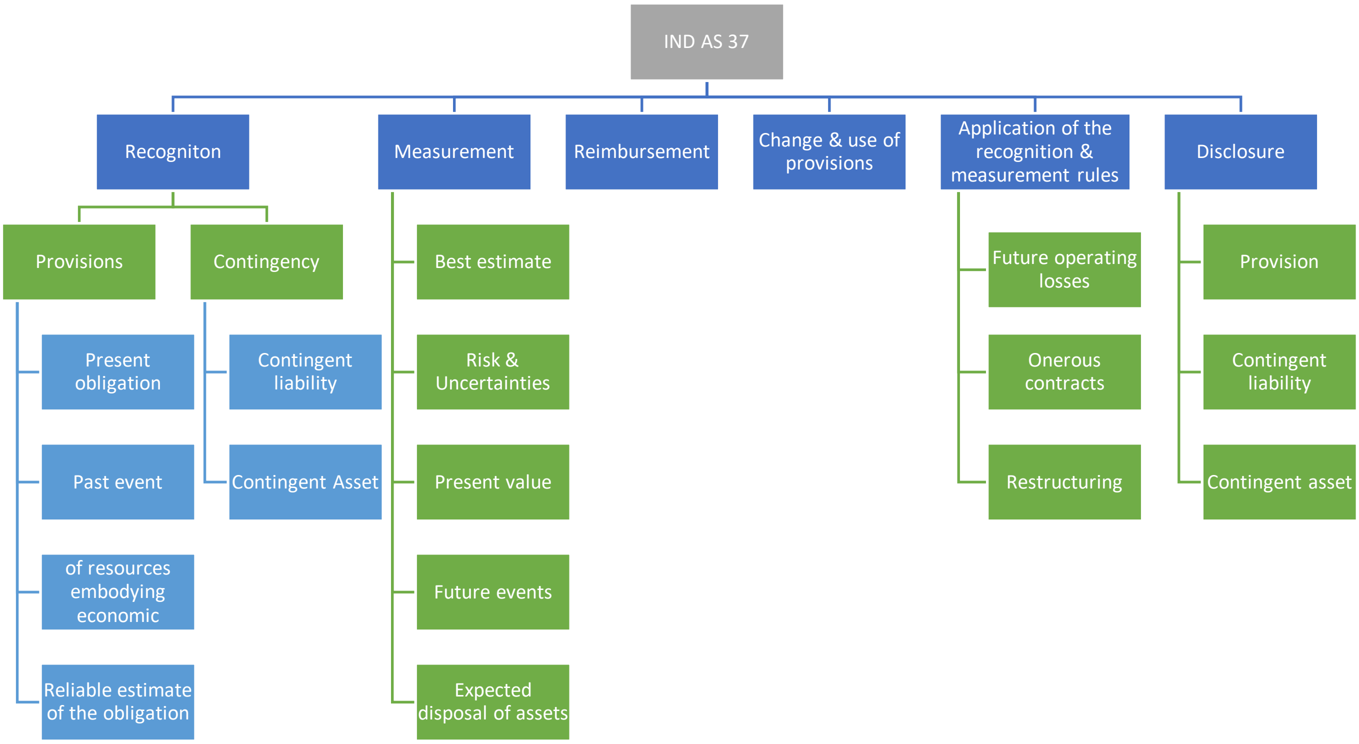
1. INTRODUCTION :



2. DEFINITION :

1. A **provision** is a liability of uncertain timing or amount.

2. A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

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

Example :
X Ltd. entered into a contract with Y Ltd. for supply of some material. As per the terms of contract in case of breach of contract, the party who breaches the contract has to pay Rs 50,00,000 to other party. X Ltd. breached the contract with Y Ltd. Now in this case the obligating event is the breach of contract that gave rise to present obligation and X Ltd. must settle the obligation.

4. A **legal obligation** is an obligation that derives from:
(a) a contract (through its explicit or implicit terms);
(b) legislation; or
(c) other operation of law.

In the aforesaid example regarding breach of the contract, the obligation is a legal obligation that arises from the terms of contract.

5. A constructive obligation is an obligation that derives from an entity's actions where:

   (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

   (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Question 1 – X Ltd.

X Ltd. is engaged in the manufacture of fertilisers. Effluents discharged in the manufacturing process have polluted the river near the manufacturing plant. The residents of the nearby locality launched a massive agitation against the pollution. X Ltd. agreed to their demands to reduce the water pollution by installing the necessary Effluent Treatment Plant. However, during the year no steps are taken to install the plant. No legislation requiring the company to reduce its pollution is in existence. In this case, though there is no law but by promising to take steps to reduce pollution, X Ltd. has created a valid expectation on the part of public that it will discharge its responsibilities. So the obligation in this case is a constructive obligation.

6. A **contingent liability** is:

   a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

   b) a present obligation that arises from past events but is not recognised because:

      i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

      ii) the amount of the obligation cannot be measured with sufficient reliability.

Question 2 – A tax

A tax case pending before the court, the liability for payment arising or not in respect of which depends on the outcome of court decision is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

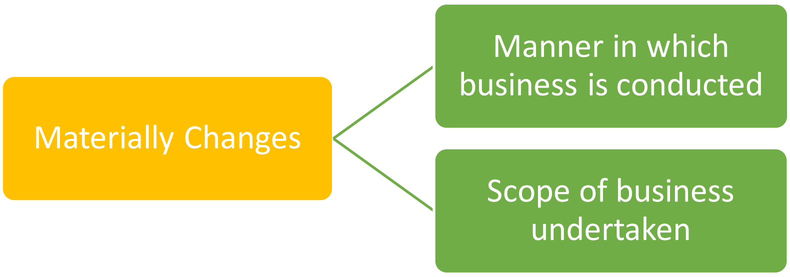
7. A **contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Question 3 – X Ltd.

X Ltd. filed a legal suit against a supplier of goods for compensation against damages on non–supply of contracted goods. This meets the definition of a contingent asset since there is a possible asset (compensation against damages) that arose from past event (contract with the supplier) and whose existence will be confirmed by the occurrence or non occurrence of uncertain future event not wholly within the control of the entity (i.e., the outcome of the legal suit).

8. An **onerous contract** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

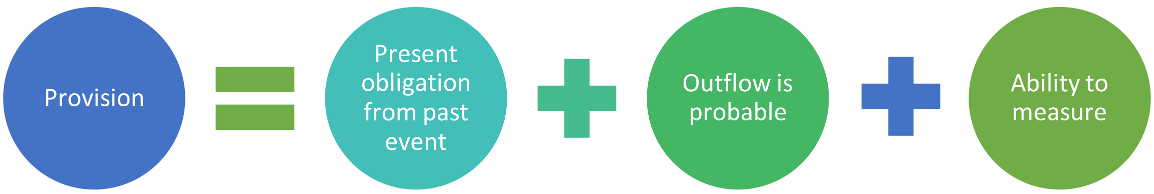
9. A **restructuring** is a programme that is planned and controlled by management, and materially changes either:
   (a) the scope of a business undertaken by an entity; or
   (b) the manner in which that business is conducted.



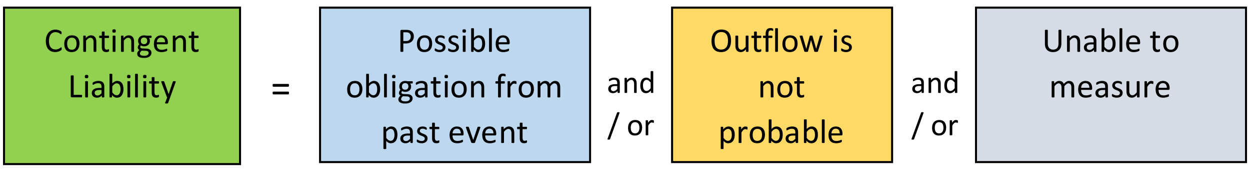
3.RELATIONSHIP BETWEEN PROVISIONS AND CONTINGENT LIABILITIES :

In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, Ind AS 37 distinguishes between the term 'contingent' and 'provisions'.

(a) **Provisions –** which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and

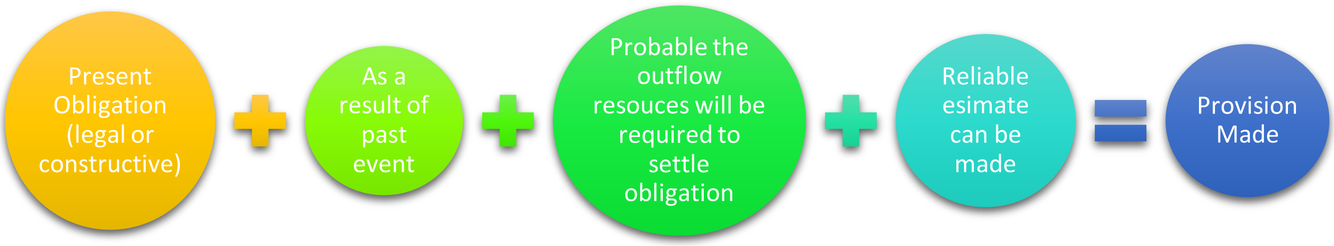


(b) **Contingent Liabilities –** which are not recognised as liabilities because they are either:
   (i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or
   (ii) present obligations that do not meet the recognition criteria in Ind AS 37 (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).



4. RECOGNITION :

4.1 PROVISIONS :

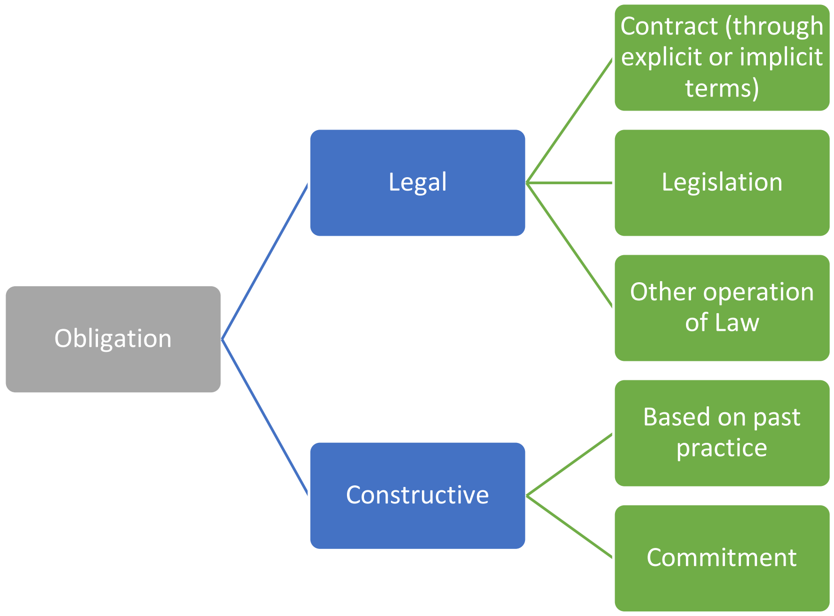


A provision should be recognised when:

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

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

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.



Question 4 – ABC Limited

ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.

Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

Question 5 – X Shipping Ltd.

X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?

Question 6 – X Chemical Ltd.

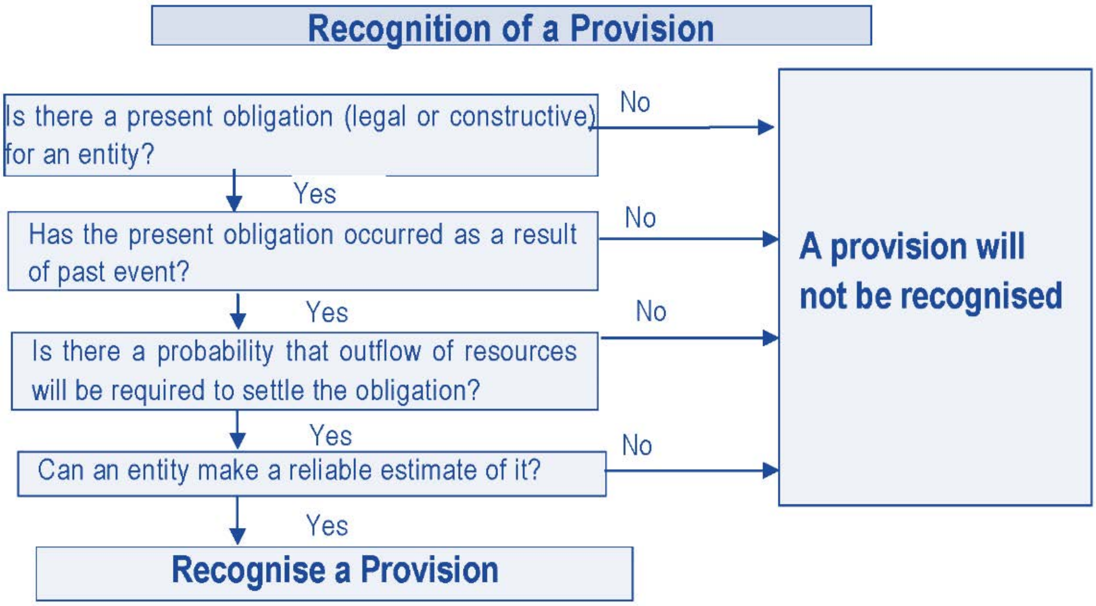
X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operations has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made into claims of pollution caused by the entity. If it is found that X Chemical Ltd. has caused contamination, then penalties and fine would be levied on it.

X Chemical Ltd. believes that it has implemented all environmental safety measures to an extent that it is unlikely to cause pollution. Management is not sure whether it has all the information about the entire 20 years. Therefore, neither management nor external experts are able to assess X Chemical Ltd.'s responsibility until the investigation has completed.

In such situation, how should management of X Chemical Ltd. account for a liability?

Question 7 – X Ltd.

X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is to be paid if the export incentives are received. As per the accounting policy of X Ltd., it recognises export incentives when actually realised, on account of the uncertainty in realising such incentives. Export incentives have not been received for the year 2011-2012, however X Ltd. is hopeful of receiving the export incentives in the year 2012-2013. In the financial statements for 2011-2012, should X Ltd. provide for both base commission and additional commission?



4.2 CONTINGENT LIABILITIES :

- An entity should not recognise a contingent liability.
- A contingent liability should be disclosed, if the possibility of an outflow of resources embodying economic benefits is not remote.

4.3 CONTINGENT ASSETS :

- An entity should not recognise a contingent asset.
- Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity.

  Example A claim that an entity is pursuing through legal processes, where the outcome is uncertain.
- Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised.

Tabular depiction

Likelihood of outcome	Contingent liability	Contingent asset
Virtually certain (greater than 95% probability)	Recognise the provision	Recognise the asset
Probable (50% - 95% of probability)	Recognise the provision	Disclose about the contingent asset
Possible but not probable (5% - 50% of probability)	Disclose the contingency	No disclosure permitted
Remote (less than 5% probability)	No disclosure required	No disclosure permitted

Question 8 – X Sugars Ltd.

X Sugars Ltd. has entered into a sale contract of Rs.3,00,00,000 with Y Choclates Ltd. for the supply of sugar during 2011-2012. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of Rs.30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment. It is, however covered by an insurance policy. According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy. The cost of goods lost was Rs.2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of Rs.30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end?

5. MEASUREMENT :

- Best Estimate
- Risk and Uncertainity
- Present Value
- Future Events
- Expected Disposal of Assets

5.1 BEST ESTIMATE :

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Question 9 – An entity

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of Rs 1 million would result. If major defects were detected in all products sold, repair costs of Rs 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

5.2 RISKS AND UNCERTAINTIES :

The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

5.3 PRESENT VALUE :

Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation.

Question 10 – RM Solar Power Ltd.

RM Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. RM Solar Power Ltd. cannot cancel this obligation or transfer to third party. RM Solar Power Ltd. has estimated the total cost of dismantling at Rs.50,00,000, the present value of which is Rs.30,00,000. Based on the facts and circumstances, RM Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should RM Solar Power Ltd. account for the obligation?

5.4 FUTURE EVENTS :

Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

Question 11 – RM Chemicals Ltd.

RM Chemicals Ltd. engaged in the chemical industry causes environmental damage by dumping waste in the river near its factory. It does not clean up because there is no environmental legislation requiring cleaning up and RM Chemicals Ltd. is causing damage for last 40 years. As at March 31, 2012, the State Legislature has passed a path breaking legislation requiring all polluting factories to clean-up the river water already contaminated. The formal Gazette notification of the law is pending. How should RM Chemicals Ltd. deal with this situation?

5.5 EXPECTED DISPOSAL OF ASSETS :

- Gains from the expected disposal of assets should not be taken into account in measuring a provision.
- Gains on the expected disposal of assets should not be taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision.

Instead, an entity should recognise gains on expected disposals of assets at the time specified by the Standard dealing with the assets concerned.

6. REIMBURSEMENTS :

Reimbursements			
Situation	**The entity has no obligation for the part of the expenditure to be reimbursed by the other party**	**Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party and it is virtually certain that reimbursement will be received if the entity settles the provision**	**Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party but the reimbursement is NOT virtually certain**
Recognition	The entity has no liability for the amount to be reimbursed. Hence no provision will be made.	• The reimbursement is recognised as a separate asset in the balance sheet	The expected reimbursement is not recognised as an asset.
		• In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.	
		• The amount recognised for the expected reimbursement shall not exceed the liability.	
Disclosure	No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement.	The expected reimbursement is disclosed.

Question 12 – X Beauty Solutions Ltd.

X Beauty Solutions Ltd. is selling cosmetic products under its brand name ‘B’, but it is getting its product manufactured from Y Ltd. It has an understanding (enforceable agreement) with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 2011-2012, a claim of Rs.30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable?

7. CHANGES IN PROVISIONS :

- Provisions should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

- Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost.

Question 13 – X Telecom Ltd.

X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor's opinion is that X Telecom Ltd. will lose the case and estimated that liability of Rs.1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years. How should X Telecom Ltd. calculate the amount of borrowing cost?

8. USE OF PROVISIONS :

- A provision should be used only for expenditures for which the provision was originally recognised.
- Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

9. APPLICATION OF THE RECOGNITION AND MEASUREMENT RULES :

9.1 FUTURE OPERATING LOSSES :

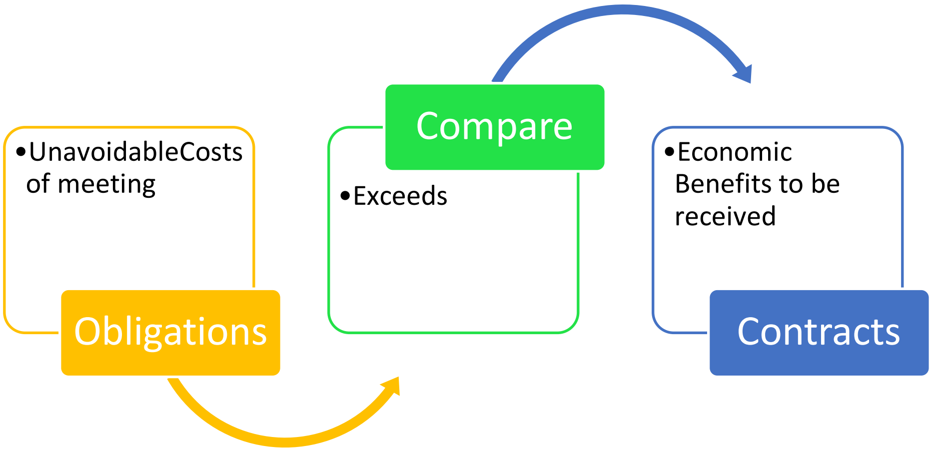
- Provisions should not be recognised for future operating losses.
- Future operating losses do not meet the definition of a liability and the general recognition criteria set out for provisions as specified in the standard. Ind AS 37 does not permit recognition of provision for future operating losses this since they do not stem from a past event.
- An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An entity should test these assets for impairment under Ind AS 36, Impairment of Assets.

Question 14 – X Packaging Ltd.

X Packaging Ltd. has two segments, packaging division and paper division. In March 2011, the board of directors approved and announced a formal plan to sell the paper division in June 2011. Operating losses of the paper division are estimated to be approximately R. 50,00,000 during the period from April 1, 2011 to the expected date of disposal. Management of X Packaging Ltd. wants to include the future operating loss of Rs.50,00,000 in a provision for restructuring in the financial statements for the period ended March 31, 2011. Can X Packaging Ltd. include these operating losses in a provision for restructuring?

9.2 ONEROUS CONTRACTS :

- If an entity has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision.



- Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of Ind AS 37 and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of Ind AS 37.
- Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.
- Before a separate provision for an onerous contract is established, an entity should recognise any impairment loss that has occurred on assets dedicated to that contract (in accordance with Ind AS 36).

Question 15 – X Metals Ltd.

X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at Rs.50 per unit at a contract price of Rs.5,00,000. As per the terms of contract, X Metals Ltd. would have to pay Rs.60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at Rs 45 per unit.

How should X Metals Ltd. account for this transaction in its books of account in respect of the above contract?

9.3 RESTRUCTURING :

Includes only the direct expenditures arising from the restructuring that are both:

(i) Necessarily entailed by restructuring

(ii) Not associated by the ongoing activities of the entity

Does not include such cost:

1. Retraining or Relocating continiung staff

2. Marketing or

3. Investment in new systems and distribution networks

Question 16 – X Cements Ltd.

X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 2011, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalised and agreed by the board of directors in that meeting, which specifies the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create a constructive obligation that needs a provision for restructuring?

Question 17 – A manufacturer

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the end of the reporting period, a provision of Rs 60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. Draft the Note.

10. SELF PRACTICE QUESTIONS :

Question 18

In 2017, an entity involved in nuclear activities recognises a provision for decommissioning costs of Rs.300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced. Draft the note.

Question 19 – An entity

An entity is involved in a dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of Rs 100 million. The entity recognises a provision for its best estimate of the obligation, but discloses none of the information required by the standard. Draft the note.

Question 20 – X Ltd.

X Ltd. is operating in the telecom industry. During the Financial Year 2011-2012, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 2010-2011 (Assessment Year 2011-2012) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 2011-2012 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of Rs 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 2011-2012, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 2011-2012.

Question 21 – An entity

An entity is a telecom operator. Laying of cables across the world is a requirement to enable the entity to run its business. Cables are also laid under the sea and contracts are entered into for the same. By virtue of laws of the countries through which the cable passes, the entity is required to restore the sea bed at the end of the contract period. What is the nature of obligation that the entity has in such a case?

Question 22 – Entity A

Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating therefrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price. Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?

Question 23 – U Ltd.

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 20X2 as per the notified Ind AS. The financial statements are due to be approved for issue on 15th May 20X2. Following are a few transactions that have taken place in some of its subsidiaries during the year: G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 20X2. They made a public announcement of their decision on 15th February 20X2.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay Rs. 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be Rs. 60 lakhs. The actual termination payments totalling to Rs. 520 lakhs were made in full on 15th May 20X2. As per latest estimates made on 15th May 20X2, the total relocation cost is Rs. 63 lakhs.
- G Ltd. had taken a property on operating lease, which was expiring on 31st March 20X6. The present value of the future lease rentals (using an appropriate discount rate) is Rs. 430 lakhs. On 15th May 20X2, G Ltd. made a payment to the lessor of Rs. 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March 20X2 was Rs. 400 lakhs. G Ltd. made further operating losses totalling Rs. 60 lakhs till 30th April 20X2.

What are the provisions that the Company is required to make as per Ind AS 37?

Question 24 – A company manufacturing

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

Question 25 – Entity XYZ

Entity XYZ entered into a contract to supply 1000 television sets for Rs. 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to Rs. 2.5 million. The penalty for non- performance of the contract is expected to be Rs. 0.25 million. Is the contract onerous and how much provision in this regard is required?

Question 26 – Marico

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of Rs. 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is Rs. 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of Rs. 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Thanks ....

CHAPTER

16

IND AS 113 – FAIR VALUE MEASUREMENT

CONCEPTS COVERED

1. OBJECTIVE
2. DEFINITIONS
3. ASSET OR LIABILITY SPECIFIC FAIR VALUE
4. UNIT OF ACCOUNT
5. THE TRANSACTIONS
    - PRINCIPAL MARKET
    - MOST ADVANTAGEOUS MARKET
6. MARKET PARTICIPANTS
7. THE PRICE
8. APPLYING FAIR VALUE RULES ON NON-FINANCIAL ASSETS
9. VALUATION TECHNIQUES
10. INPUTS TO VALUATION TECHNIQUES
11. FAIR VALUE HIERARCHY
12. SELF PRACTICE QUESTIONS

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1. OBJECTIVE :

- Defines fair value
- Sets out in a single Ind AS a framework for measuring fair value; and
- Requires disclosures about fair value measurements

Fair value is a market-based measurement, not an entity-specific measurement.

2. DEFINITIONS :

This Ind AS defines fair value as 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.

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

3. ASSET OR LIABILITY SPECIFIC FAIR VALUE :

The standard emphasis that in order to get a fair value of an asset/ liability, the restrictions or conditions that might be related to a particular entity should not be taken into account because a fair value will be based on market participant assumptions rather to an entity specific conditions or restriction which usually will not affect fair valuation of an asset/ liability.

Question 1 – Entity Specific restrictions

An entity is having a land which has a restriction to develop into a commercial house because of restricted business objective in which currently it operates. The entity wants to sell the land and there would not be any restriction for a buyer of the land to develop a commercial house. Since this restriction is entity specific, hence it will not be considered while calculating fair value of the land.

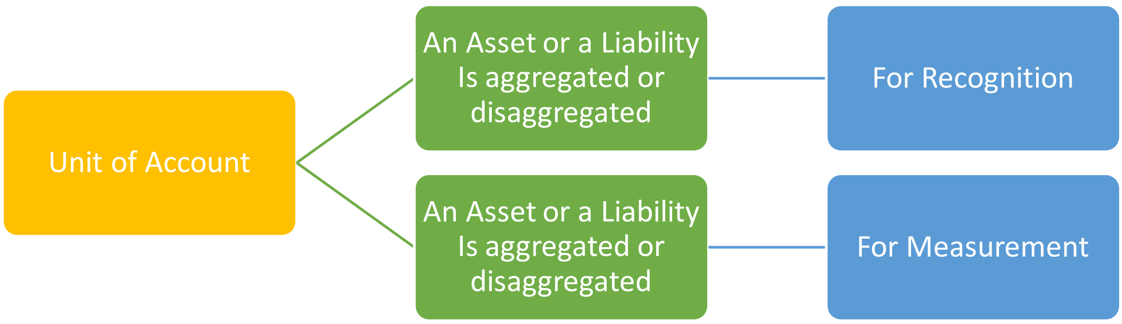
Question 2 – A manufacturing company

A manufacturing company is having certain securities which have been pledged with a bank and restricted to sell it for next 2 years. The restriction is entity specific and hence will not be considered while calculating fair value of the security as other market participant will not consider this restriction which is purely an entity specific.

Question 3 – Asset/ Liability specific restrictions

A car has been bought for private use and there is a restriction of not to use the car for any commercial purposes. Commercial vehicle is having more fair value than private vehicle. since the restriction to use the vehicle is asset specific and market participant will also consider the asset specific restrictions while calculating fair values for such asset and hence this condition will be considered while evaluating fair value of the car.

4. UNIT OF ACCOUNT :



Example :

An Entity having certain securities which are quoted at market and these are recognized at fair value in the Balance Sheet. Quoted prices at Individual level will be used in order to find Fair Values of these Investments.

Example :

In order to evaluate fair values of assets to identify impairment as per Ind-As 36- Impairment of Assets which requires to measure such Fair Value at Cash generating units, hence group of assets will be used in order to find fair Values for the requirement of such Standard.

5. THE TRANSACTION :

A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(a) in the principal market for the asset or liability; or

(b) in the absence of a principal market, in the most advantageous market for the asset or liability.

5.1 PRINCIPAL MARKET :

Market which is normally the place in which the assets/ liabilities are being transacted with highest volume with high level of activities comparing with any other market available for similar transactions.

Question 4 – Share of a company

Share of a company which is listed at BSE and NYSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

5.2 MOST ADVANTAGEOUS MARKET :

- This is the market which either maximizes the amount that would be received when an entity sells an asset or minimize the amount that is to be paid while transferring the liability.
- In the absence of principal market, this market is used for Fair Valuation of the Assets/ Liabilities. In many cases Principal market & most advantageous market will be same.
- The market will be assessed based on net proceeds from the sale which will deduct expenses associated with such sale in most advantageous market.

Question 5 – Diamond (a commodity)

Diamond (a commodity) has got a domestic market where the prices are lesser comparing to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done at domestic market only i.e. 90% and balance 10% only can be sold via export. The highest level of activities with highest volume is being done at domestic market. Hence, principal market for diamond would be domestic market. Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. However, if principal market is available, then its prices would be used for fair valuation of assets/ liabilities.

6. MARKET PARTICIPANTS

An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

What are market participants?

The parties which eventually transact the assets/ liabilities either in principal market or most advantageous market in their best economic interest i.e.

- They should be independent and not a related party. However, if related parties have done similar transaction on arm's length price, then it can be between related parties as well.
- The parties should not be under any stress or force to enter into these transactions
- All parties should have reasonable and sufficient information about the same.

Question 6 – A land

A land has legal restriction to use it for commercial purposes in next 10 years irrespective of its holder. The fair value of the land will include this restriction about its usage because it is an asset related restriction and any buyer will need to take over with similar restriction to use the land for next 10 years. Now to evaluate its fair value, one has to consider the restriction based on the assumptions which normally would be taking into account by its market participants, mentioned as below

a) Whether the restriction is commonly imposed on each such type of land?

b) How useful it will be after the end of 10 years?

c) Whether there is any alternative use which may be considered normally by a participant for similar kind of deals?

d) How liquid the sale of land will be with such restrictions?

e) Comparing the price with similar kind of land without restrictions to arrive at its fair values.

7. THE PRICE :

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

7.1 TRANSACTION COST :

Principal (or most advantageous) market is where significant level of transactions and activities takes place and it eventually covers/ considers all such transaction costs. Hence, it would not be appropriate to consider any transaction cost further while assessing fair values from such principal markets.

7.2 TRANSPORT COST :

If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

It would be considered, if in case it is an inherent part of the Assets/ Liability so transacted e.g. commodity.

	Principal market	Most advantageous market
Transaction Cost	NO	YES
Transport cost	YES	YES

Question 7 – An entity

An entity sells certain commodity which are available actively at location A and which is considered to be its principal market (being significant volume of transactions and activities takes place). However, fair value of the commodity is required to be assessed for location B which is far from location A and requires a transport cost of Rs. 100. Since the transport cost is not a transaction cost and it is not specific to any transaction but it is inherent cost which requires to be incurred while bringing such commodity from location A to location B, it will be considered while evaluating fair value from the principal market.

8. APPLYING FAIR VALUE RULES ON NON-FINANCIAL ASSETS :

Fair valuation in case of non-financial assets especially buildings and other fixed assets often require to look for the best and highest use by its market participants and that will be the reference point to evaluate fair value of such non-financial assets.

8.1 HIGHEST AND BEST USE :

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

8.2 VALUATION PREMISE :

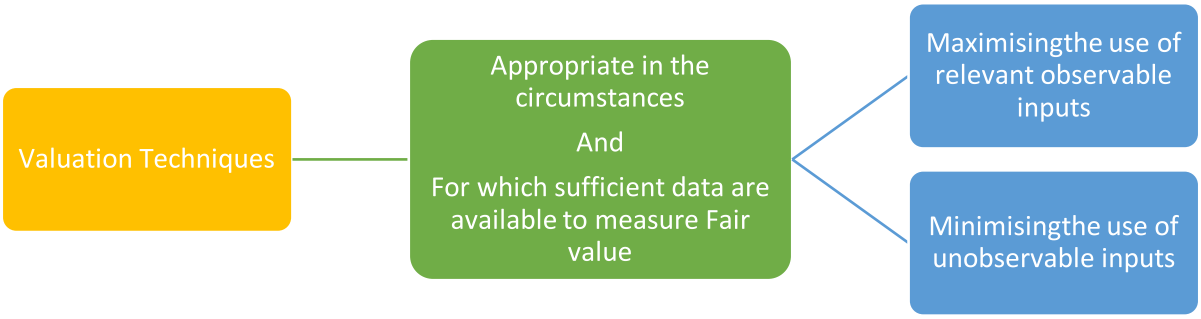
Fair value measurement of non-financial assets would be based on either

1) In combination with other assets, or
2) At stand alone basis,

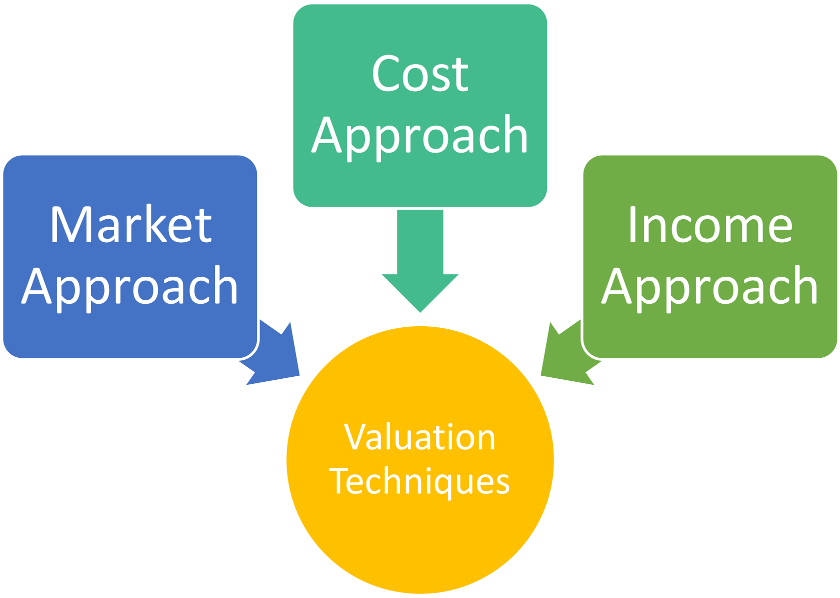
9. VALUATION TECHNIQUE :

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

It is pertinent to note that the overall objective to use any valuation approach or technique is in accordance with all relevant data available related to the Asset/ liability which could utilize all directly observable inputs.



Ind AS 113 specifies following three approaches to measure fair values:



1. **MARKET APPROACH :** The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.

Quoted prices are indicative values of any business if it exchanges in an active market. However, in the absence of such quoted prices, it is relevant to value the business based on market values and do some adjustment relevant to the assets/ liabilities. Standard specifies a valuation technique called "Matrix pricing" which is normally used to value debt securities. This technique relates the securities with some similar benchmarked securities including coupons, credit ratings etc. to derive at fair value of the debt.

Example :
An entity does not have any security which is quoted in an active market, however its price to earnings ratio is being used to corroborate its enterprise value with certain adjustments relevant to the business e.g. there are some specific restrictions to use certain assets for some specific period being in a specialized industry.

2. **INCOME APPROACH :** The income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

It is a present value of all future earnings from an entity whose fair values are being evaluated or in other words all future cash flows to be discounted at current date to get fair value of the asset / liability.

Assumption to the future cash flows and an appropriate discount rate would be based on the other market participant's views. Related risks and uncertainty would require to be considered and would be taken into either in cash flow or discount rate.

Standard defines the below techniques which may be considered while using Income approach

a) Present value techniques
b) Option pricing modals e.g. Black-scholes Merton modal or Binomial modal,
c) The multi period excess earning method.

3. **COST APPROACH :** This method describes how much cost is required to replace existing asset/ liability in order to make it in a working condition. All related costs will be its fair value. It actually considers replacement cost of the asset/ liability for which we need to find fair value.

Question 8 – An entity

Discount Rate assessment to measure present value:
Investment 1 is a contractual right to receive Rs. 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

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

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

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

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

10. INPUTS TO VALUATION TECHNIQUES :

Valuation techniques used to measure fair value shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

It has widely been mentioned that observable inputs should be used to evaluate fair value of an asset/ liability and we should minimize using any unobservable inputs.

Standard describes the below instances where observable inputs are being used in case of certain Financial Instruments :

Market (by Nature)	Prices (Observable)	Rationale	IND AS 113 Compliant
Exchange Markets	Closing prices	Readily available	Yes
Dealer Market	Bid & Ask prices	Readily available than closing prices	Yes
Brokered Market	Buy & Sell order matching, commercial and residential markets	Broker knows better prices from both buy & Sell side	Yes
Principal to principal Markets	Negotiated prices with no intermediary	Little information available in market	Yes

11. FAIR VALUE HIERARCHY

The hierarchy has been categorized in 3 levels which are based on the level of inputs that are being used to find out such fair values.

Level 1 Inputs :

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available.

A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (e.g. on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

- The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the assetorliability
- Whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date

Example :

An entity is holding investment which is quoted in BSE, India and NYSE, USA. However, significant activities are being done at BSE only. The fair value of the investment would be referenced to the quoted price at BSE India (which is Level 1 fair value- Direct quoted price with no adjustments).

Level 2 Inputs :

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability, for example:

- (i) interest rates and yield curves observable at commonly quoted intervals;
- (ii) implied volatilities; and
- (iii) credit spreads.
- (iv) market-corroborated inputs.

Example :

Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency. It requires rate of swap which is of 11 years. However, normally the rates are available only for the maximum period of 10 years. The rate for 11 years can be established using extrapolation or some other techniques which is based on 10 years' available rates of swap. The fair value of 11 years so derived would be level 2 fair value.

Example :

An entity has an investment in another entity which has no active market. However, some similar investment is being traded in an active market. Now, the fair valuation can be done based on either the prices based on the market which is not active or similar traded investment in an active market. This would be considered as level 2 inputs.

Level 3 Inputs :

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability.

12. SELF PRACTICE QUESTIONS :

Question 9

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

In Market A :

The price that would be received is Rs.26, transaction costs in that market are Rs.3 and the costs to transport the asset to that market are Rs.2.

In Market B :

The price that would be received is Rs.25, transaction costs in that market are Rs1 and the costs to transport the asset to that market are Rs.2.

You are required to calculate:

(i) The fair value of the asset, if market A is the principal market, and

(ii) The fair value of the asset, if none of the markets is principal market.

Question 10 – Company J

Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.

Determine the highest and best use of the land.

Question 11 – ABC Ltd.

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

Question 12 – UK Ltd.

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

(Rs. in crore)

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

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

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

Question 13 – KK Ltd.

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

Particulars	Rs. in crore
Valuation as per Market Approach	5268.2
Valuation as per Income Approach	3235.2
Debt obligation as on Measurement date	1465.9
Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	8,52,84,223 shares

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

Question 14 – DS Limited

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

(i) DS Limited holds some vacant land for which the use is not yet determined. the land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

On what basis will the land be fair valued under Ind AS?

(ii) DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market.

Under which level of fair value hierarchy will the above inputs be classified?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares?

Question 15 – A Ltd.

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

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

a. Labour costs

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

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

b. Allocation of overhead costs:

Assigned at 80% of labour cost

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

i. Profit on labour and overhead costs:

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

ii. The risk that the actual cash outflows might differ from those expected, excluding inflation:

A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

d. Effect of inflation on estimated costs and profits

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

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

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

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

You are required to calculate the fair value of the asset retirement obligation.

Question 16 – Entity A

(i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of Rs. 10. Entity XYZ's after-tax maintainable profits are estimated at Rs. 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is Rs. 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

Thanks ....

Rahul Malkan

CHAPTER

17

IND AS 10 – EVENTS AFTER REPORTING PERIOD

CONCEPTS COVERED

1. INTRODUCTION
2. DEFINITIONS
3. TYPES OF EVENTS
4. RECOGNITION AND MEASUREMENTS OF ADJUSTING EVENTS
5. DISCLOSURE OF NON ADJUSTING EVENTS
6. SPECIAL CASES
7. DIVIDENDS
8. SELF PRACTICE QUESTIONS

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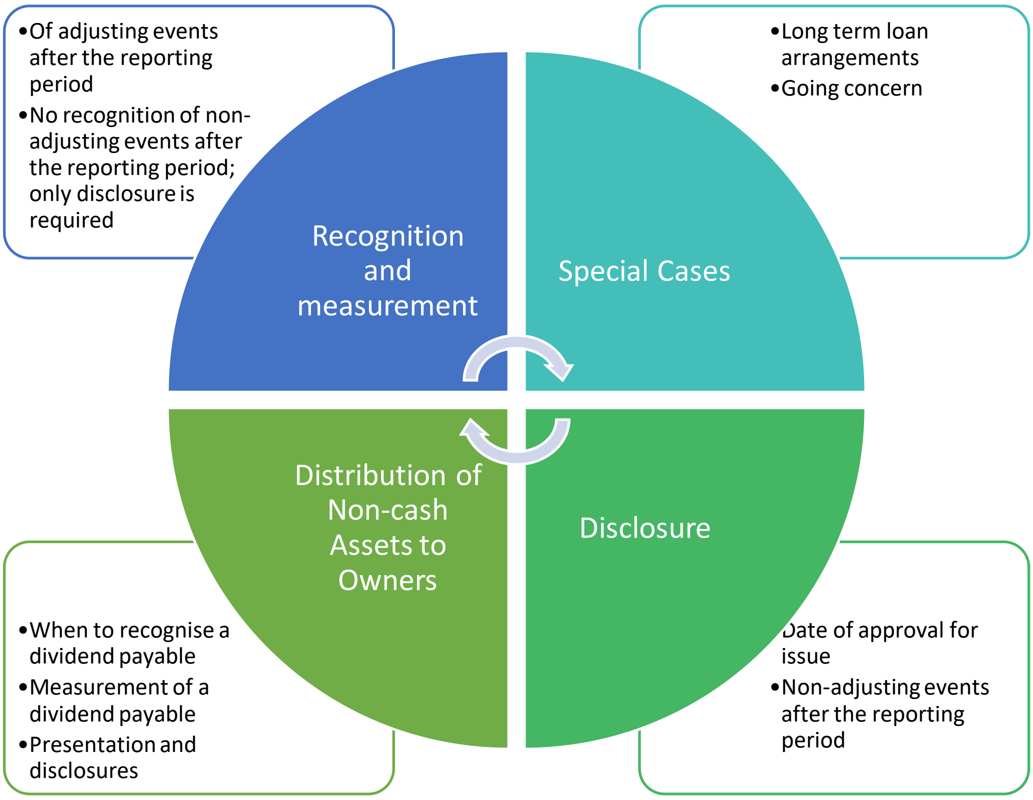
1. INTRODUCTION :



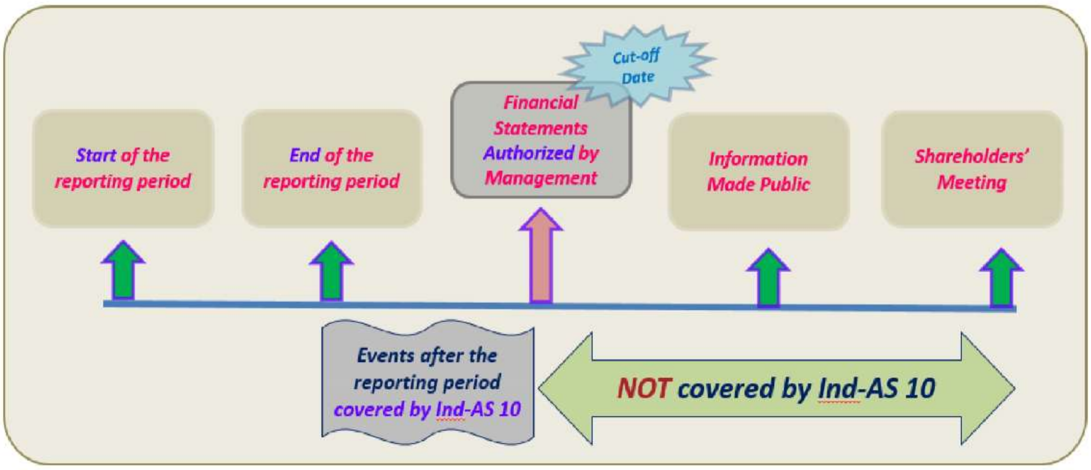
2. DEFINITIONS :

1. **Events After The Reporting Period :**

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved.

Example

The financial year of an entity ends on 31st March, 2012. If the board of directors approves the financial statements on 15th May, 2012, 'after the reporting period' will be the period between 31st March, 2012 and 15th May, 2012 and the events occurring during this period should be considered as 'events after the reporting period'.



2. **Approval Of Financial Statements :**

The definition says that the last date of the concerned period is the date of approval of financial statements. Now the question arises: what is meant by approval of financial statements? When can one say that the financial statements are approved? Which body needs to be considered as approving authority? If there is a hierarchy of approvals, at what level, one can assume that the financial statements are approved?

The financial statements will be treated as approved when board of directors approves the same.

3. **When Date Of Approval Is After The Public Announcement Of Some Other Financial Information :**

'Events after the reporting period' include all events up to the date when the financial statements are approved for issue, even if those events occur after the public announcement of profit or of other selected financial information.

Question 1

What is the date of approval for issue of the financial statements prepared for the reporting period from 1st April, 20X1 to 31st March, 20X2, in a situation where following dates are available? Completion of preparation of financial statements 28th May, 20X2 Board reviews and approves it for issue 19th June, 20X2

Available to shareholders	1st July, 20X2
Annual General Meeting	15th September, 20X2
Filed with regulatory authority	16th October, 20X2

Will your answer differ if the entity is a partnership firm?

Question 2 – ABC Ltd.

ABC Ltd. prepared interim financial report for the quarter ending 30th June, 20X1. The interim financial report was approved for issue by the Board of Directors on 15th July, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending 30th June, 20X1?

Question 3 – The Board of Directors

The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1-20X2 for issue on 15th June, 20X2. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on 30th June, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case?

4. **Should The Company Report Only Unfavourable Events?**

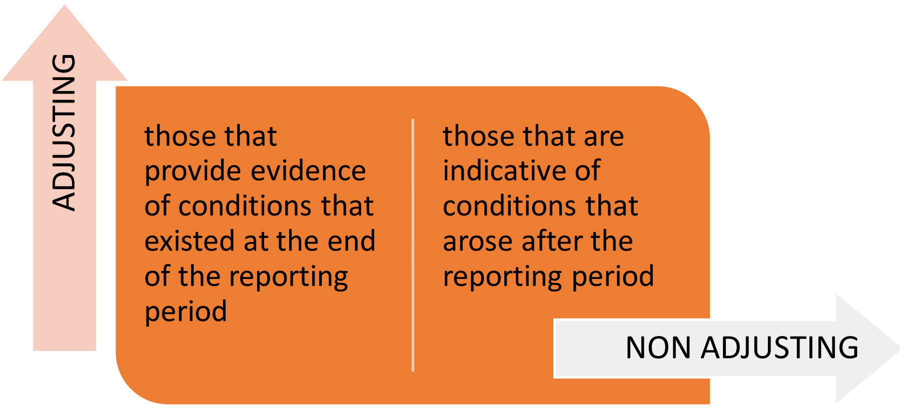
The standard clearly states that events can be favourable as well as unfavourable

3. TYPES OF EVENTS :

The 'events after the reporting period' are classified into two categories

(i) Adjusting Events: those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(ii) Non Adjusting Events: those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).



4. RECOGNITION AND MEASUREMENTS OF ADJUSTING EVENTS :

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period

Question 4 – ABC Ltd.

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 2011-2012. The court has issued the order on 15th April, 2012 and rejected the claim of the company. Accordingly, the company is liable to pay the additional tax. The financial statements of the company for the year 2011-2012 have been approved on 15th May, 2012. Should the company account for such tax in the year 2011-2012 or should it account for the same in the year 2012-2013?

Question 5 – A customer

A customer went bankrupt after the reporting period. Can this be treated as a adjusting event?

Question 6 – A company

A company has inventory of 100 finished cars on 31st March, 2012, which are having a cost of Rs.4,00,000 each. On 30th April, 2012, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to Rs.3,00,000 each. The financial statements of the company for the year 2011-2012 are not yet approved. Should the company value its stock at Rs.4,00,000 each or should it value at Rs.3,00,000 each? Ignore estimated costs necessary to make the sale.

Question 7 – ABC Ltd.

ABC Ltd., has purchased a new machinery during the year 2011-2012. The asset was finally installed and made ready for use on 15th March, 2012. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same. The supplier company sent the bills on 10th April, 2012, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 2011-2012 or in the year 2012-2013?

Question 8 – ABC Ltd.

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 20X1-20X2. The court has issued the order on 15th April, 20X2 and rejected the claim of the company. Accordingly, the company is liable to pay the additional tax. The financial statements of the company for the year 20X1-20X2 have been approved on 15th May, 20X2. Should the company account for such tax in the year 20X1-20X2 or should it account for the same in the year 20X2-20X3?

5. DISCLOSURE OF NONADJUSTING EVENTS AFTER THE REPORTING PERIOD :

Recognition, Measurement and Disclosure

Adjusting events after the reporting period

Adjust the amounts recognised in the financial statements to reflect it

Non-adjusting events after the reporting period

Do not adjust the amounts recognised in the financial statements to reflect it

If non-adjusting events after the reporting period are material, then disclose

- the nature of the event; and
- an estimate of its financial effect, or a statement that such an estimate cannot be made.

6. SPECIAL CASES :

6.1. LONG TERM LOAN ARRANGEMENTS :

Notwithstanding anything contained in the definition of non-adjusting events, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an adjusting event.

Example :

ABC Ltd., in order to raise funds, has privately placed debentures of Rs.1 crore, on 1st January, 2011, issued to PQR Ltd. As per the original terms of agreement, the debentures are to be redeemed on 31st March, 2019. One of the conditions of the private placement of the debentures was that debt-equity ratio at the end of any reporting year should not exceed 2:1. If this condition is not fulfilled, then, PQR Ltd., has a right to demand immediate redemption of the debentures. On 31st March, 2016, debt-equity ratio of ABC Ltd., exceeds 2:1. Therefore, PQR Ltd., decides to return the debentures.

Thus, on 31st March, 2016, the liability of the ABC Ltd., towards PQR Ltd., (which was originally a long-term liability) becomes a current liability, since, it is now a liability on demand. However, ABC Ltd., enters into an agreement with PQR Ltd., on 15th April, 2016 that PQR Ltd., will not demand the payment immediately. The financial statements are approved by the BOD on 30th April, 2016.

Now, in such a case, the liability is turning into demand liability on 31st March, 2016. The agreement that PQR Ltd., will not demand the money immediately is a subsequent event. Even though it is a subsequent event not affecting the condition existing at the balance sheet date, yet because of the specific provisions of Ind AS 10, it has to be given effect in the financial statements for the year 2015-2016. Accordingly, though as per original terms the liability would have been otherwise reclassified as a current liability as on 31st March, 2016, by giving effect to the event after the reporting period due to the specific provisions of Ind AS 10, it would continue to be classified as a non-current liability as on 31st March, 2016. In other words, the re-classification of debentures as current liability as at 31st March, 2016 will be adjusted and once again classified as a non-current liability as at that date.

6.2 GOING CONCERN :

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

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

Example :

A going concern company assumes that the raw material inventory and work in progress will be completed in due course and the inventories of finished goods would be ready for sale. But, if the company has no intention to continue with the business, it may take a decision to sell the raw material and WIP at best available market price, may be at scrap value also.

Question 9 – Company XYZ Ltd.

Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the F.Y. 20X4-20X5 have been approved by the Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis?

Question 10 – PQR Ltd.

In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of Rs. 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of Rs. 27,00,000 is expected.

The financial statements for the year ending 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed?

7. DIVIDENDS :

- If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, Financial Instruments: Presentation) after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.
- If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.

- The crux of difference between adjusting event and non-adjusting event depends on the fact whether the event provides evidence for existence of a condition at the end of reporting period or not.

Question 11 – ABC Ltd.

ABC Ltd., declares the dividend on 15th July, 2012 as the results of year 2011-2012 as well as Q1 ending 30th June, 2012 are better than expected. The financial statements of the company are approved on 20th July, 2012 for the financial year ending 31st March, 2012. Will the dividend be accounted for in the financial year 2012-2013 or will it be accounted for in the year 2011-2012?

Question 12

What would be the treatment for dividends declared to redeemable preference shareholders after the reporting period but before the financial statements are approved for issue for the year 20X1-20X2. Whether Ind AS 10 prescribes any accounting treatment for such dividends?

8. SELF PRACTICE QUESTIONS :

Question 13 – ABC Ltd.

ABC Ltd., has announced its interim results for Quarter 1, ending 30th June, 2012 on 5th July, 2012. However, till that time the AGM for the year 2011-2012 was not held. The financial statements for 2011-2012 were approved by the board of directors on 15th July, 2012. What will be the 'after the reporting period' as per the definition given in Ind AS 10?

Question 14 – KKK Ltd.

KKK Ltd., is in a legal suit with the GST department. The company gets a court order in its favour on 15th April, 2012, which resulted into reducing the tax liability as on 31st March, 2012. The financial statements for 2011-2012 were approved by the board of directors on 15th May, 2012. The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting. Comment on the company's views in the light of Ind AS 10.

Question 15 – XYZ Ltd.

XYZ Ltd., is trading in laptops. On 31st March, 2012, the company has 50 laptops which were purchased at Rs.45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 2012, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to Rs.35,000 each. The financial statements for 2011-2012 were approved by the board of directors on 15th May, 2012. The company does not want to value the stock at Rs.35,000 less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 2012 and the reduced prices were not applicable as on 31st March, 2012. Comment on the company's views.

Question 16 – XY Ltd.

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

Question 17 – A Ltd.

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

Question 18 – A company manufacturing

A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on 20th April, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition.

Duty drawback has been credited by the Department on 28th June, 20X2 and financial statements have been approved by the Board of Directors of the company on 26th July, 20X2. Whether duty drawback credit should be treated as an adjusting event?

Question 19 – XYZ Ltd.

XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of Rs. 5 lakhs to ABC Ltd. between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.

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

Question 20

Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event?

Question 21 – X Ltd.

X Ltd. was having investment in form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2?

Question 22 – ABC Ltd.

ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of Rs. 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of Rs. 28,00,000 and the company has expected that the demand would be settled at Rs. 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly.

Thanks ....

Rahul Malkan

CHAPTER

18

IND AS 20 – ACOUNTING FOR GOVT. GRANT & DISCLOSURE OF GOVT. ASSISTANCE

CONCEPTS COVERED

1. DEFINITIONS
2. RECOGNITION OF GOVT. GRANTS
3. ACCOUNTING FOR GOVT. GRANTS
4. PRESENTATION OF GRANTS RELATED TO ASSETS
5. PRESENTATION OF GRANTS RELATED TO INCOME
6. REPAYMENT OF GOVERNMENT GRANTS
7. SELF PRACTICE QUESTIONS

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1. DEFINITIONS :

1. **Government** refers to government, government agencies and similar bodies whether local, national or international.

2. **Government assistance** is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.

3. **Government grants** are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

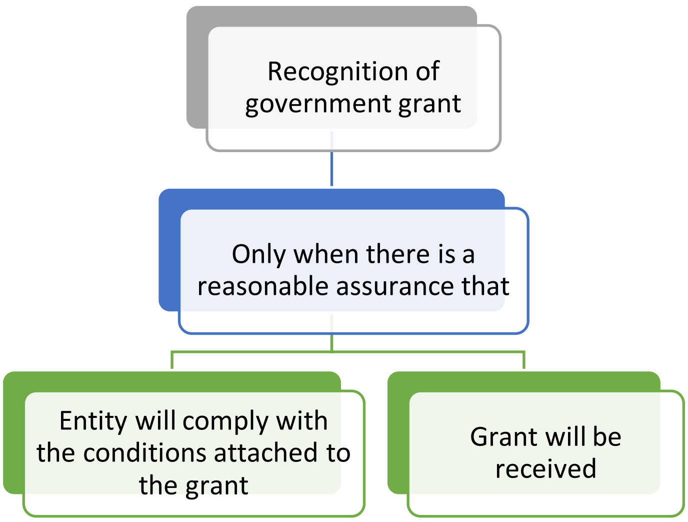
4. **Grants related to assets** are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

5. **Grants related to income** are government grants other than those related to assets.

6. **Forgivable loans** are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

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

2. RECOGNITION OF GOVT GRANTS :



Question 1

Government gives a grant of Rs.10,00,000 for research and development of H1N1 vaccine to A Pharmaceuticals Limited. There is no condition attached to the grant. Examine how the Government grant be realized.

Question 2

Government gives a grant of Rs.10,00,000 for research and development of H1N1 vaccine to A Pharmaceuticals Limited even though similar vaccines are available in the market but are expensive. The entity has to ensure by developing a manufacturing process over a period of 2 years that the costs come down by at least 40%. Examine how the Government grant be realized.

Question 3 – A village

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

Question 4 – A Limited

A Limited received from the government a loan of Rs.50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized.

3. ACCOUNTING FOR GOVT GRANTS :

3.1 Grant related to Depreciable Asset :

There are two approaches to the accounting of government grant: 'capital approach' or 'income approach'. Under capital approach, a grant is recognised outside profit or loss, i.e., grant is credited directly to equity whereas under the income approach grant is recognised in profit or loss over one or more periods.

The Standard prescribes only the income approach

Question 5

Continuing with the facts given in the Illustration 4, state how the grant will be recognized in the statement of profit or loss assuming:

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

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

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

3.2 Grant related to Non Depreciable Asset :

Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations.

Question 6 – A grant of land

A grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building once the building is constructed and put to use.

3.3 Conditional Grants received as part of a package of financial or fiscal aids :

In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.

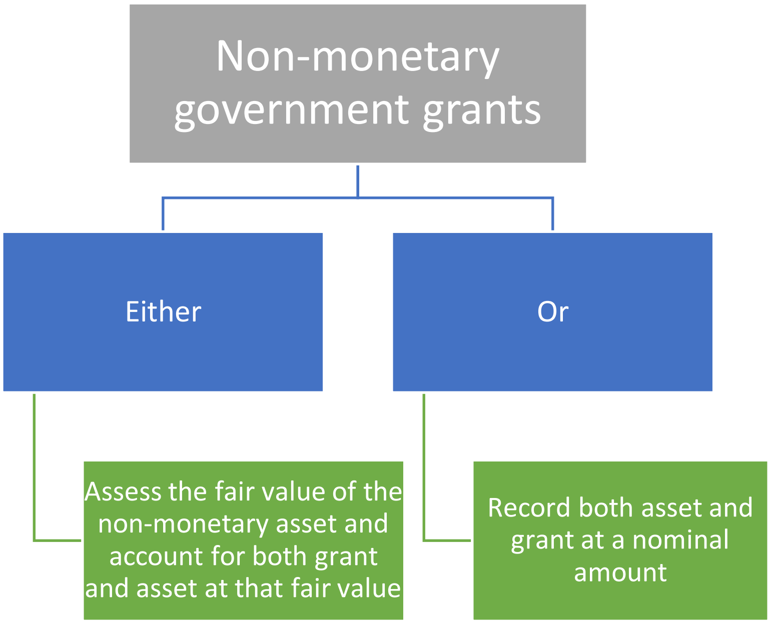
3.4 Grant for expenses or losses already incurred :

Such grants are recognised in P/L in the period in which entity becomes eligible to receive the grant.

3.5 Grant received for immediate Financial Support :

Such grants are received for giving immediate financial support rather than an incentive to undertake an specific expenditure. Such grants should be recognised in P/L in the year in which the entity becomes eligible to receive it.

3.6 Non-monetary government grants :



Question 7 – A Limited

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

3.7 Government Assistance – No Specific relation to Operating Activities :

In some countries government assistance to entities may be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the entity.

In this regard, Appendix A to Ind AS 20 provides that government assistance to entities meets the definition of government grants in Ind AS 20, even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited directly to shareholders' interests and should be recognised in profit or loss on a systematic basis.

4. PRESENTATION OF GRANTS RELATED TO ASSETS :

4.1 Presentation in the Balance Sheet :

Question 8 – A Limited

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

4.2 Disclosure in the statement of cash flows :

Question 9

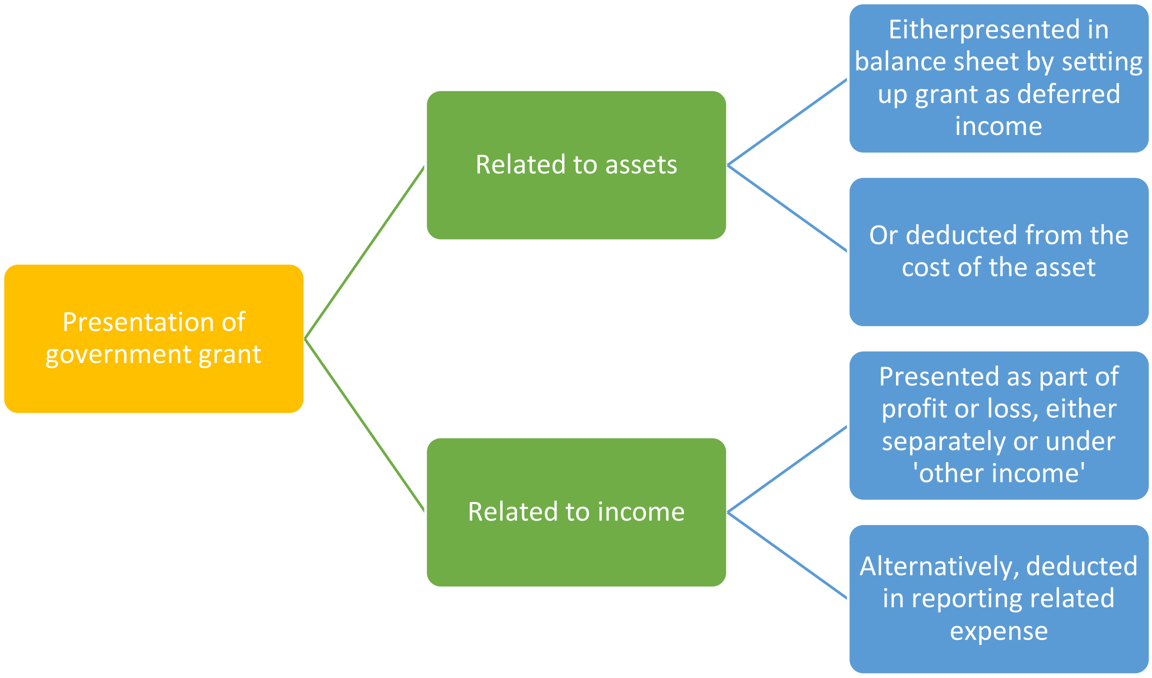
Continuing with the facts given in the Illustration 7 above, state how the same will be disclosed in the Statement of cash flows.

5. PRESENTATION OF GRANTS RELATED TO INCOME

Two methods are prescribed for presentation of grants related to income. The grant could be

(a) (first method) presented as a credit in the statement of profit and loss, either separately or under a general heading such as 'Other income'; or

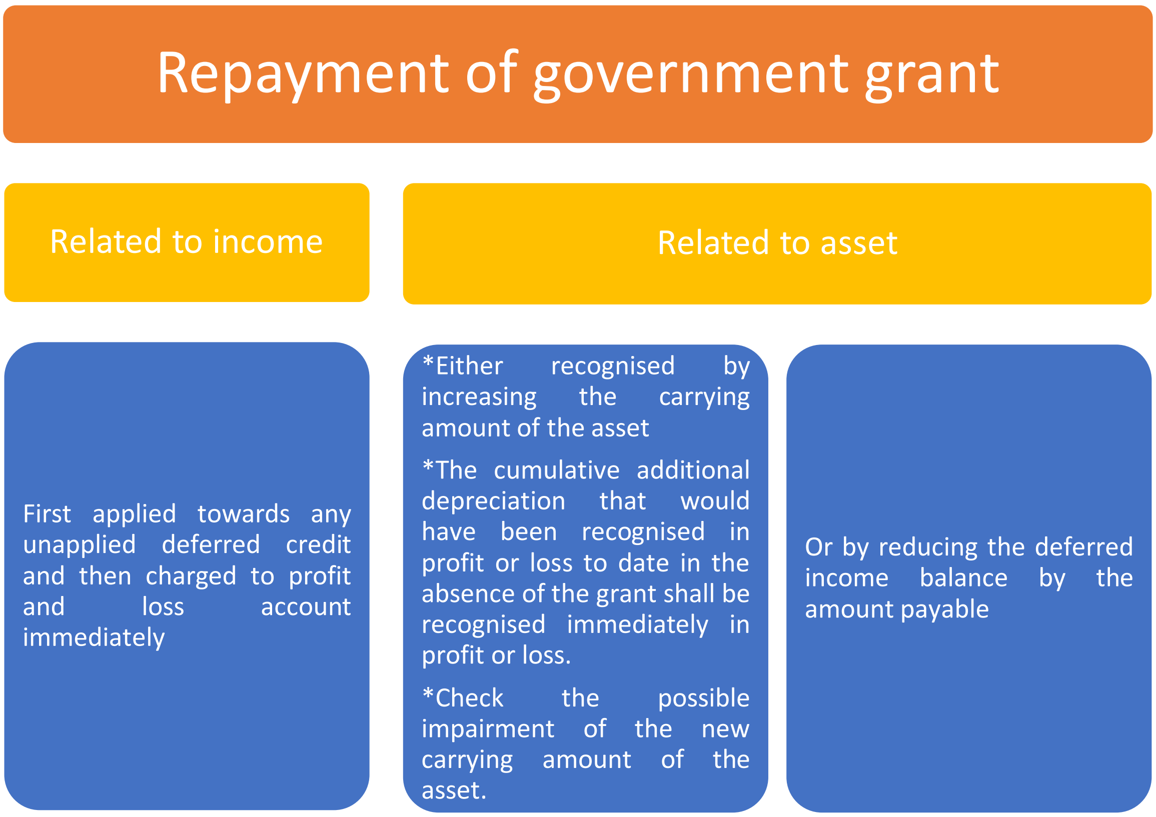
(b) (second method) deducted in reporting the related expense.



Question 10 – A Ltd.

A Ltd. received a government grant of Rs. 10,00,000 to defray expenses for environmental protection. Expected environmental costs to be incurred is Rs. 3,00,000 per annum for the next 5 years. How should A Ltd. present such grant related to income in its financial statements?

6. REPAYMENT OF GOVERNMENT GRANTS :



Question 11 – A Ltd.

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

7. SELF PRACTICE QUESTIONS :

Question 12 – ABC Ltd.

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

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

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

Question 13 – A Limited

A Limited received from the government a loan of Rs.1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset.

Question 14 – MNC Ltd.

MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then how the same is to be accounted for if it is

(a) A Grant related to asset or

(b) A Grant related to income?

Question 15 – ABC Ltd.

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Question 16 – Rainbow ABC Ltd.

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of Rs. 1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clean river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

(ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

Suggest the accounting treatment of, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.

Question 17 – An entity

An entity opens a new factory and receives a government grant of Rs. 15,000 in respect of capital equipment costing Rs. 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis. Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20.

Question 18 – A company

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

Question 19 – Entity A

Entity A is awarded a government grant of Rs.60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs. 1,00,000, rising by Rs.10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3.

Thanks ....

CHAPTER

19

IND AS 12 – INCOME TAXES

CONCEPTS COVERED

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1. INTRODUCTION :

Example :
Asset costing Rs. 1,00,000 was purchased on 1/1/2019. Depreciation @ 20% was charged as per SLM. However for Tax calculation 100 % is allowed for tax purpose. Assume PBDT of Rs. 2,00,000 for year 1 and year 2. Show how would IND AS 12 change the way taxes are accounted. Assume tax rate @ 30%.

2. DEFINITIONS :

A. **Accounting profit** is profit or loss for a period before deducting tax expense.

B. **Taxable profit** (tax loss) is the profit (loss) for a period, computed as per the income tax act, upon which income taxes are payable (recoverable).

C. **Tax expense** (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

D. **Current tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

E. **Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

F. **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:
- deductible temporary differences;
- the carry forward of unused tax losses; and
- the carry forward of unused tax credits.

G. **Temporary differences** are differences between the carrying amount of an asset or liability in the balance sheet and its tax base.

H. Temporary differences may be either:
- **taxable temporary differences**, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
- **deductible temporary differences**, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

I. The **tax base** of an asset or liability is the carrying amount to that asset or liability for tax purposes.

3. TAX EXPENSE :

- Tax expense or tax income is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.
- The following needs to be appreciated:
  (a) Tax expense could be positive or negative. Thus, there could be a tax income.
  (b) Tax expense is the aggregate of:
  - current tax; and
  - deferred tax.

4. DEFERRED TAX, ITS RECOGNITION, MEASUREMENT AND PRESENTATION

The following steps should be followed in the recognition, measurement and presentation of deferred tax liabilities or assets:

Step 1	• Compute carrying amounts of assets and liabilities
Step 2	• Compute tax base
Step 3	• Compute temporary differences
Step 4	• Classify temporary differences into either: • (a) Taxable temporary difference • (b) Deductible temporary difference
Step 5	• Identify exceptions
Step 6	• Assess deductible temporary differences, tax losses and tax credits
Step 7	• Determine the tax rate
Step 8	• Calculate and recognise deferred tax
Step 9	• Accounting of deferred tax
Step 10	• Offsetting of deferred tax liabilities and deferred tax assets

STEP 1 : COMPUTE CARRYING AMOUNT :

For the purpose of this Standard, we can define carrying amount at which an asset or liability is recognised in the balance sheet, after making necessary adjsutments like depreciation, impairment, etc. In other words carrying amount of the assets and liabilities means balance as per the ledger.

Question 1 – Entity A

Entity A had acquired an item of plant and machinery for Rs 1,00,000 on April 1, 2001. It depreciated this item @ 10% per annum on SLM basis. For the year ended March 31, 2002, it provides depreciation of Rs 10,000. The carrying amount of this item of plant and machinery as on March 31, 2002 is Rs 90,000.

STEP 2 : COMPUTE TAX BASE :

(a) The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Question 2 – Entity A

Entity A had acquired an item of plant and machinery for Rs 1,00,000 on April 1, 2001. It depreciated this item @ 10% per annum on SLM basis. For the year ended March

31, 2002, it provides depreciation of Rs 10,000. The carrying amount of this item of plant and machinery as on March 31, 2002 is Rs 90,000. As per taxation laws, this item of plant and machinery has to be depreciated @ 30% per annum on WDV basis. The entity thus for the purposes of taxation computes depreciation of Rs 30,000. The tax base of this item of plant and machinery is Rs 70,000 (Rs 1,00,000 – Rs 30,000).

(b) Four scenarios could be anticipated for computation of the tax base of either an asset or a liability:

- Tax base of an asset.
- Tax base of a liability.
- Items with a tax base but no carrying amount.
- Items of assets and liabilities where tax base is not apparent.

- **Tax Base of Asset :**

  The principle to compute tax base of an asset is as under:

  ❖ The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

  ❖ The carrying amount of the asset could be recovered either through sale of the asset or through its use or partly through use and partly through sale. The method of recovery has to be determined at each reporting date.

Question 3 – Entity A

Entity A has inventory with carrying amount of Rs.1,00,000 as at the reporting date. It recovers the value of inventory through sale in a subsequent reporting period. The sale value is the economic benefit derived by the entity and is taxable. However, as per the matching and other concepts, against this sale the entity is entitled to deduct its cost. The cost is the carrying amount of the inventory i.e., Rs.1,00,000. The tax base in this case is Rs.1,00,000.

Question 4 – Entity A

Entity A has acquired an item of asset for Rs.1,00,000 for production of certain items to be sold by the entity. It is deductible equally over two years in the books of accounts. The carrying amount as the end of first reporting period is Rs.50,000 (Rs.1,00,000 – Rs.50,000). In the income tax, Rs.75,000 is deductible in year 1 and balance is deductible in year 2. We have to compute its tax base as on the last day of the first reporting period. However, in income-tax, it can claim only Rs.25,000 being 25% of the cost of the asset as 75% has already been claimed in year 1. Thus, the tax base in this case is Rs.25,000.

Question 5

Interest receivable have a carrying amount of 100. The related interest revenue will be taxed on a cash basis. The tax base of the interest receivable is nil.

Question 6 – An entity

An entity that follows mercantile system of accounting has trade receivables of Rs.1,000. It creates a general bad debt allowance of Rs.50. The carrying amount in the books of accounts of trade receivables is thus Rs.950. However, in income-tax, general bad debt provision is not deductible. In the subsequent period, entity is able to recover only Rs.950. The amount recovered is a taxable economic benefit. But for tax purposes, entity is entitled for a deduction of Rs.1,000 against this recovery of trade receivable. The tax base is Rs.1,000.

Question 7 –An entity

An entity that follows mercantile system of accounting has trade receivables of Rs.1,000. It creates a specific bad debt of Rs.50. The carrying amount in the books of accounts of trade receivables is thus Rs.950. However, in income-tax, specific bad debt provision is deductible in the very year it is created. In the subsequent period, entity is able to recover only Rs.950. The amount recovered is a taxable economic benefit. For tax purposes, entity will be entitled for a deduction of Rs.950 against this recovery of trade receivable; Rs.50 already deducted in the earlier period. The tax base is Rs.950.

- ❖ If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.
- ❖ It is quite feasible that in certain cases, the economic benefits that are derived from the recovery of an asset are not taxable. In these situations, the tax base of the asset is taken at its carrying amount.

Question 8 – An entity

An entity has an investment in listed equity shares. There is no tax on gains that arise on sale of these listed equity shares. Thus, the tax base in this case will be the carrying amount of the investments.

Question 9 – An entity

An entity has given a loan of Rs.10,000 which is the carrying amount. The repayment of loan has no tax consequences. The tax base is Rs.10,000.

- **Tax Base of Liability :**

  The principle to compute tax base of a liability is as under:

- The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods.

Question 10

Current liabilities include accrued expenses with a carrying amount of Rs.100. The related expense will be deducted for tax purposes on a cash basis. The tax base of the accrued expenses is nil.

Question 11

Current liabilities include accrued expenses with a carrying amount of Rs.100. The related expense has already been deducted for tax purposes. The tax base of the accrued expenses is Rs.100.

- If those liabilities are not tax deductible, the tax base of that liability is equal to its carrying amount.

Question 12

Current liabilities include accrued fines and penalties with a carrying amount of Rs.100. Fines and penalties are not deductible for tax purposes. The tax base of the accrued fines and penalties is Rs.100.

- It is an other than temporary difference, as the expenses are not allowable as per income tax.

Question 13

A loan payable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences. The tax base of the loan is Rs.100.

- In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

Question 14

Current liabilities include interest revenue received in advance, with a carrying amount of Rs.100. The related interest revenue was taxed on a cash basis. The tax base of the interest received in advance is nil.

- It is an other than temporary difference, as the expenses are not allowable as per income tax.

Question 15

A loan payable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences. The tax base of the loan is Rs.100.

❖ In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

Question 16

Current liabilities include interest revenue received in advance, with a carrying amount of Rs.100. The related interest revenue was taxed on a cash basis. The tax base of the interest received in advance is nil.

- **Items with a Tax Base but No Carrying Amount :**

❖ There are certain items that have a tax base but no carrying amount. These include items that are charged to revenue statement in the period in which they are incurred but are allowed as a deduction over a number of periods as per the taxation laws.

Question 17 – A Limited

A Limited has been incorporated recently. It incurred Rs.1,00,000 on its incorporation. It has been charged to revenue in the very first accounting period. The taxation laws allow deduction over a period of 5 years. The carrying amount at the end of year 1 is Nil. The tax base will be Rs.80,000 (20,000 x 4) as Rs.20,000 being 1/5th is allowable as a deduction in taxation laws over 4 years.

Question 18 – Public issue

Public issue expenses. The entity may have written off the public issue expenses in the very first year. But since tax laws permit deduction over 5 years, the temporary differences will exist till complete deduction is claimed in taxation laws.

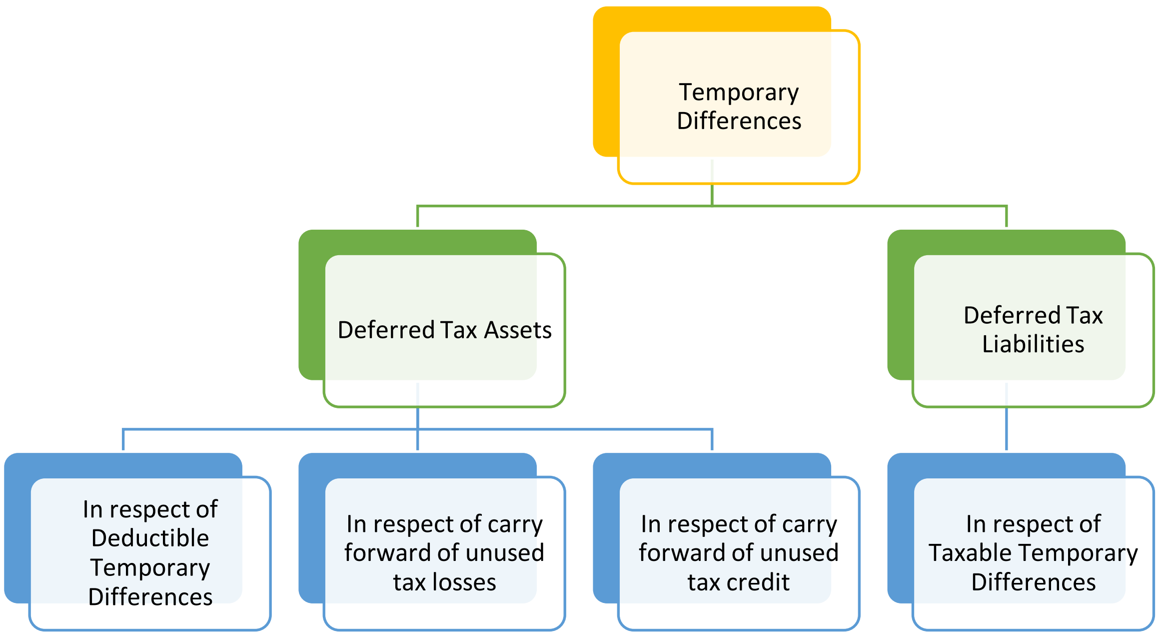
- **Items of Assets and Liabilities where Tax Base is not Apparent :**

❖ There could be situations where it may be difficult to compute the tax base of an item. One however, knows the carrying amount. This is because of the provisions of taxation laws. Whereas in books of accounts, all or most of the revenue and gains are included as part of one single performance statement, in the taxation laws they are charged under different head. The taxable amount amongst other things depends under which head an item at the time of recovery may be charged. In India, income or gains are charged either as 'Salaries', 'Income from house property', 'Profits and gains of business', 'Capital Gain' & 'Income from other sources'. Further certain specific or weighted deductions are also permissible. For example rental income is subject to a flat deduction. So how will you compute the rental income received in advance? Moreover, there are cases depending upon the substance of the transaction, the rental income is to be charged as business income. At times, reverse may be the case. Many more similar situations could be anticipated.

Question 19 – Entity A

Entity A has an industrial undertaking that consists of land, building, plant and machinery. It is contemplating disposing the entity. It has the option to recover the carrying amount of the entity either by disposing the entire entity as a slump sale or dispose of each asset on a piecemeal basis. Depending upon the manner of recovery and period of holding, the carrying amount may be subject to indexation benefit, the recovery may be charged either as a business profit or capital gains. Again it could be long term gain capital gain or short term capital gain. As at the end of the reporting period, the entity is not sure of the manner and time of recovery.

STEP 3 : COMPUTE TEMPORARY DIFFERENCE :



Question 20 – An entity

An entity has an item of plant and machinery acquired on the first day of the reporting period for Rs.1,00,000. It depreciates it @ 20% p.a on SLM basis. The carrying amount in balance sheet is Rs.80,000. The taxation laws require depreciation @ 30% on WDV basis. The tax base at the end of the reporting period is Rs.70,000. The temporary difference is Rs.10,000 (Rs.80,000 – Rs.70,000).

Question 21 – An entity

An entity acquires an asset on the first day of reporting period for Rs.120 with a useful life of 6 years and no residual value. It depreciates the asset on SLM basis. The tax rate is 30%. The tax depreciation is as assumed in the computation below.

The following computations are performed.

Financial Statements

Year	**1**	**2**	**3**	**4**	**5**	**6**
Gross Block	120	120	120	120	120	120
Cumulative Depreciation	20	40	60	80	100	120
Carrying Amount	100	80	60	40	20	0

Financial Statements

Year	**1**	**2**	**3**	**4**	**5**	**6**
Tax base brought forward	120	30	20	13	8	3
Depreciation charge (assumed)	90	10	7	5	5	3
Tax base carried forward	30	20	13	8	3	0

Temporary Difference

Year	**1**	**2**	**3**	**4**	**5**	**6**
Carrying Amount	100	80	60	40	20	0
Tax base carried forward	30	20	13	8	3	0
Temporary difference	70	60	47	32	17	0
Cumulative impact	+70	–10	–13	–15	–15	–17
	+70	–70				

Movement in Balance Sheet

Year	**1**	**2**	**3**	**4**	**5**	**6**
Temporary difference @30%	70	60	47	32	17	0
Deferred tax liability	21	18	14	10	5	0
Movement in provision	+21	–3	–4	–4	–5	–5
Cumulative	+21	–21				

STEP 4 : CLASSIFY TEMPORARY DIFFERENCE :

(a) Temporary differences are to be classified into:

- Taxable temporary differences
- Deductible temporary differences

(b) Taxable temporary differences are those temporary differences that results in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

As the name 'taxable temporary difference' suggests, these are the temporary differences that will be taxed in future. These taxable temporary differences will increase tax liabilities. All taxable temporary differences, subject to limited exceptions, give rise to deferred tax liability.

Taxable temporary difference arises where the:

- carrying amount of an asset exceeds its tax base; or
- tax base of a liability exceeds its carrying amount.

Question 22 – An asset

An asset which costs Rs.150 has a carrying amount of Rs.100. Cumulative depreciation for tax purposes is Rs.90 and the tax rate is 25%. The tax base of the asset is Rs.60 (cost of Rs.150 less cumulative tax depreciation of Rs.90). To recover the carrying amount of Rs.100, the entity must earn taxable income of Rs.100, but will only be able to deduct tax depreciation of Rs.60. Consequently, the entity will pay income taxes of Rs.10 (Rs.40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of Rs.100 and the tax base of Rs.60 is a taxable temporary difference of Rs.40.

(c) Deductible temporary differences are those temporary differences that results in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Again, it should be noted, the name 'deductible temporary difference' suggests, these are the temporary differences that will be deducted in future when computing the tax liability. These deductible temporary differences will reduce tax liabilities. All deductible temporary differences, subject to exceptions/recognition criteria, give rise to deferred tax assets.

Deductible temporary difference arises where the:

- carrying amount of a liability exceeds its tax base; or
- tax base of an asset exceeds its carrying amount.

Question 23 – An entity

An entity recognises a liability of Rs.100 for gratuity and leave encashment expenses by creating a provision for gratuity and leave encashment. For tax purposes, any amount with regard to gratuity and leave encashment will not be deductible until the entity pays the same. The tax rate is 25%. The tax base of the liability is nil (carrying amount of Rs.100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of Rs.100 and, consequently, reduce its future tax payments by Rs.25 (Rs.100 at 25%). The difference between the carrying amount of Rs.100 and the tax base of nil is a deductible temporary difference of Rs.100.

(d) Based on the above discussions, a matrix as under may be drawn:

	For Assets	**For Liabilities**
If carrying amount > tax base	Taxable Temporary Difference ↓ Deferred Tax Liability (e.g. WDV as per books > WDV as per Income Tax)	Deductible Temporary Difference ↓ Deferred Tax Asset (e.g. Provision for Bonus as per books > Provision for Bonus as per IT)
If carrying amount < tax base	Deductible Temporary Difference ↓ Deferred Tax Asset (e.g. WDV as per books < WDV as per Income Tax)	Taxable Temporary Difference ↓ Deferred Tax Liability (e.g. Loan carrying amount as per books< Loan carrying amounts as per tax)
If carrying amount = tax base	No temporary difference	No temporary difference

STEP 5: IDENTIFY EXCEPTIONS :

Exception 1 : The initial recognition of goodwill in the case of a business combination

No deferred tax liability is to be recognised for taxable temporary difference arising on goodwill arising in a business combination in tax jurisdictions where such goodwill is not tax deductible. In all other cases of temporary difference, either taxable or deferred, either deferred tax liability or deferred tax asset should be recognised in accordance with other provisions of this Ind AS

Exception 2 : The initial recognition of an asset or liability in a transaction which: (i) is not a business combination; and (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss)

The Standard prohibits recognition of deferred tax liability or deferred tax assets in cases of either taxable or deductible temporary difference arising in a transaction:

(a) is not a business combination; and
(b) does not affect neither the accounting profit nor the taxable profit.

The Standard implies that if the carrying amount of any asset or liability is not equal to its tax base at the time of its transaction where the transaction is:
(i) Not in the nature of business combination.
(ii) Not impacting either the accounting profit or the taxable profit.
(iii) Neither deferred tax liability nor deferred tax asset should be recognised.

Exception 3 : Temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures

Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest.

STEP 6: ASSESS (ALSO REASSESS) DEDUCTIBLE TEMPORARY DIFFERENCES, TAX LOSSES AND TAX CREDITS

(a) As we are aware that deductible temporary differences reduces the taxable profits of future periods. It signifies that future tax payments will be smaller by a particular amount. However economic benefits will flow to the entity in the form of lower tax liability in future only in case it has future profits. If there are no future profits, it means there are no tax payments which in turn mean that deductible temporary differences are of no benefit.

(b) Therefore, an entity should recognise deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised. This is based on the principle of prudence and conservatism. It should be noted that the entity has to make sufficient taxable profits in future. Not making losses will not suffice.

(c) If tax law does not impose any restrictions on sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences.

(d) If tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences.

(e) Probable means more likely than not. The Standard provides a three step criteria to be applied in a serial order. The criterion is applied in the case of the same taxable entity assessed by the same taxation authority.

STEP 7 : DETERMINE THE TAX RATE :

Having determined the taxable temporary differences and deductible temporary difference that needs to be considered for recognition of deferred tax liabilities or assets respectively, we now need to determine the tax for creation to deferred tax liabilities or assets. The principal is:

- Deferred tax assets and liabilities shall be measured:
  - (i) at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled;
  - (ii) based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

STEP 8 : CALCULATE AND RECOGNISE DEFERRED TAX :

(a) This is the simplest of all steps. Having determined the taxable temporary differences and the deductible temporary differences as per Step 6 and the applicable tax rates with reference to tax laws, one has to multiply amount determined in Step 6 with the rates determined in Step 7.

- Taxable temporary differences when multiplied with tax rates will lead to deferred tax liabilities.
- Deductible temporary differences when multiplied with rates will lead to deferred tax assets.

(b) The following should be kept in mind:

- Deferred tax liabilities or assets should not be discounted.
- The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period.
- An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised.
- Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

STEP 9 : ACCOUNTING OF DEFERRED TAX :

(a) The accounting of deferred tax effects of a transaction of an event is consistent with the accounting for that transaction or event.

(b) A transaction and the deferred tax effects of a transaction may be accounted for in:

- Statement of profit and loss;
- Outside profit and loss account:
  - (i) In other comprehensive income such as revaluation amount in accordance with Ind AS 16, Property, Plant and Equipment
  - (ii) Directly in equity such as correction of an error in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

STEP 10 : OFFSETTING DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES :

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

- the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
  - (i) the same taxable entity; or
  - (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

5. SELF PRACTICE QUESTIONS :

Question 24 – An entity

An entity has a deductible temporary difference of Rs.50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to Rs.60,000. The cost of implementing this tax planning strategy is Rs.12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Question 25 – A Limited

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 2001, it has interest receivable of Rs.10,000 and the tax rate was 25%. On February 28, 2001, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 2002. Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is December 31, 2001 and these are approved for issued on May 31, 2002.

Question 26

An asset which cost Rs.150 has a carrying amount of Rs.100. Cumulative depreciation for tax purposes is Rs.90 and the tax rate is 25%. Calculate the tax base.

Question 27 – ABC Ltd

On 1st April 2001, ABC Ltd. acquired 100% shares of XYZ Ltd for INR 4,373 crores. By 31st March, 2005, XYZ Ltd had made profits of INR 5 crores, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Question 28 – ABC Ltd

ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January 20X1 for INR 1000 crores. By 31st March, 20X5 PQR Ltd. had made profits of INR 50 crores (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Question 29 – A company

A company had purchased an asset at Rs.1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20%. (Depreciation rate for Tax purposes is 25%. The operating profit is Rs.1,00,000 for all the 5 years. Tax rate is 30% for the next 5 years. Calculate the Book Value as per financial and tax purposes and then DTL.

Question 30 – A Ltd.

A Ltd. Acquired B Ltd. The following assets and liabilities are acquired in a business combination:

	Fair Value	Carrying Amount	Temporary difference
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)
	570	595	(25)
9% Debentures	(100)	(100)	
	470	495	
Consideration Paid	500	500	
Goodwill	30	5	(25)

Calculate Deferred Tax Asset.

Question 31 – B Limited

B Limited is a newly incorporated entity. Its first financial period ends on March 31, 2001. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of Rs.9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of Rs.4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.
Discuss the treatment of deferred tax as on March 31, 2001.

Question 32 – A Ltd.

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of Rs. 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of a B Ltd. share was Rs. 2.00

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at Rs. 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1. The following matters emerged:

- Property having a carrying value of Rs. 15 Cr at 1 April 20X1 had an estimated market value of Rs. 18 Cr at that date.
- Plant and equipment having a carrying value of Rs. 11 Cr at 1 April 20X1 had an estimated market value of Rs. 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of Rs. 2.50 Cr. The fair value of the inventory on the acquisition date is Rs. 3 Cr.

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.

Question 33 – X Ltd.

X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, the following events affected the tax position of the group:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of Rs. 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of Rs. 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than Rs. 20,00,000.

(iii) During the year ended 31st March, 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was Rs. 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

(iv) On 1st April, 2017, X Ltd. borrowed Rs. 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1st April, 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March, 2020 will be Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

Question 34 – PQR Ltd.

PQR Ltd., a manufacturing company, prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 2018, the following events affected the tax position of the group:

- QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of Rs. 30,00,000. QPR Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.
- During the year ended 31st March, 2018, PQR Ltd. capitalised development costs which satisfied the criteria as per Ind AS 38 'Intangible Assets'. The total

amount capitalised was Rs. 16,00,000. The development project began to generate economic benefits for PQR Ltd. from 1st January, 2018. The directors of PQR Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

- On 1st April, 2017, PQR Ltd. borrowed Rs. 1,00,00,000. The cost to PQR Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%.

Question 35 – An entity

An entity is finalising its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30th June, 20X2.

The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

Deferred tax asset	Rs. 80,000
Deferred tax liability	Rs. 60,000

Of the deferred tax asset balance, Rs. 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.

Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries.

Question 36 – Entity H

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs.15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

Acquisitions	**Book values Rs.'000**	**Tax base Rs.'000**	**Fair values Rs.'000**
Land and buildings	600	500	700
Property, plant and equipment	250	200	270
Inventory	100	100	80
Accounts receivable	150	150	150
Cash and cash equivalents	130	130	130
Accounts payable	(160)	(160)	(160)
Retirement benefit obligations	(100)	-	(100)

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition.

Thanks ....

CHAPTER

20

IND AS 24 – RELATED PARTY DISCLOSURE

CONCEPTS COVERED

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1. INTRODUCTION :

It is quite probable that related party relationship may have an effect on the profit or loss and financial position of an entity. The effect gets manifested through:

(a) Transactions that are entered between related parties may not be entered with unrelated parties;

- Example : An entity may sell goods to its parent at cost. It may not sell goods at cost to an unrelated party.

(b) Transactions with unrelated parties get influenced because of related party relationships.

- Example : S Limited, a subsidiary of H Limited, in steel manufacturing used to purchase billets from UR Limited. H Limited acquires 100% stake in FS Limited who also manufactures billets. FS Limited is now a fellow subsidiary of S Limited. H Limited instructs S Limited not to purchase billets from UR Limited but from FS Limited.

2. SCOPE :

The standard is applied to

Identifying Related Party relationship → Identifying Related Party transactions → Identifying outstanding balances between an entity and its related parties → Identifying commitments between an entity and its related parties → Identifying the circumstances in which disclosures of above items is to be made and → Determining the disclosure to be made about the above items

3. DEFINITIONS :

1. A **related party** is
   (i) a person or (ii) entity
   that is related to the reporting entity.

2. A **reporting entity** in this Standard is an entity that is preparing its financial statements.

   Thus two types of related party relationships are envisaged.
   1. One relationship is between the reporting entity and a person or persons.
   2. The other relationship is between the reporting entity and another entity or entities.

Note: The Standard clarifies that in considering each possible related party relationship, the attention should be directed to the substance of the relationship and not merely the legal form.

4. UNDERSTANDING WHICH ARE RELATED PARTY AND WHICH ARE NOT :

1. A **person** or **a close member of that person's family is related to a reporting entity** if that person:
   a) has control or joint control over the reporting entity;
   b) has significant influence over the reporting entity; or
   c) is a member of the key management personnel of
      - the reporting entity or
      - a parent of the reporting entity.

2. **Close members of the family of a person** are the one who may be expected to influence or be influenced by that person in their dealings with the entity. It includes:
   a) that person's children, spouse or domestic partner, brother, sister, father and mother;
   b) children of that person's spouse or domestic partner; and
   c) dependants of that person or that person's spouse or domestic partner.

3. A **parent** is an entity that controls one or more subsidiaries to present consolidated financial statements.

EXAMPLES :

1. Mr. A holds 51% in equity share capital of A Limited. A Limited has no other form of share capital. As Mr. A controls A Limited, he is a related party.
2. Mrs. A is wife of Mr. A. Mr. A holds 51% of equity shares of A Limited. A Limited has no other form of share capital. Mr. A controls A Limited. Since Mr. A is a related party, Mrs. A is also a related party of A Limited.
3. Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he is related to A Limited.
4. Mr. D is a director of H Limited. S Limited is a subsidiary of H Limited. Mr. D is related to S Limited.

Understanding relationship between the reporting entity and another entity/entities :

4. An **entity is related to a reporting entity** if any of the following conditions applies:

   (a) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

Example :

SA Limited and SB Limited are subsidiaries of H Limited. SA Limited, SB Limited and H Limited are related to each other.

   (b) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

Example :
AS Limited is an associate of S Limited. S Limited is a subsidiary of H Limited. SH Limited is another subsidiary of H Limited. AS Limited and SH Limited are related parties.

(c) Both entities are joint ventures of the same third party.

Example :
H Limited has entered into 2 joint ventures, JHA Limited (joint venture with A Limited) and JHB Limited (joint venture with B Limited). JHA Limited and JHB Limited are related parties.

(d) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

Example :
JH Limited is a joint venture of H Limited. AH limited is an associate of H Limited. JH Limited and AH Limited are related parties.

(e) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(f) The entity is controlled or jointly controlled by a person identified above.

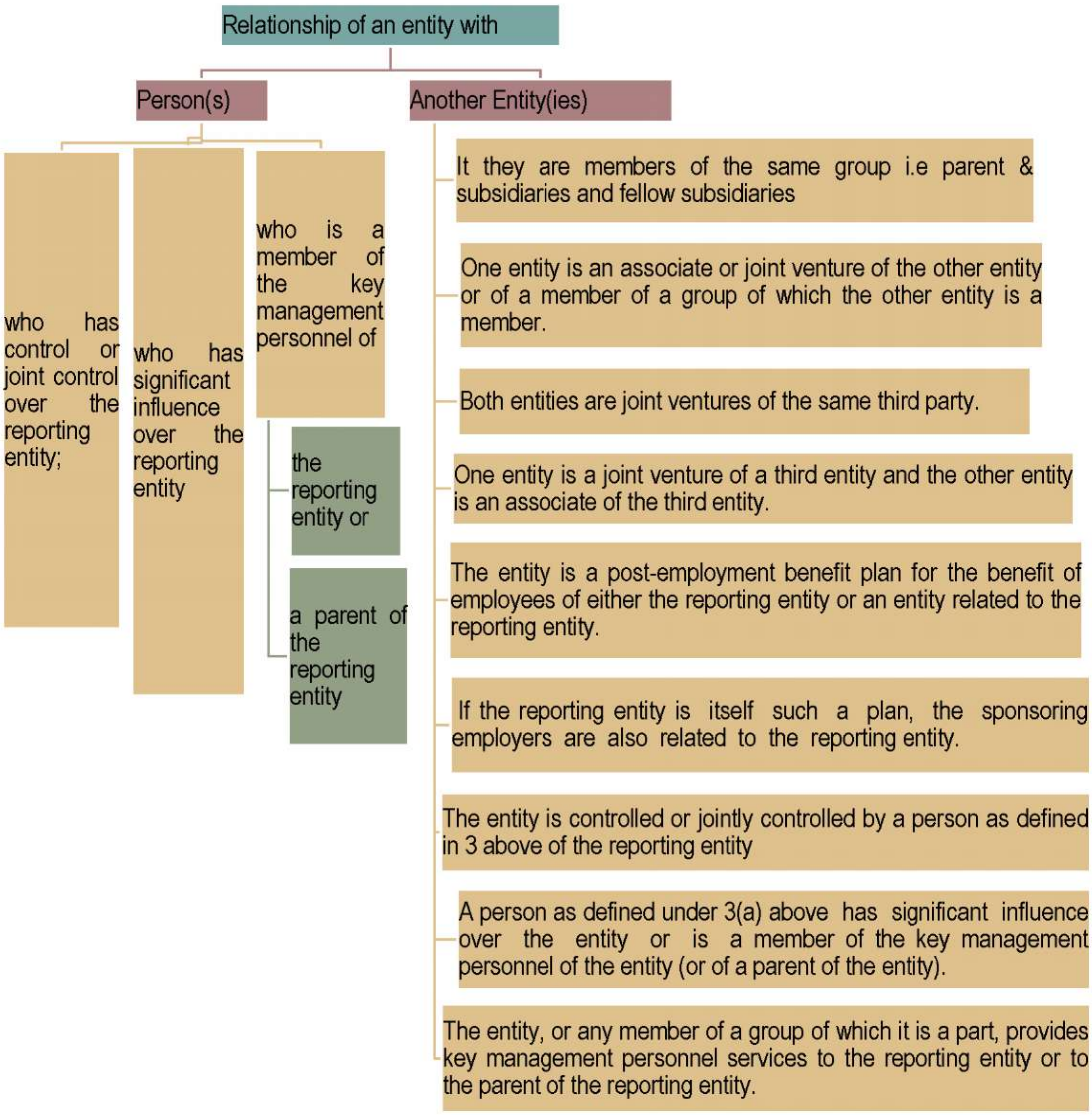
Example :
Mr. A controls A Limited (the reporting entity). He also controls B Limited. A Limited and B Limited are related to each other.

(g) A person identified above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Example :
Mr. A controls A Limited (the reporting entity). He is a non-executive director in B Limited. A Limited and B Limited are related parties.

(h) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Example :
A Ltd is a parent company with 3 subsidiary companies B Ltd. C Ltd & D Ltd. It also has an associate company E Ltd. Subsidiary F Ltd of E Ltd provides key management personnel services to A Ltd. F Ltd. is in a related party relationship with A, B, C D & E Ltd.



Question 1 – Mr.X

Mr X and his close family members have investments in A Ltd. and B Ltd. Together they hold 20% of equity capital of A Ltd. and 20% shares in B Ltd. Analyse related party relationship of A Ltd. and B Ltd.

Question 2 – Mr.S

Mr.S and his close family members held 51% of equity share capital of XYZ Ltd. Mrs.S is KMP in A Ltd. Mr and his close family members hold 20% of equity share capital of B Ltd. Mr.S and his close family members hold 51% of equity share capital of C Ltd. B Ltd. is a subsidiary of AB Ltd.

Analyse inter party relationship.

5. UNDERSTANDING WHO ARE NOT RELATED PARTIES

The Standard clarifies that certain relationships are not related party relationships. These are as follows:

(a) Two entities are not related parties simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

Example :
Mr.A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. There are no transactions between these two entities. X Limited and Y Limited are not related parties.

Example :
Mr.A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. Y Limited purchases the entire production of X Limited. The transactions are always at arm's length. X Limited and Y Limited may be related parties as it is quite possible that Y Limited may be able to exercise control/significant control over X Limited. As per this Standard substance is more important than mere legal form.

(b) Two venturers are not related parties simply because they share joint control over a joint venture.

Example :
JV Limited is an equal joint venture of J Limited and V Limited. J Limited and V Limited are not related parties.

(c) (i) providers of finance, (ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, are not related parties simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision making process).

Example :
A Bank and B Bank has provided finance to XY Limited. By virtue of loan agreement, they occupy a non-executive observer seat on the Board of Directors of XY Limited. A Bank and B Bank are not related parties of XY Limited.

(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

Example :

A Limited is an auto ancillary of an automobile company. It supplies all its production to the automobile company. Automobile company has no other interest in A Limited. A Limited and automobile company are not related parties.

Not a related parties

- (a)Two entities are not related parties simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
- (b)Two venturers are not related parties simply because they share joint control over a joint venture.
- (c)(i) providers of finance, (ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, are not related parties simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).
- (d)a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

6. EXEMPTION TO GOVERNMENT – RELATED ENTITIES :

- A reporting entity is also exempt from the disclosure requirements in relation to (i) related party transactions (ii) outstanding balances and (iii) commitments with:
  - (a) a government that has control, joint control or significant influence over the reporting entity; and
  - (b) another entity that is a related party because the same government has control, joint – control or significant influence over both the reporting entity and the other entity.

7. SELF PRACTICE QUESTIONS :

Question 3 – Entity P

Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited. Examine related party relationships of various entities.

Question 4 – Mr.A

Mr.A has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited. Required

(a) Examine related party relationships from the perspective of C Limited for A Limited.

(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

(c) Will the outcome in (a) & (b) would be different if Mr.A has joint control over A Limited.

(d) Will the outcome in (a) & (b) would be different if Mr.A has significant influence over A Limited.

Question 5 – Mr.X

Mr. X has an investment in A Limited and B Limited.

Required

(i) Examine when can related party relationship be established

  (a) from the perspective of A Limited's financial statements:

  (b) from the perspective of B Limited's financial statements:

(ii) Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited

Question 6 – Government G

Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1. Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

Question 7 – Power Limited

Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from Power Limited. Power Limited whose financial year ends on March 31, 2012, acquired 100% shareholding of Transmission Limited on July 15, 2011. However, the entire shareholding is disposed of on March 21, 2012. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.

For which period, related party disclosure should Power Limited make in its financial statements for the year ended March 31, 2012 with respect to transactions with Transmission Limited.

Question 8 – Mr.X

Mr.X is a domestic partner of Ms.Y. Mr.X has an investment in A Limited and Ms.Y has an investment in B Limited. Required

(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements:

(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements:

(c) Will A Limited and B Limited be related parties if Mr.X has only significant influence over A Limited and Ms.Y also has significant influence over B Limited.

Question 9 – A Limited

A Limited has both (i) joint control over B Limited and (ii) joint control or significant influence over C Limited

Required

(a) Examine related party relationship from the perspective of C Limited's financial statements.

(b) Examine related party relationship from the perspective of B Limited's financial statements.

Question 10 – ABC Ltd.

ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs.P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 2011. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 2011 to 31st May 2011 totalled Rs.8,00,000. Following the share purchase by Mrs.P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten month period from 1st June 2011 to 31st March 2011 totalled Rs.60,00,000. On 31st March 2012, the trade receivables of XYZ Ltd. included Rs.18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show (where possible by quantifying amounts) how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31st

March 2012 as per Ind AS. You are required to mention the disclosure requirements as well.

Question 11 – Mr.Atul

Mr.Atul is an independent director of a company X Ltd. He plays a vital role in the Management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of Rs.2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr.Atul.

Similarly, a non-executive director, Mr.Naveen also attended 5 BOD meetings and charged Rs.1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

Question 12 – Mr.X

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 20X2 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period 20X1-20X2. Mr. Y owns 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

Provide answers to the query raised by the Managing Director Mr. Y as per Ind AS.

Question 13 – Uttar Pradesh State Government

Uttar Pradesh State Government holds 60% shares in PQR Limited and 55% shares in ABC Limited. PQR Limited has two subsidiaries namely P Limited and Q Limited. ABC Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the Key management personnel in PQR Limited. ·

(a) Determine the entity to whom exemption from disclosure of related party transactions is to be given. Also examine the transactions and with whom such exemption applies.

(b) What are the disclosure requirements for the entity which has availed the exemption?

Question 14 – S Ltd.

S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd. Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?

Thanks ....

CHAPTER

21

IND AS 21 – THE EFFECTS OF CHANGES IN FOREIGN RATES

CONCEPTS COVERED

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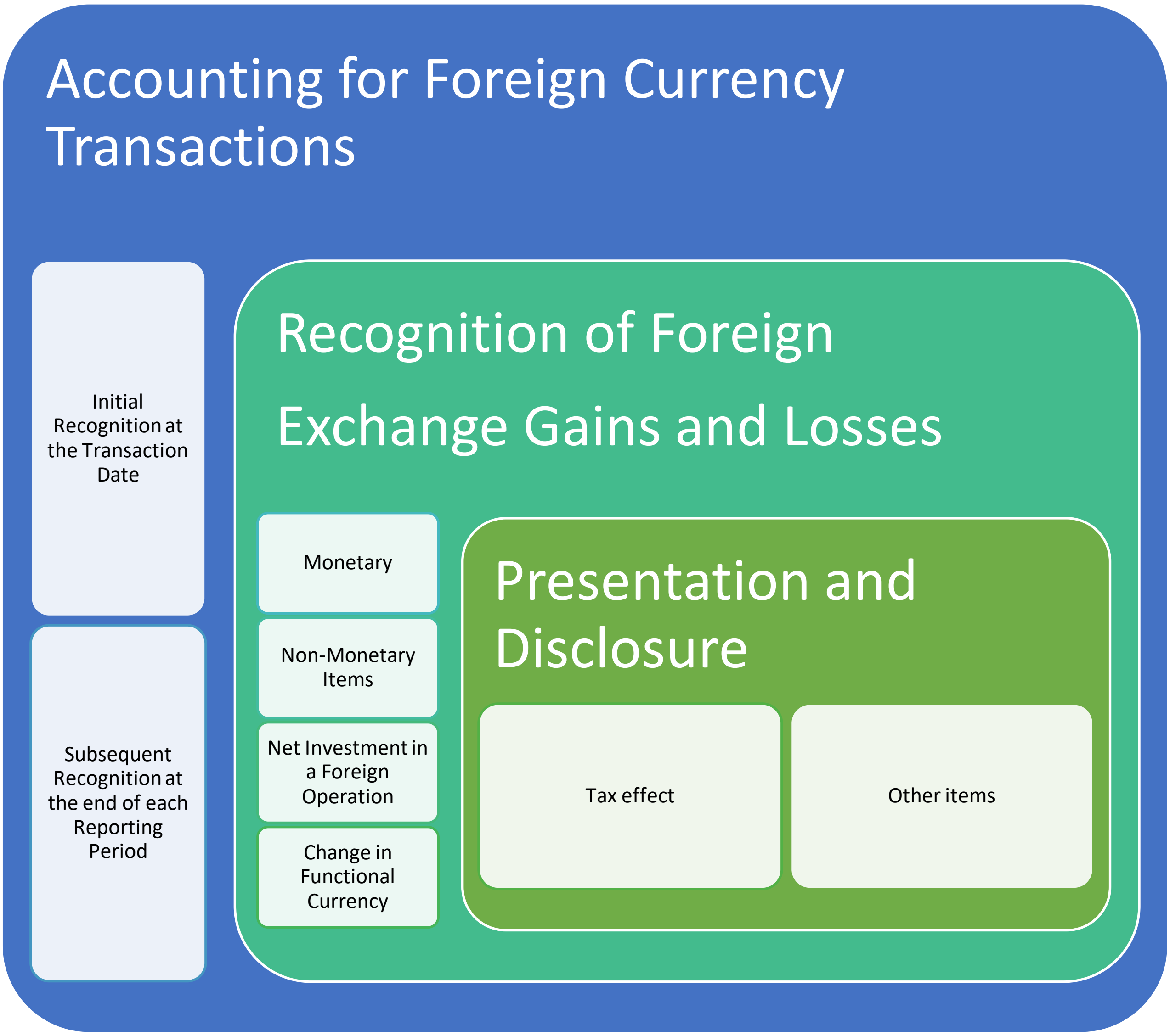
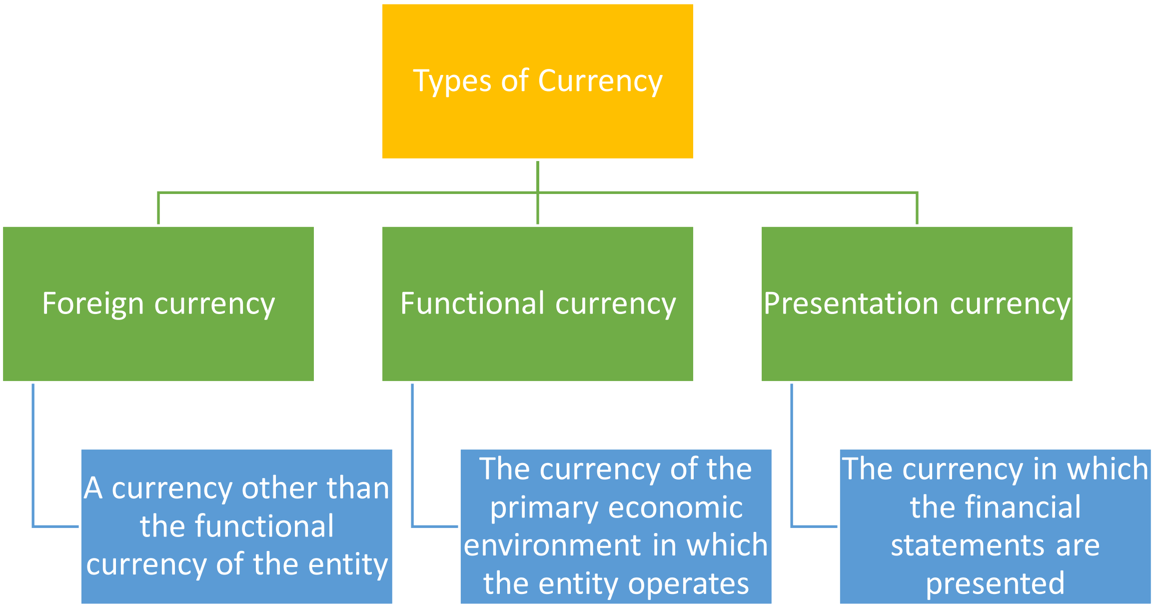
1. INTRODUCTION :



2. DEFINITIONS :

In this context, the Standard defines foreign currency as a currency other than the functional currency of the entity.

1. **Functional currency** is the currency of the primary economic environment in which the entity operates. In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates.
2. **Foreign operation** has been defined as an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.
3. **Presentation currency** is the currency in which the financial statements are presented, the presentation currency may be different from the entity's functional currency.



3. FUNCTIONAL CURRENCY :

- An entity measures its assets, liabilities, equity, income and expenses in its functional currency.

- All transactions in currencies other than the functional currency are foreign currency transactions.

  Ind AS 21 requires each entity to determine its functional currency.

- In determining its functional currency, an entity emphasises the currency that determines the pricing of the transactions that it undertakes, rather than focusing on the currency in which those transactions are denominated.

- The following are the factors that may be considered in determining an appropriate functional currency:
  - (a) the currency that mainly influences sales prices for goods and services; this often will be the currency in which sales prices are denominated and settled;
  - (b) the currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services; and
  - (c) the currency that mainly influences labour, material and other costs of providing goods and services; often this will be the currency in which these costs are denominated and settled.

- Other factors that may provide supporting evidence to determine an entity's functional currency are:
  - (a) the currency in which funds from financing activities i.e., issuing debt and equity instruments) are generated;
  - (b) the currency in which receipts from operating activities are usually retained.

Question 1 – Future Ltd.

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$ What is the functional currency of Future Ltd.?

Question 2 – Small India Private Limited

Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is Small's functional currency?

Question 3 – A is an Oman based

A is an Oman based company having a foreign operation, B, in India. The foreign operation was primarily set up to execute a construction project in India. The functional currency of A is OMR.

78% of entity B 's finances have been raised in USD by way of contribution from A. B's bank accounts are maintained in USD as well as INR. Cash flows generated by B are transferred to A on a monthly basis in USD in respect of repayment of finance received from A.

Revenues of B are in USD. Its competitors are globally based. Tendering for the construction project happened in USD.

B incurs 70% of the cost in INR and remaining 30% costs in USD.

Since B is located in India can it can presume its functional currency to be INR?

Question 4 – S Ltd.

S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 20X1. Since then the company's operations have increased considerably. The company was engaged in the business of trading of motor cycles. The company only deals in imported Motor cycles. These motor cycles are imported from US.

After importing the motor cycles, these are sold across India through its various distribution channels. The company had only private customers earlier but the company also started corporate tie-up and increased its customer base to corporates also. The purchase of the motor cycles are in USD because the vendor(s) from whom these motor cycles are purchased those are all located in US.

All other operating expenses of the company are incurred in India only because of its location and they generally happen to be in INR

Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motor cycles in India are different from those in other countries.

The company is also expecting that in the coming years, its customers base will increase significantly in India and the current proportion may also change.

Currently, the invoices are raised to the corporate customers in USD for the purpose of hedging. However, private customers don't accept the same arrangement and hence invoices are raised to them in INR.

What would be the functional currency of this company?

Currency of a Hyperinflationary Economy as a Functional Currency :

An entity cannot adopt a functional currency other than that determined in accordance with this Standard. If the functional currency of an entity is the currency of a hyperinflationary economy, it cannot avoid restatement in accordance with Ind AS 29 by selecting some other currency as its functional currency.

4. MONETARY VS NON – MONETARY ITEMS :

No.	Particulars	Monetary Items	Non-monetary
1	Units of Currency	Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.	There is no fixed or determinable number of units of currency
		Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable	

Examples of Monetary items include :

- pensions and other employee benefits to be paid in cash;
- provisions that are to be settled in cash; cash dividends that are recognised as a liability;
- contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency.

Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable.

Examples of non-monetary items include:

- amounts prepaid for goods and services (e.g., prepaid rent) and income received in advance, on the basis that no money will be paid or received in the future;
- goodwill;
- intangible assets;
- inventories;

- property, plant and equipment;
- provisions that are to be settled by the delivery of a non-monetary asset.

5. ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS :

Initial Recognition at the Transaction Date :

A foreign currency transaction is initially recorded by translation in the entity's functional currency at the exchange rate on the transaction date (or at rate that approximates the actual exchange rate).

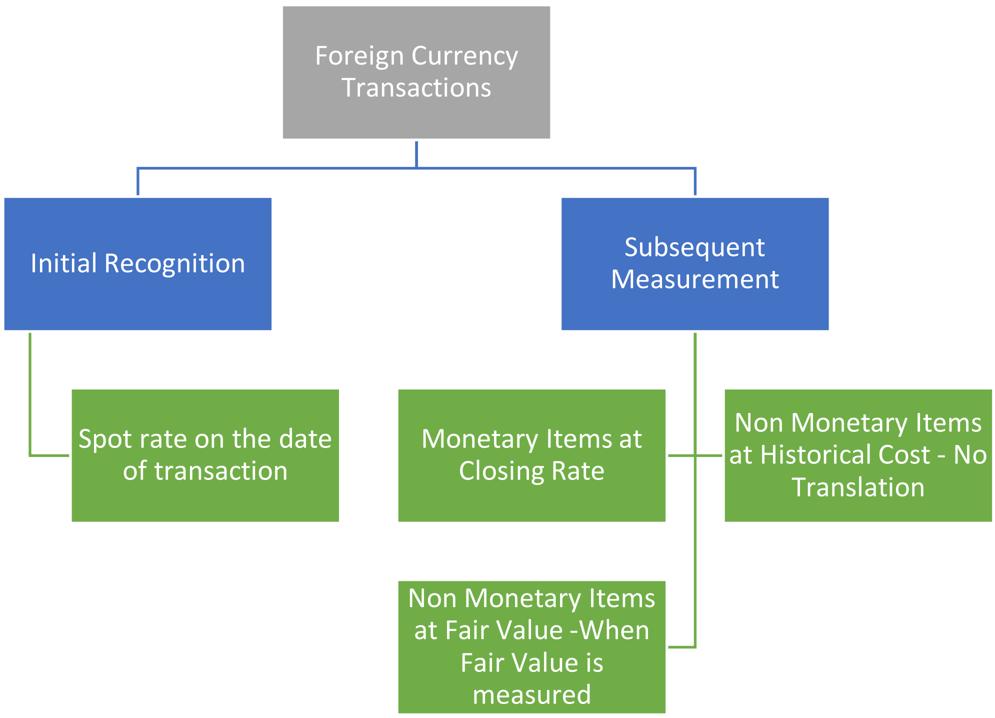
Subsequent Recognition at the end of each Reporting Period :

At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:

(a) monetary items are translated at the exchange rate at the reporting date i.e., closing rate;

(b) non-monetary items measured at historical cost are not retranslated and instead remain at the exchange rate at the date of the transaction; and

(c) non-monetary items measured at fair value in a foreign currency are translated at the exchange rate on the date the fair value was determined.



Recognition of Foreign Exchange Gains and Losses :

1. Monetary Items :

Exchange differences arising on the settlement of monetary items or on translating monetary items are recognised in profit or loss, except:

(i) for accounting for exchange difference as required by application of hedge accounting under Ind AS 109 – for example Ind AS 109 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge should be recognised initially in other comprehensive income to the extent that the hedge is effective;

(ii) for monetary items that in substance form part of the reporting entity's net investment in a foreign operation (discussed below);

(iii) for long-term foreign currency monetary items in case the entity has exercised the option for recognising exchange differences on such items in equity (discussed below).

2. **Non-Monetary Items :**

- Ind AS require certain gains and losses to be recognised in other comprehensive income.
- If the gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss is also recognized in profit or loss.

Change in Functional Currency :

- Once an entity has determined its functional currency, it is not changed unless there is a change in the relevant underlying transactions, events and conditions.
- If circumstances change and a change in functional currency is appropriate, then the change is accounted for prospectively from the date of the change.
  For example, a change in the currency that mainly influences the sales price of goods and services may lead to a change in an entity's functional currency.
- For accounting the effect of a change in functional currency prospectively.

6. SELF PRACTICE QUESTIONS :

Question 5 – Parent P

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for Rs.1,500 lakhs. The net assets of S are 1,000 and the NCI in S is Rs.100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of Rs.200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of Rs.180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is Rs.20 lakhs
Calculate P's gain on disposal.

Question 6 – Infotech Global Ltd.

Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).
The following is the statement of financial position of Infotech Global Ltd. prior to translation:

	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	9,85,000	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274

Profit for the year	20,000
Accounts payable	8,40,000
Accrued liabilities	47,000
Total equity and liabilities	9,85,000

Required:

Translate the statement of financial position of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre- populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

Question 7 – A Ltd.

On 30th January, 20X1, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 $ = Rs. 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = Rs. 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = Rs. 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%. A Ltd. follows Revaluation method in respect of Plant & Machinery.

Question 8 – P Ltd.

On 1st January, 2018, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= Rs. 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1 = Rs. 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.

Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS.

Question 9 – A Ltd.

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are Rs. 72 per USD and Rs. 75 per USD respectively.

Question 10 – Global Limited

Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1.
The exchange rates as at 30th September, 20X1 was Rs. 82 / EURO and at 31st March, 20X2 was Rs. 84 / EURO.
What is the value at which the goodwill has to be recognised in the financial statements of Global Limited as on 31st March, 20X2?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was Rs. 83 / EURO and on 31st March, 20X2 was Rs. 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements.

Question 11 – Makers Ltd.

On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = Rs. 2.50.
- 31st March, 20X2 – FCY 1 = Rs. 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = Rs. 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss.

Thanks ....