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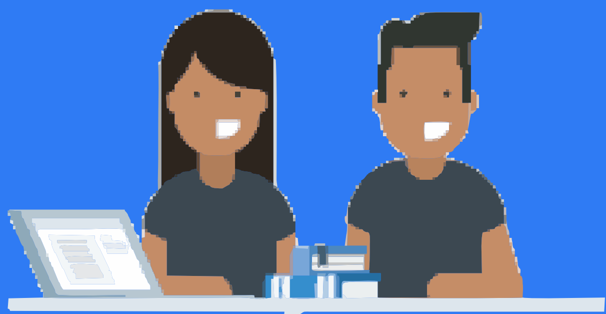
Based on Revised Syllabus announced by ICAI

FINANCIAL REPORTING

BOOK 2

Prof.Rahul Malkan



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FINANCIAL REPORTING – BOOK 2

CHAPTER

1

IND AS 108 – OPERATING SEGMENTS

CONCEPTS COVERED

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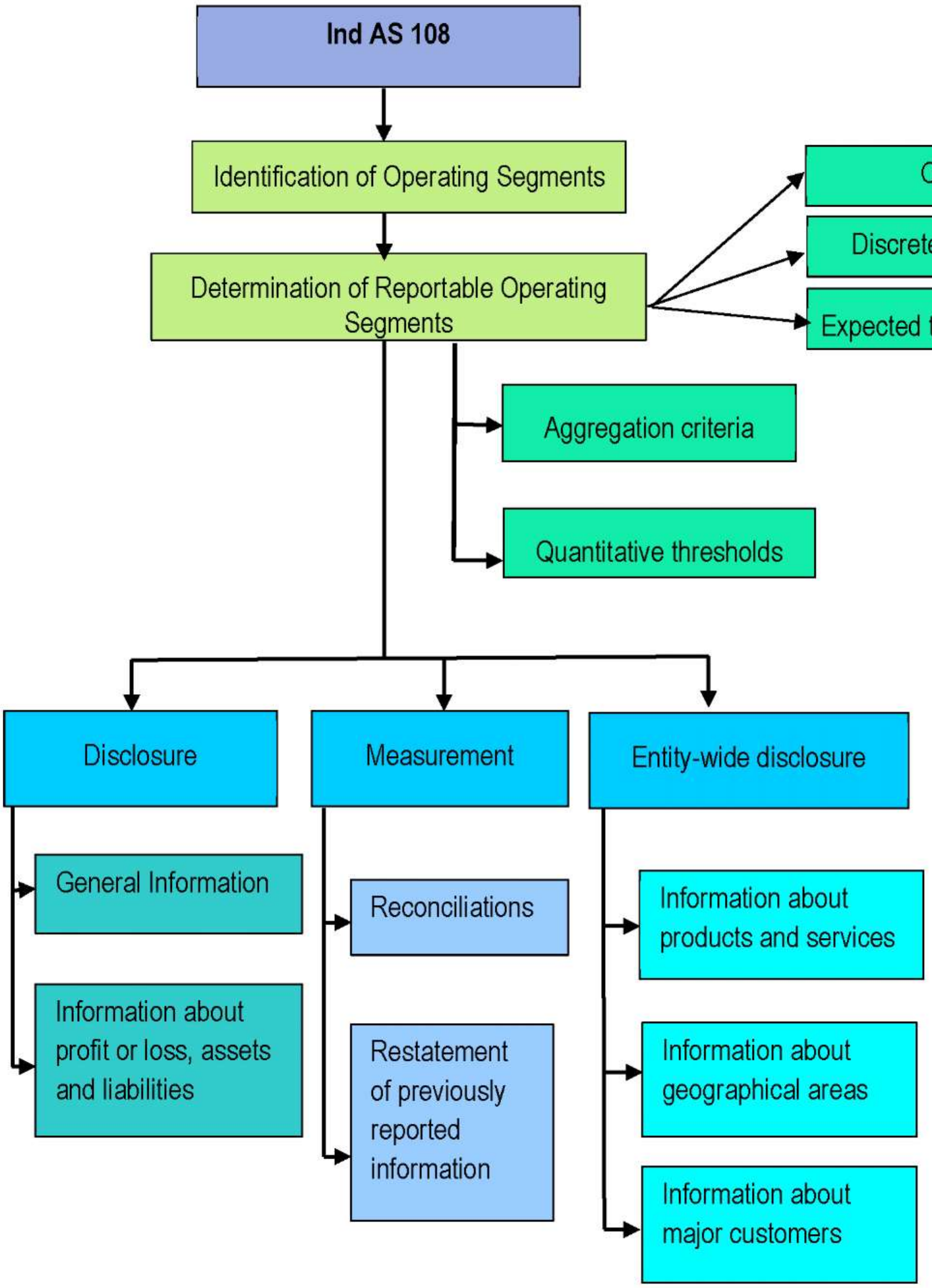
1. INTRODUCTION :

An entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Ind AS 108 requires an entity to disclose information to enable the stakeholders to have insight into the entity's operations from the same perspective as that of its management. Ind AS 108 requires disclosure of information in a manner which enables users to make informed decisions based on their assessment of the economic environments in which the different businesses of an entity operate.



2. SCOPE :

Ind AS 108 should apply to companies to which Indian Accounting Standards notified under the Companies Act, 2013 apply.

If an entity that is not required to apply Ind AS 108 chooses to disclose information about segments that does not comply with Ind AS 108, it should not describe the information as segment information.

If a financial report contains both the consolidated financial statements of a parent that is within the scope of Ind AS 108 as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

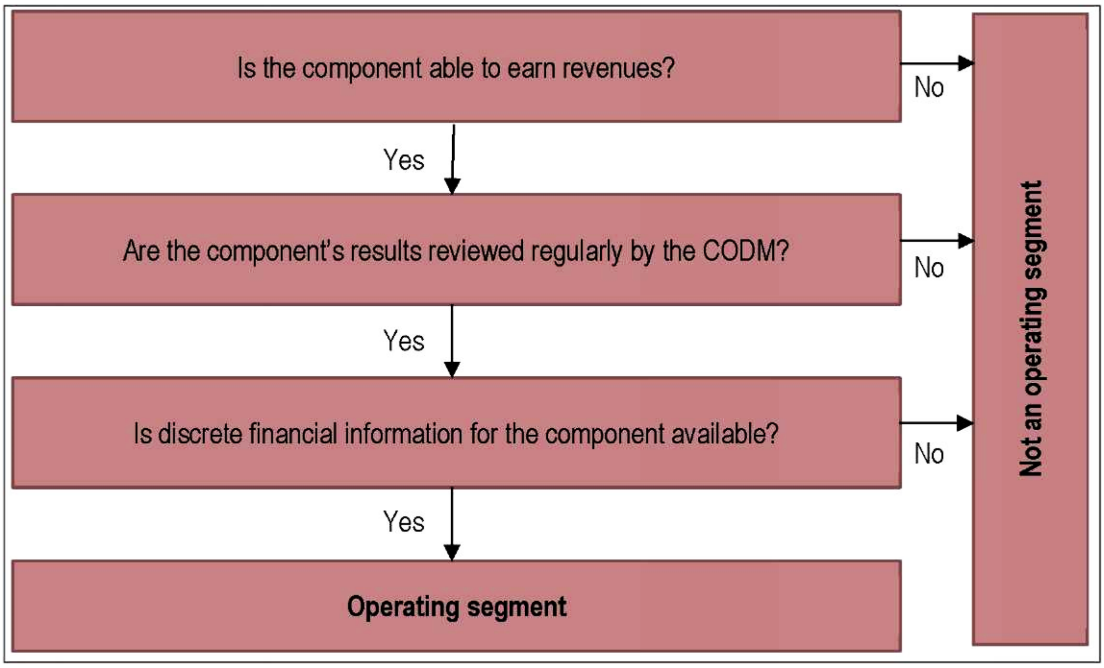
3. OPERATING SEGMENTS

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'?

4. 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.

Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the CODM to discuss operating activities, financial results, forecasts, or plans for the segment. The term 'segment manager' identifies a function, not necessarily a manager with a specific title. The chief operating decision maker also may be the segment manager for some operating segments. A single manager may be the segment manager for more than one operating segment. If the characteristics apply to more than one set of components of an organisation but there is only one set for which segment managers are held responsible, that set of components constitutes the operating segments.

The characteristics may apply to two or more overlapping sets of components for which managers are held responsible. That structure is sometimes referred to as a matrix form of organisation. For example, in some entities, some managers are responsible for different product and service lines worldwide, whereas other managers are responsible for specific geographical areas. The CODM regularly reviews the operating results of both sets of components, and financial information is available for both. In that situation, the entity should determine which set of components constitutes the operating segments by reference to the core principle.

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?

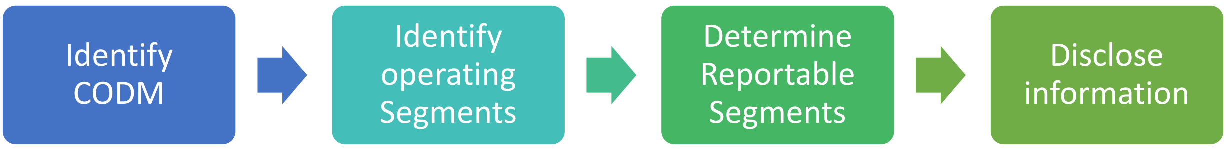
5. REPORTABLE SEGMENTS :

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.



6. 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?

7. 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.

8. DISCLOSURES

An entity should disclose the following for each period for which a statement of profit and loss is presented:

a. general information;
b. information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement; and
c. reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts.

Reconciliations of the amounts in the balance sheet for reportable segments to the amounts in the entity's balance sheet are required for each date at which a balance sheet is presented. Information for prior periods should be restated.

GENERAL INFORMATION :

An entity should disclose the following general information:

a. factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated); and

b. the judgements made by management in applying the aggregation criteria. This includes a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics; and

c. types of products and services from which each reportable segment derives its revenues.

INFORMATION ABOUT PROFIT OR LOSS, ASSETS AND LIABILITIES :

An entity should report a measure of profit or loss for each reportable segment. An entity should report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the CODM.

a. revenues from external customers;

b. revenues from transactions with other operating segments of the same entity;

c. interest revenue;

d. interest expense;

e. depreciation and amortisation;

f. material items of income and expense disclosed in accordance with Ind AS 1, Presentation of Financial Statements;

g. the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;

h. income tax expense or income; and

i. material non-cash items other than depreciation and amortisation.

9. MEASUREMENTS :

The amount of each segment item reported should be the measure reported to the CODM for the purposes of making decisions about allocating resources to the segment and assessing its performance.

Adjustments and eliminations made in preparing an entity's financial statements and allocations of revenues, expenses, and gains or losses should be included in determining reported segment profit or loss only if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker.

Similarly, only those assets and liabilities that are included in the measures of the segment's assets and segment's liabilities that are used by the chief operating decision maker should be reported for that segment. If amounts are allocated to reported segment profit or loss, assets or liabilities, those amounts should be allocated on a reasonable basis.

An entity should provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. At a minimum, an entity should disclose the following:

a. the basis of accounting for any transactions between reportable segments;

b. the nature of any differences between the measurements of the reportable segments' profits or losses and the entity's profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations). Those differences could include accounting policies and policies or allocation of centrally incurred costs that are necessary for an understanding of the reported segment information;

c. the nature of any differences between the measurements of the reportable segments' assets and the entity's assets (if not apparent from the reconciliations. Those differences could include accounting policies and policies for allocation of jointly used assets that are necessary for an understanding of the reported segment information;

d. the nature of any differences between the measurements of the reportable segments' liabilities and the entity's liabilities (if not apparent from the reconciliations. Those differences could include accounting policies and policies for allocation of jointly utilised liabilities that are necessary for an understanding of the reported segment information;

e. the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss; and

f. the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

10. RECONCILIATIONS :

An entity should provide reconciliations of all of the following:

a. the total of the reportable segments' revenues to the entity's revenue;

b. the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to the entity's profit or loss after those items;

c. the total of the reportable segments' assets to the entity's assets if the segment assets are reported;

d. the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are reported; and

e. the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items should be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies should be separately identified and described.

The following illustrate reconciliations of reportable segment revenues, profit or loss, assets and liabilities to the entity's corresponding amounts.

Reconciliation of reportable segment revenues, profit or loss, assets and liabilities

Revenues	**Rs**
Total revenues for reportable segments	39,000
Other revenues	1,000
Elimination of intersegment revenues	(4,500)
Entity's revenues	35,500

Profit or Loss	**Rs**
Total profit or loss for reportable segments	3,970
Other profit or loss	100
Elimination of intersegment profits	(500)
Unallocated amounts:	
Litigation settlement received	500
Other corporate expenses	(750)
Adjustment to pension expense in consolidation	(250)
Income before income tax expense	3,070

Assets	**Rs**
Total assets for reportable segments	79,000
Other assets	2,000
Elimination of receivable from corporate headquarters	(1,000)
Other unallocated amounts	1,500
Entity's assets	81,500

Liabilities	**Rs**
Total liabilities for reportable segments	43,850
Unallocated defined benefit pension liabilities	25,000
Entity's liabilities	68,850

11. RESTATEMENTS OF PREVIOUSLY REPORTED INFORMATION :

If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, should be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive should be made for each individual item of disclosure. Following a change in the composition of its reportable segments, an entity should disclose whether it has restated the corresponding items of segment information for earlier periods.

If an entity has changed the structure of its internal organisation in a manner that causes the composition of its reportable segments to change and if segment information for earlier periods, including interim periods, is not restated to reflect the change, the entity should disclose in the year in which the change occurs segment information for the current period on both the old basis and the new basis of segmentation, unless the necessary information is not available and the cost to develop it would be excessive.

12. ENTITY – WIDE DISCLOSURE :

Some entities' business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity's reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity's reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Certain information required should be provided only if it is not provided as part of the reportable segment information required by Ind AS 108.

INFORMATION ABOUT PRODUCTS AND SERVICES :

An entity should report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact should be disclosed. The amounts of revenues reported should be based on the financial information used to produce the entity's financial statements.

INFORMATION ABOUT GEOGRAPHICAL AREAS :

An entity should report the following geographical information, unless the necessary information is not available and the cost to develop it would be excessive:

(a) revenues from external customers
 - (i) attributed to the entity's country of domicile and
 - (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues should be disclosed separately. An entity should disclose the basis for attributing revenues from external customers to individual countries; and

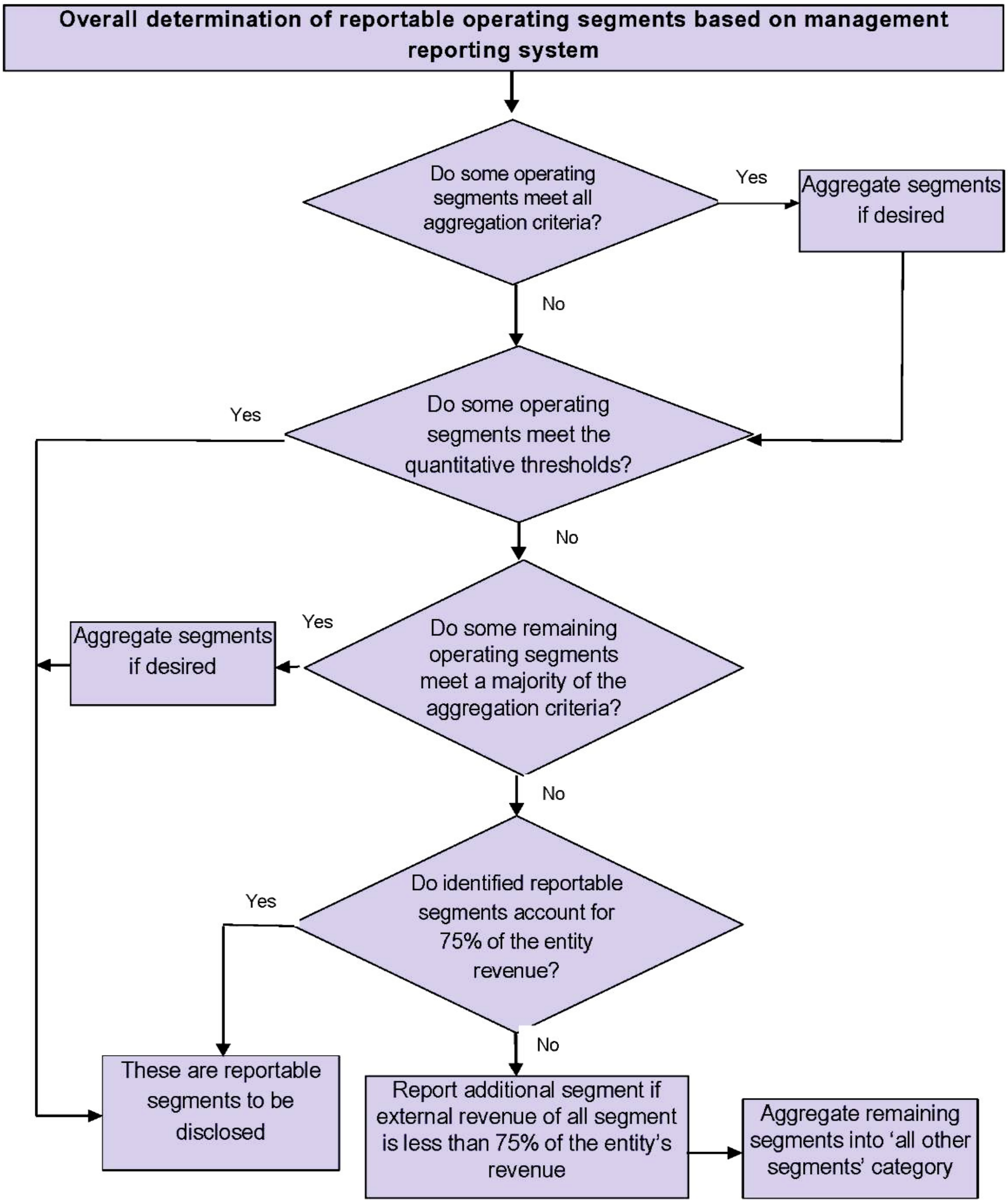
(b) non-current assets (For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period) other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts
 - (i) located in the entity's country of domicile and
 - (ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets should be disclosed separately.

INFORMATION ABOUT MAJOR CUSTOMERS :

An entity should provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10% or more of an entity's revenues, the entity should disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of Ind AS 108, a group of entities known to a reporting entity to be under common control should be considered a single customer. However,

judgement is required to assess whether a government (including government agencies and similar bodies whether local, national or international) and entities known to the reporting entity to be under the control of that government are considered a single customer. In assessing this, the reporting entity should consider the extent of economic integration between those entities.
The following illustrates the information about major customers. Neither the identity of the customer nor the amount of revenues for each operating segment is required.
Revenues from one customer of Diversified Company's software and electronics segments represent approximately Rs 5,000 of the Company's total revenues.

SUMMARY :



13. 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 ....

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CHAPTER

2

IND AS 34 – INTERIM FINANCIAL REPORTING

CONCEPTS COVERED

1. INTRODUCTION
2. OBJECTIVE
3. SCOPE
4. DEFINITIONS
5. CONTENTS OF AN INTERIM FINANCIAL REPORT
6. DISCLOSURE IN ANNUAL FINANCIAL STATEMENTS
7. RECOGNITION AND MEASUREMENT
8. RESTATEMENT OF PREVIOUSLY REPORTED INTERIM PERIODS
9. INTERIM FINANCIAL REPORTING AND IMPAIRMENT
10. SELF PRACTICE QUESTIONS

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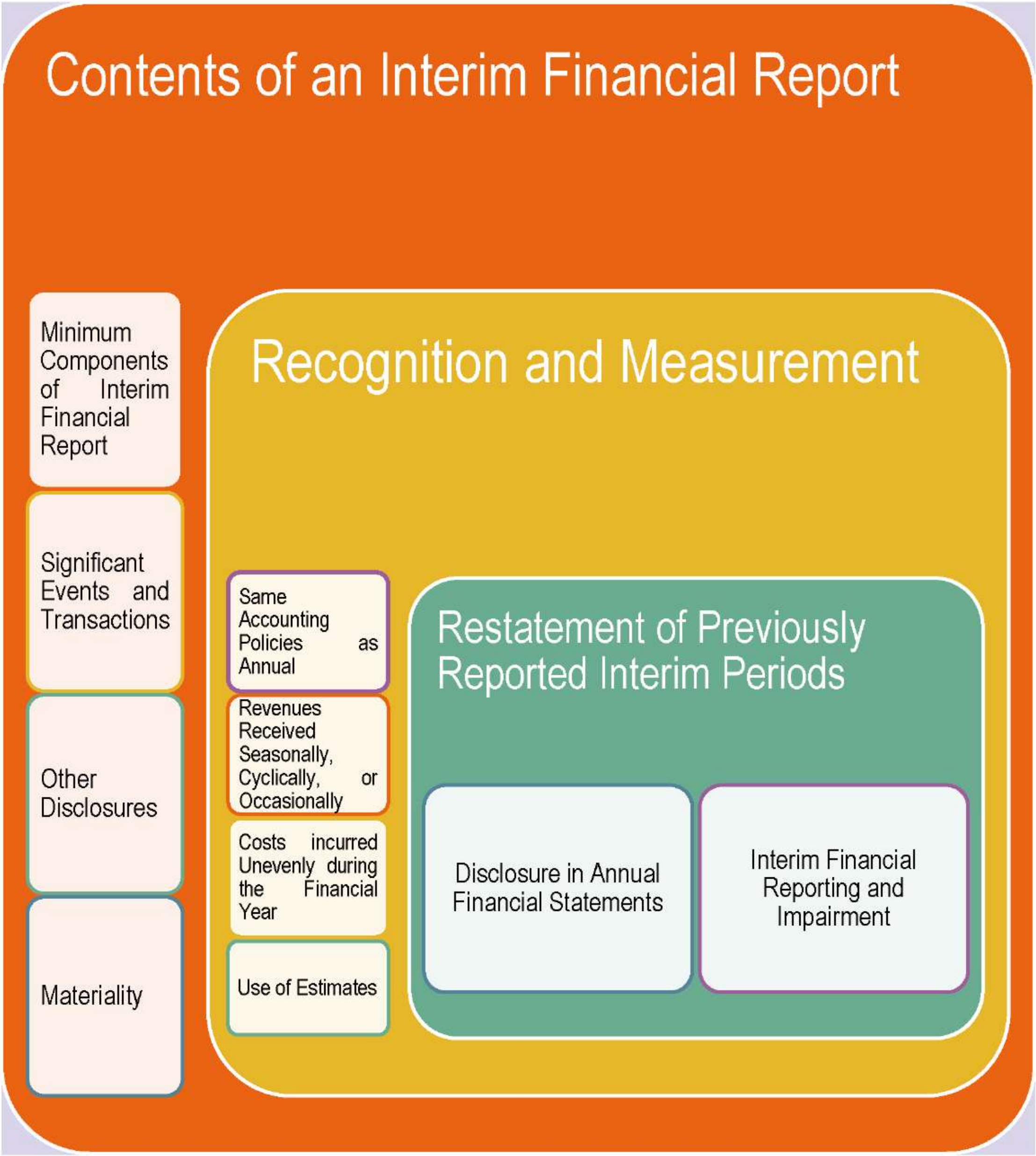
1. INTRODUCTION :



Interim Financial Reporting applies when an entity prepares an interim financial report. Ind AS 34 does not mandate an entity as when to prepare such a report. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity. Permitting less information to be reported than in annual financial statements (on the basis of providing an update to those financial statements), the standard outlines the recognition, measurement and disclosure requirements for interim reports.

2. OBJECTIVE :

The objective of this Standard is to prescribe

a) the minimum content of an interim financial report

b) the principles for recognition and measurement in complete or condensed financial statements for an interim period.

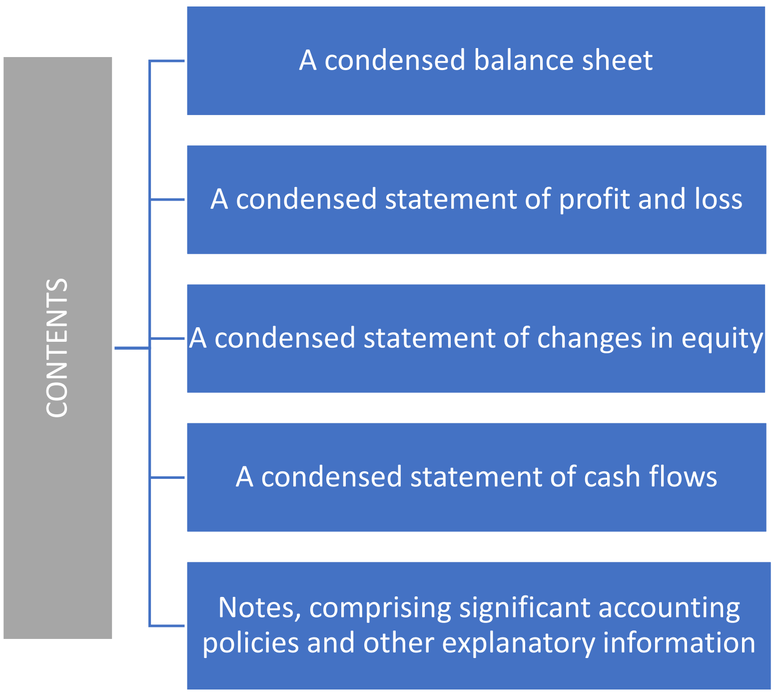
3. SCOPE :

- This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period.
- This Standard applies if an entity is required or elects to publish an interim financial report in accordance with Indian Accounting Standards (Ind AS).
- Each financial report, annual or interim, is evaluated on its own for conformity to Ind AS. The fact that an entity may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not prevent the entity's annual financial statements from conforming to Ind AS if they otherwise do so.
- If an entity's interim financial report is described as complying with Ind AS, it must comply with all of the requirements of this Standard.

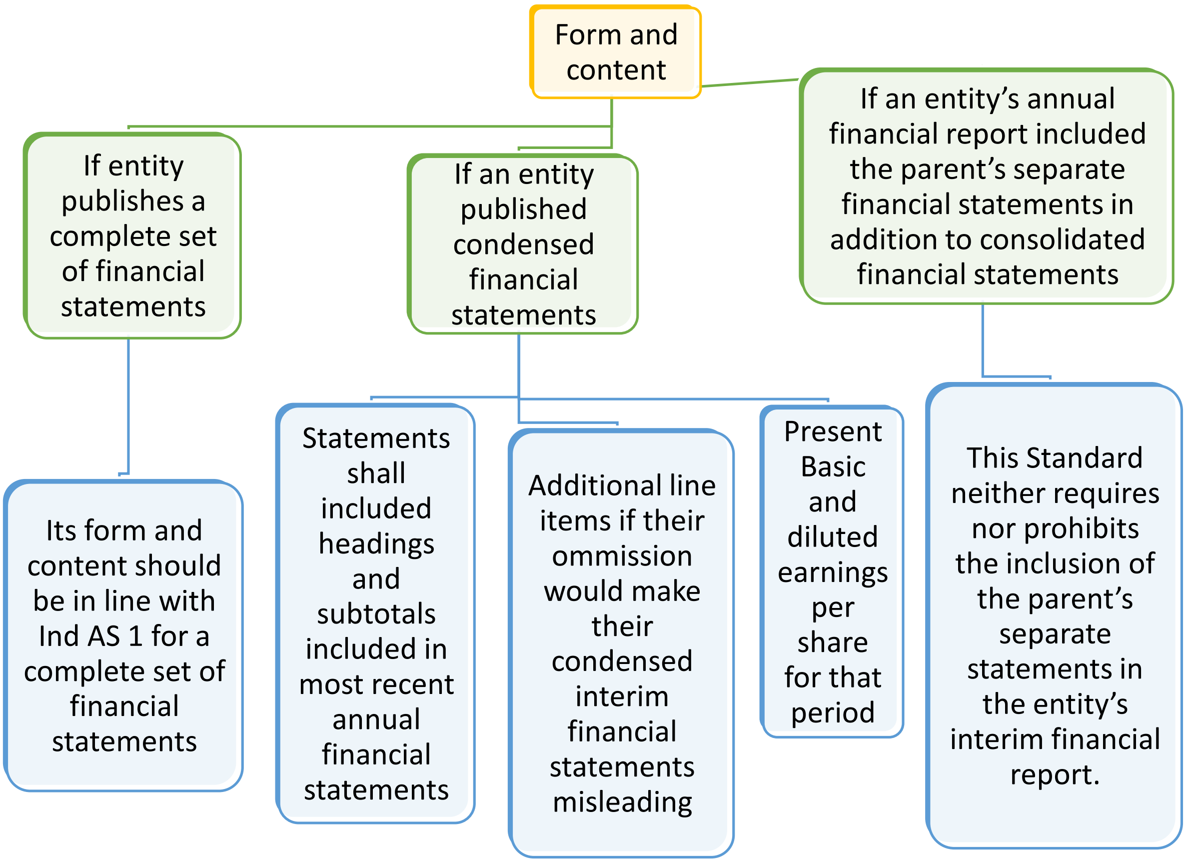
4. DEFINITIONS :

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.

5. CONTENTS OF INTERIM FINANCIAL :



5.1 Form And Content of Interim Financial Report :



5.2 Significant Events and Transactions :

The following is a list of events and transactions for which disclosures would be required if they are significant: the list is not exhaustive.	
1.	the write-down of inventories to net realisable value and the reversal of such writedown;
2.	recognition of a loss from the impairment of financial assets, property, plant and equipment, intangible assets, assets arising from contracts with customers, or other assets, and the reversal of such an impairment loss;
3.	the reversal of any provisions for the costs of restructuring;
4.	acquisitions and disposals of items of property, plant and equipment;
5.	commitments for the purchase of property, plant and equipment;
6.	litigation settlements;
7.	corrections of prior period errors;
8.	changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;
9.	any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period;
10.	related party transactions;

11.	transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments;
12.	changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and
13.	changes in contingent liabilities or contingent assets.

5.3 Other Disclosures :

a)	a statement that the same accounting policies and methods of computation are followed in the interim financial statements. If those recently used policies or methods have been changed, a description of the nature and effect of the change should also be given.
b)	explanatory comments about the seasonality or cyclicality of interim operations.
c)	the nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence.
d)	the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years.
e)	issues, repurchases and repayments of debt and equity securities.
f)	dividends paid (aggregate or per share) separately for ordinary shares and other shares
g)	Segment information as per IND AS 108
h)	events after the interim period that have not been reflected in the financial statements for the interim period.
i)	the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by Ind AS 103, Business Combinations.
j)	for financial instruments, the disclosures about fair value of Ind AS 113, Fair Value Measurement, and Ind AS 107, Financial Instruments: Disclosures.
k)	for entities becoming, or ceasing to be, investment entities, as defined in Ind AS 110, Consolidated Financial Statements, the disclosures in Ind AS 112, Disclosure of Interests in Other Entities.
l)	the disaggregation of revenue from contracts with customers required by Ind AS 115, Revenue from Contracts with Customers.

5.4 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.

5.5 Materiality :

- In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data.
- In making assessments of materiality, it shall be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.
- While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understand ability of the interim figures
- Unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure.

6. DISCLOSURE IN ANNUAL FINANCIAL STATEMENTS :

- If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate shall be disclosed in a note to the annual financial statements for that financial year.
- Ind AS 8 requires disclosure of the nature and (if practicable) the amount of a change in estimate that either has a material effect in the current period or is expected to have a material effect in subsequent periods.
- An entity is not required to include additional interim period financial information in its annual financial statements.

7. 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.

Examples :

Employer payroll taxes and insurance contributions

If employer payroll taxes or contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised in interim periods using an estimated average annual effective payroll tax or contribution rate, even though a large portion of the payments may be made early in the financial year. A common example is an employer payroll tax or insurance contribution that is imposed up to a certain maximum level of earnings per employee. For higher income employees, the maximum income is reached before the end of the financial year, and the employer makes no further payments through the end of the year.

Major planned periodic maintenance or overhaul

The cost of a planned major periodic maintenance or overhaul or other seasonal expenditure that is expected to occur late in the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

Provisions
A provision is recognised when an entity has no realistic alternative but to make a transfer of economic benefits as a result of an event that has created a legal or constructive obligation. The amount of the obligation is adjusted upward or downward, with a corresponding loss or gain recognised in profit or loss, if the entity's best estimate of the amount of the obligation changes. This Standard requires that an entity apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

Year-end bonuses
The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.
A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance.

Variable lease payments
Contingent lease payments can be an example of a legal or constructive obligation that is recognised as a liability. If a lease provides for contingent payments based on the lessee achieving a certain level of annual sales, an obligation can arise in the interim periods of the financial year before the required annual level of sales has been achieved, if that required level of sales is expected to be achieved and the entity, therefore, has no realistic alternative but to make the future lease payment.

Intangible assets
An entity will apply the definition and recognition criteria for an intangible asset in the same way in an interim period as in an annual period. Costs incurred before the recognition criteria for an intangible asset are met, are recognised as an expense. Costs incurred after the specific point in time at which the criteria are met are recognised as part of the cost of an intangible asset. 'Deferring' costs as assets in an interim balance sheet in the hope that the recognition criteria will be met later in the financial year is not justified.

Vacations, holidays, and other short-term compensated absences
Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Ind AS 19, Employee Benefits requires that an entity measure the expected cost of and obligation for accumulating compensated absences at the amount the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. That principle is also applied at the end of interim financial reporting periods. Conversely, an entity recognises no expense or liability for non-accumulating compensated absences at the end of an interim reporting period, just as it recognises none at the end of an annual reporting period.

Other planned but irregularly occurring costs

An entity's budget may include certain costs expected to be incurred irregularly during the financial year, such as charitable contributions and employee training costs. Those costs generally are discretionary even though they are planned and tend to recur from year to year. Recognising an obligation at the end of an interim financial reporting period for such costs that have not yet been incurred generally is not consistent with the definition of a liability.

Measuring interim income tax expense

Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

Depreciation and amortisation

Depreciation and amortisation for an interim period is based only on assets owned during that interim period. It does not take into account asset acquisitions or dispositions planned for later in the financial year.

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?

8. RESTATEMENT OF PREVIOUSLY REPORTED INTERIM PERIODS :

A change in accounting policy, other than one for which the transition is specified by a new Ind AS, shall be reflected by:

(a) restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with Ind AS 8; or

(b) when it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years to apply the new accounting policy prospectively from the earliest date practicable.

9. INTERIM FINANCIAL REPORTING AND IMPAIRMENT :

An entity is required to assess goodwill for impairment at the end of each reporting period, and, if required, to recognise an impairment loss at that date in accordance with Ind AS 36. However, at the end of a subsequent reporting period, conditions may have so changed that the impairment loss would have been reduced or avoided had the impairment assessment been made only at that date.

Accordingly, an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill.

Question 9 – ABC Ltd.

ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of Rs 20,00,000 for the third quarter of 2011.

Following adjustments are made while computing the net profit:

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

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

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

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

10. 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 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 3

IND AS 8 – ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATED & ERRORS

CONCEPTS COVERED

1. INTRODUCTION
2. OBJECTIVE
3. SCOPE
4. DEFINITIONS
5. ACCOUNTING POLICIES
6. CHANGES IN ACCOUNTING ESTIMATES
7. SELF PRACTICE QUESTIONS

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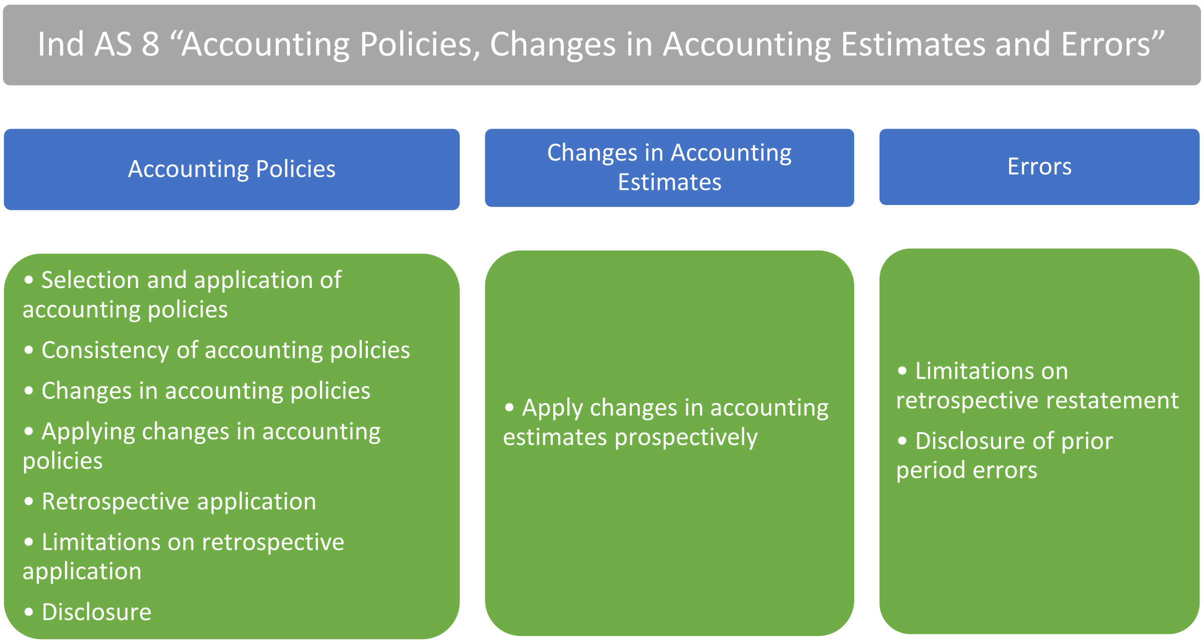
1. INTRODUCTION :

Ind AS 1, Presentation of Financial Statements, lays down the foundation for an entity regarding how the financial statements need to be presented. Ind AS 1 gives equal importance to the disclosure, in notes, of significant accounting policies and other explanatory information besides balance sheet, statement of profit and loss and statement of cash flows.

Accounting policies, estimates and correction of errors play a major role in the presentation of financial statements.



2. OBJECTIVE :

1. To prescribe the criteria for selecting and changing accounting policies
2. To prescribe the accounting treatment and disclosure of changes in accounting policies
3. To prescribe the accounting treatment and disclosure of changes in accounting estimates
4. To prescribe the accounting treatment and disclosure of corrections of errors
5. To provide better base for inter-firm and intra-firm comparison

3. SCOPE :

This standard shall be applied in

- selecting and applying accounting policies;
- accounting for changes in accounting policies;
- accounting for changes in accounting estimates; and
- accounting for corrections of prior period errors.

However, tax effects of retrospective application of accounting policy changes and correction of prior period errors are not dealt with in this standard. The tax effects of these items are dealt with Ind AS 12, 'Income Taxes'

Note: Requirements of Ind AS 8 in respect of changes in accounting policies do not apply in an entity's first Ind AS financial statements.

4. 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. 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.

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards issued by the Institute of Chartered Accountants of India states that 'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

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. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

A. the effects of the retrospective application or retrospective restatement are not determinable;

B. the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

C. the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

   i. provides evidence of circumstances that existed on the date(s)as at which those amounts are to be recognised, measured or disclosed; and

   ii. would have been available when the financial statements for that prior period were approved for issue from other information.

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.

5. ACCOUNTING POLICIES :

5.1 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

5.2 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.

Example : An entity has grouped its property, plant and equipment into four classes viz., land, factory building, plant and machinery and furniture. The entity may propose to apply revaluation model only to land. It need not apply this model to building or plant and machinery.

Accounting policies are the bases or principles or conventions or rules which are followed by an entity while preparing the financial statements. If the entity keeps on changing the base from year to year, it will not reflect the true and fair position of the entity. Secondly the results of earlier years cannot be compared with the latest years as the base of the measurement is changed. Therefore, it is utmost necessity that the entity follows the accounting policies consistently.

5.3 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?

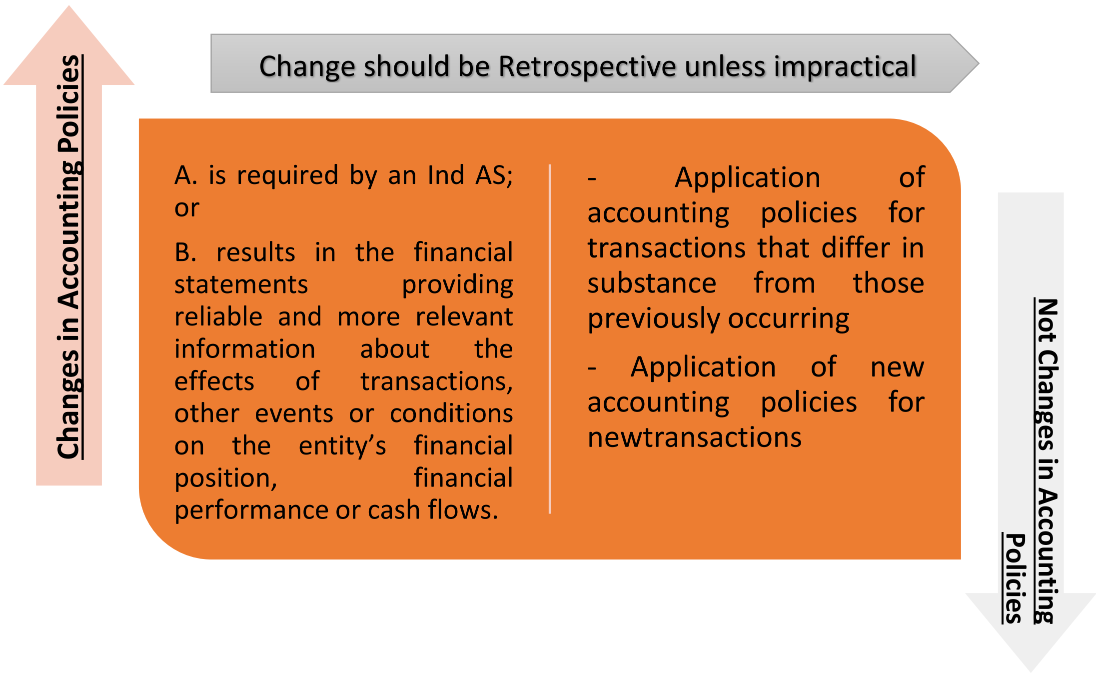
Question 7 – Entity ABC

Whether change in functional currency of an entity represents a change in accounting policy?

5.4 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.

When retrospective application is required, a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the change



5.5 DISCLOSURE ACCOUNTING POLICIES? :

When initial application of an Ind AS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the Ind AS;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

(c) the nature of the change in accounting policy;

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

  (i) for each financial statement line item affected; and

  (ii) if Ind AS 33, 'Earnings per Share', applies to the entity, for basic and diluted earnings per share;

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

6. CHANGES IN ACCOUNTING ESTIMATES :

6.1 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.

6.2 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 by including it in profit or loss in:
  - the period of the change, if the change affects that period only; or
  - the period of the change and future periods, if the change affects both. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods.
- To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.
- Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate.

6.3 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?

6.4 DISCLOSURE OF CHANGES IN ESTIMATES :

The entity should disclose:

i. Effect of change in estimate on the current period

ii. If applicable and practicable, effect of change in estimate on the future periods

iii. If applicable but impracticable, the fact that it is impracticable to estimate the effect on future periods.

7. 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

4

IND AS 37 – PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. DEFINITIONS
4. PROVISIONS AND OTHER LIABILITIES
5. RELATIONSHIP BETWEEN PROVISIONS & CONTINGENT LIABILITIES
6. RECOGNITION
   - PROVISIONS
   - CONTINGENT LIABILITY
   - CONTINGENT ASSET
7. MEASUREMENT
8. REIMBURSEMENT
9. CHANGE IN PROVISIONS
10. USE PROVISIONS

11. APPLICATION OF THE RECOGNITION & MEASUREMENT RULES

- FUTURE OPERATING LOSSES
- ONEROUS CONTRACTS
- RESTRUCTURING

12. DISCLOSURES

13. LEVIES

14. SUMARRY

15. SELF PRACTICE QUESTIONS

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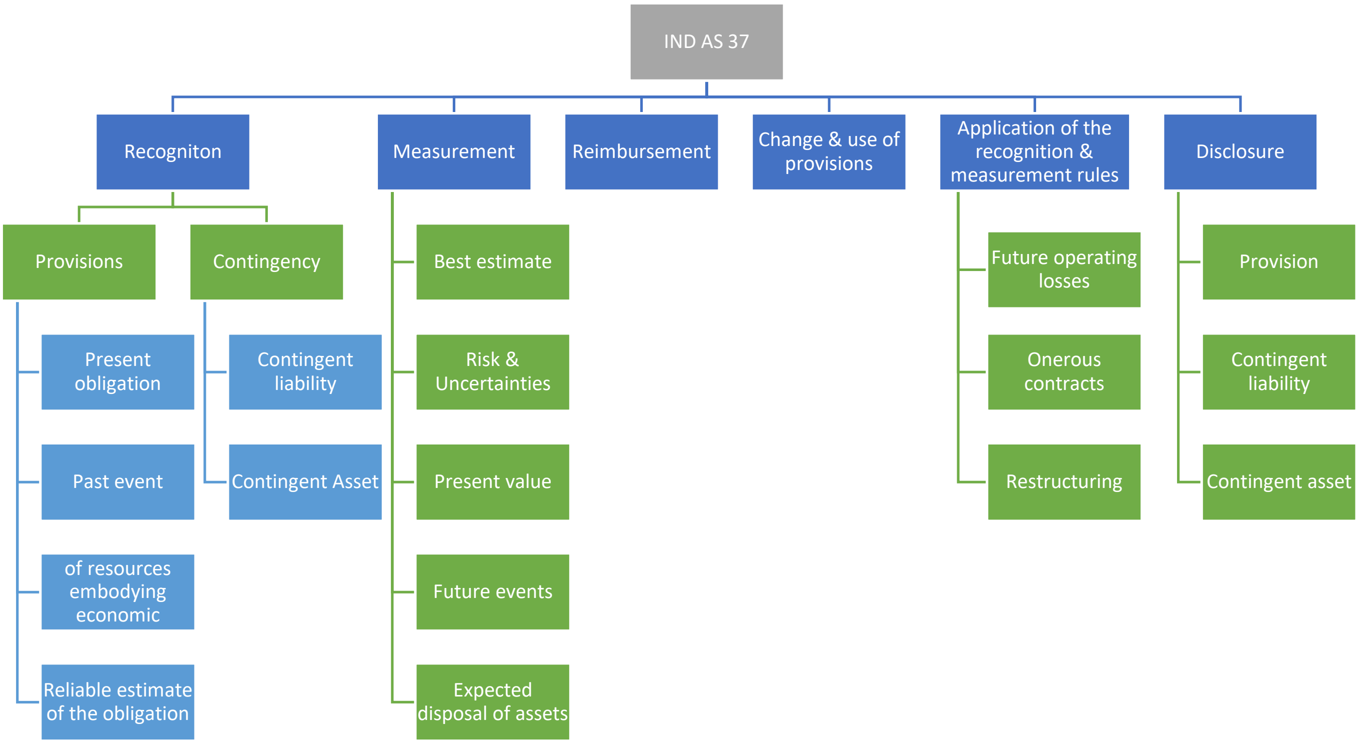
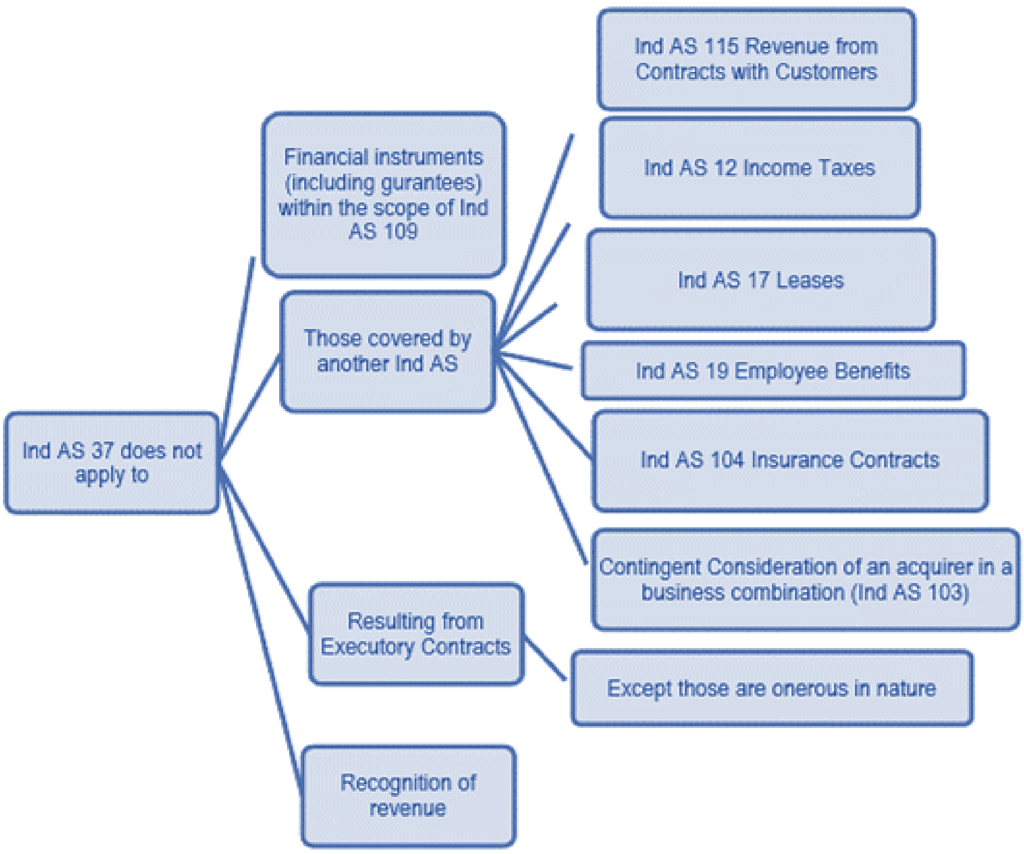
1. INTRODUCTION :



2. SCOPE :

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



Executory Contracts :

Executory contracts are contracts under which

- neither party has performed any of its obligations or
- both parties have partially performed their obligations to an equal extent.

Note : Ind AS 37 is applied to executory contracts only if they are onerous.

Examples of executory contracts: Take & Pay contracts and through put contracts.
In case of take and pay contracts, an agreement is entered into between two entities wherein the purchaser is legally obligated to take delivery of goods or accept services offered by seller (and make payment for those goods or services) and if the goods or services are not taken, he is required to pay a specified amount of penalty.
In case of through put contracts, an agreement is entered into between two entities wherein one entity undertakes to pass (put through) to another entity an agreed minimum amount of material or services during a specified period of time.
Such types of commitments, the entity has entered into are exempt from the requirements of Ind AS 37, i.e., such contracts are not covered under Ind AS 37 unless they are onerous.

3. 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.

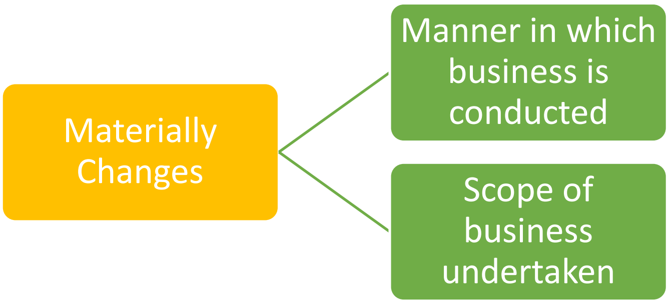
7. A **contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

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.



4. PROVISIONS AND OTHER LIABILITIES :

Since there is uncertainty about the timing or amount of the future expenditure required in settlement of the provisions, they are different from liabilities. However, in case of liability, uncertainty is generally much less than for provisions. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees.

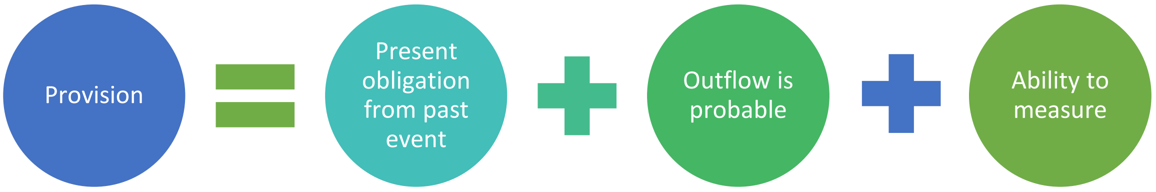
Example : Amounts relating to accrued vacation pay.

Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

5. 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:

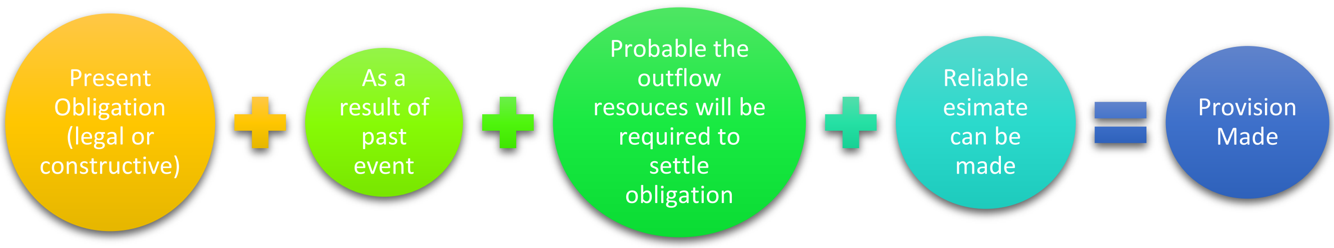
(i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or

(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).

Contingent Liability	=	Possible obligation from past event	and / or	Outflow is not probable	and / or	Unable to measure

6. RECOGNITION :

6.1 PROVISIONS :

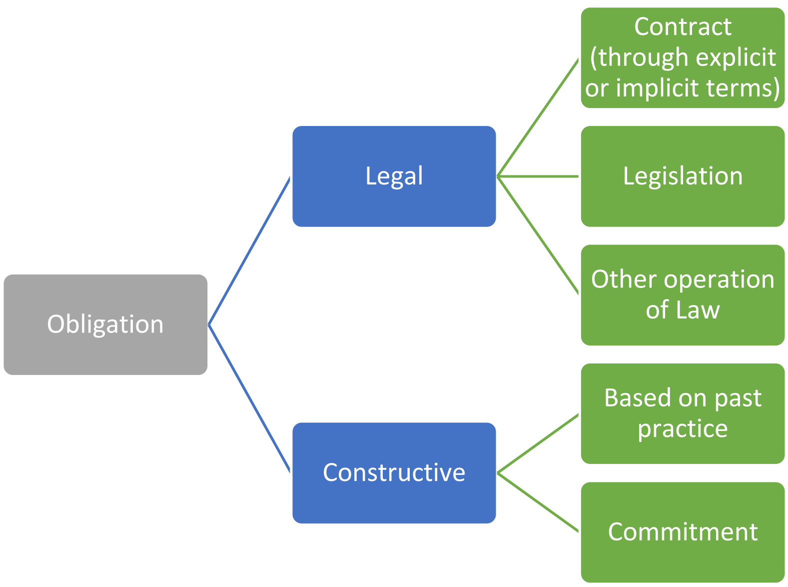


A provision should be recognised when:

(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.

Examples

- Penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity.
- Similarly, an entity should recognise a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused.

Example : Fitting smoke filters in a certain type of factory.

Since, the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

Example : Staff retraining as a result of changes in the income tax system

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no obligation because no obligating event (retraining) has taken place.

Conclusion – No provision is recognised.

Example : Legal requirement to fit smoke filters

Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 20X1. The entity has not fitted the smoke filters. It is assumed that a reliable estimate can be made of any outflows expected.

(a) At March 31, 20X1, the end of the reporting period

Present obligation as a result of a past obligating event – There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion – No provision is recognised for the cost of fitting the smoke filters.

(b) At March 31, 20X2, the end of the reporting period

Present obligation as a result of a past obligating event – There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement – Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion – No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example : Repairs and maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. Ind AS 16, Property, Plant and Equipment gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example : Refurbishment costs – no legislative requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no present obligation.

Conclusion – No provision is recognised.

The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions—even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, i.e., it is depreciated over five years. The re-lining costs then incurred are capitalised with the consumption of each new lining shown by depreciation over the subsequent five years.

Example : Refurbishment costs – legislative requirement

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no present obligation.

Conclusion – No provision is recognised.

The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in above example on refurbishment costs. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions—the entity could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, i.e., an amount equivalent to the expected maintenance costs is depreciated over three years.

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.

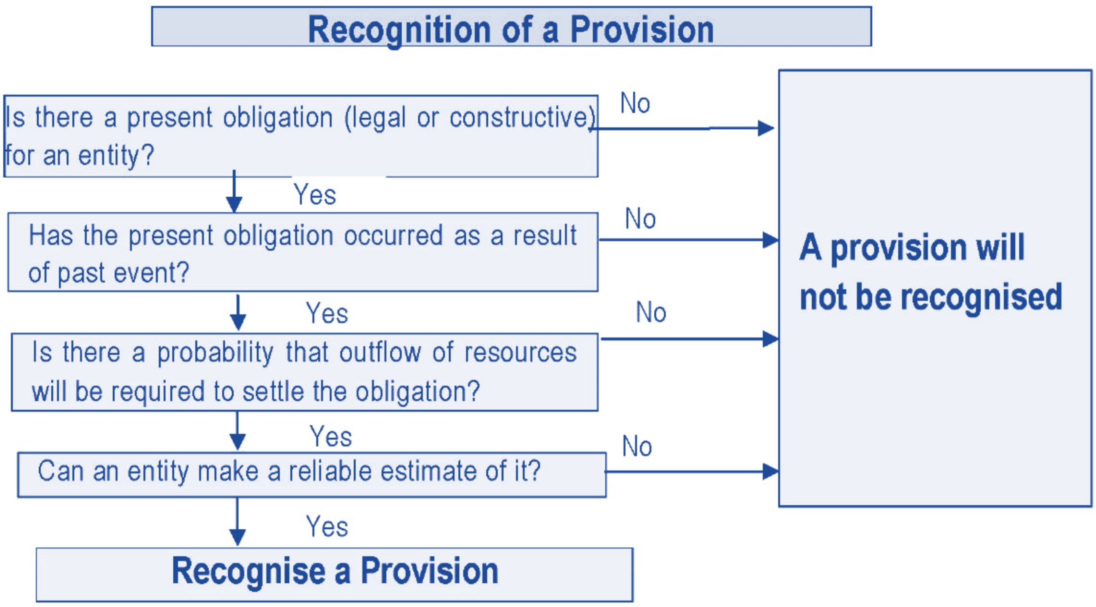
X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operations has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made 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?



6.2 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.
- Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties should be treated as a contingent liability.
- The entity should recognise a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.
- Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable.
- If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision should be recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

The principles describing provisions and contingent liabilities is as follows:

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation; or (b) a possible obligation 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.		
There is a present obligation that probably requires an outflow of resources.	There is a possible obligation or a present obligation that may, but	There is a possible obligation or a present obligation where the

	probably will not, require an outflow of resources.	likelihood of an outflow of resources is remote.
A provision is recognised.	No provision is recognised.	No provision is recognised.
Disclosures are required for the provision.	Disclosures are required for the contingent liability.	No disclosure is required.

6.3 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.
- However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
- A contingent asset should be disclosed, where an inflow of economic benefits is probable.
- Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements **of the period in which the change occurs**.

Where, as a result of past events, there is a possible asset 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		
The inflow of economic benefits is virtually certain	The inflow of economic benefits is probable, but not virtually certain	The inflow is not probable
The asset is not contingent and its recognition is appropriate	No asset is recognised	No asset is recognised
	Disclosures are required	No disclosure is required

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.

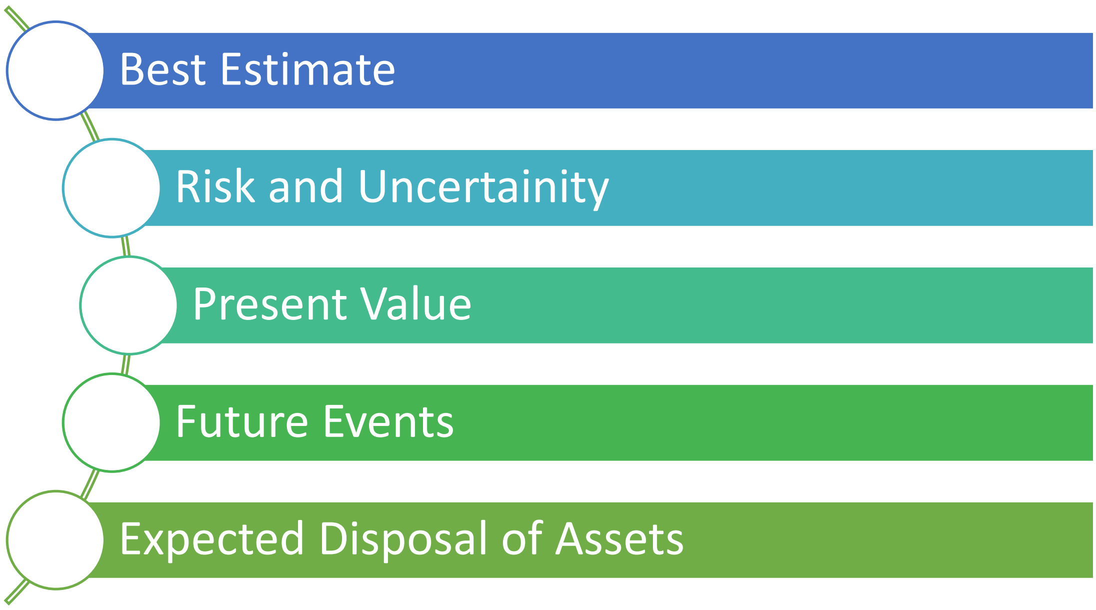
X Sugars Ltd. has entered into a sale contract of Rs.3,00,00,000 with Y Choclates Ltd. for the supply of sugar during 2011-2012. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation 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?

7. MEASUREMENT :



7.1 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.

- The estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.
- The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and in some cases, reports from independent experts, for example, in legal cases, expert legal advice might be taken. The evidence considered includes any additional evidence provided by events after the reporting period.
- Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, for example, customer refunds, warranties, etc., the Best obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value'. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60% or 90%.
- Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

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.

7.2 RISKS AND UNCERTAINTIES :

1. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.
2. Risk describes variability of outcome.
3. A risk adjustment should be made for the amount that the entity would pay in excess of the expected present value of outflows due to uncertainty attached with the actual outcome.
4. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities.

   For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case.

5. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
6. Risk adjustment can be accounted for in number of ways such as:
    - Adding it to the expected present value of future outflows.
    - Adjusting the estimates of future outflows.
    - Adjusting the discount rate.
7. Disclosure of the uncertainties surrounding the amount of the expenditure should be made.

7.3 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.
- Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions should therefore be discounted, where the effect is material.
- Ind AS 37 does not require cash flows to be discounted unless this has a material effect.
    - The expected present value of outflows are calculated as follows:
    - ▪ Each outcome is discounted to its present value.
    - ▪ The present value of outcomes are weighted by their associated probabilities.
- The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability.
- The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

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?

7.4 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.
- Expected future events may be particularly important in measuring provisions. For example, an entity may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology.

- The effect of possible new legislation should be taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

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?

7.5 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.

8. 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?

9. 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?

10. 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.

11. APPLICATION OF THE RECOGNITION AND MEASUREMENT RULES :

11.1 FUTURE OPERATING LOSSES :

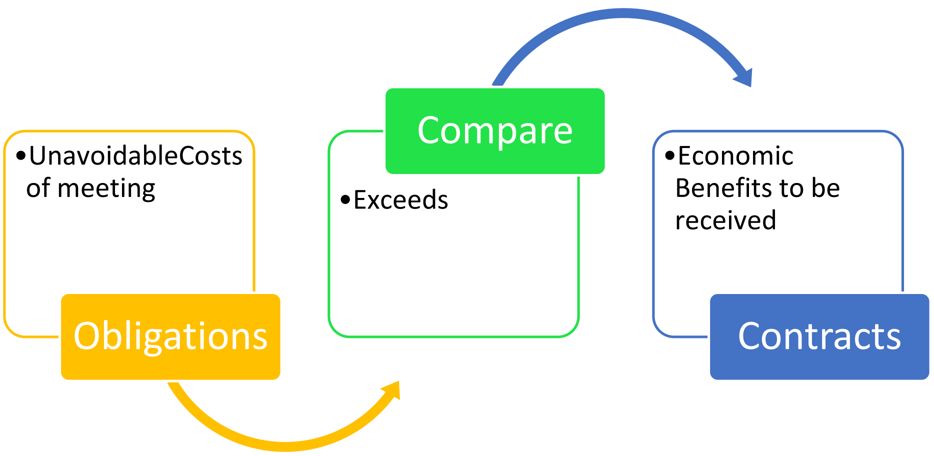
- Provisions should not be recognised for future operating losses.
- Future operating losses do not meet the definition of a liability and the general recognition criteria set out for provisions as specified in the standard. Ind AS 37 does not permit recognition of provision for future operating losses 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?

11.2 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?

11.3 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?

12. DISCLOSURE :

- For each class of provision, an entity should disclose:
  - (a) the carrying amount at the beginning and end of the period;
  - (b) additional provisions made in the period, including increases to existing provisions;
  - (c) amounts used (i.e., incurred and charged against the provision) during the period;
  - (d) unused amounts reversed during the period; and (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. Comparative information is not required to be disclosed.
- An entity should disclose the following for each class of provision:
  - (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
  - (b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events; and
  - (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

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.

13. LEVIES :

13.1 WHAT IS A LEVY? :

A charge imposed by governments on entities in accordance with laws and/or regulations. It leads to outflow of resources embodying economic benefits It excludes • outflows of resources that are within the scope of other Ind AS

- fines or other penalties that are imposed for breaches of the legislation
- payment made to the government for acquiring assets or for rendering services as per the contractual agreement
- liabilities that arise from emissions trading schemes.

Note: Government' refers to government, government agencies and similar bodies whether local, national or international.

- the accounting for a liability to pay a levy if that liability is within the scope of Ind AS 37
- accounting for a liability to pay a levy whose timing and amount is certain.
- the accounting for the costs that arise from recognising a liability to pay a levy.

Note: Entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

13.2 ACCOUNTING PRINCIPLES :

- If and activity triggers the payment of the levy, it will be considered as an obligating event that gives rise to a liability to pay a levy

Example :
If the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. The generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation.

- Any compulsion to operate in future will not be considered as constructive obligation for an entity, to pay a levy.
- The preparation of financial statements under the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.
- The liability to pay a levy is recognised progressively if the obligating event occurs over a period of time (ie if the activity that triggers the payment of the levy, as identified by the legislation, occurs over a period of time).

Example :
If the obligating event is the generation of revenue over a period of time, the corresponding liability is recognised as the entity generates that revenue.

- If an obligation to pay a levy is triggered when a minimum threshold is reached, the accounting for the liability that arises from that obligation shall be consistent with the principles established in the standard

Example :
If the obligating event is the reaching of a minimum activity threshold (such as a minimum amount of revenue or sales generated or outputs produced), the corresponding liability is recognised when that minimum activity threshold is reached.

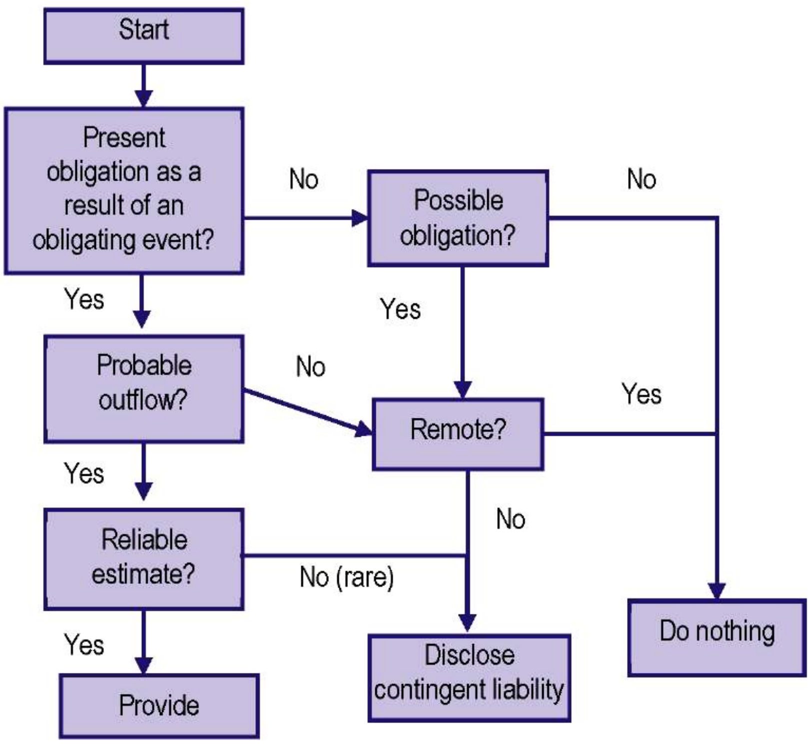
- An entity shall apply the same recognition principles in the interim financial report that it applies in the annual financial statements. As a result, in the interim financial report, a liability to pay a levy:
  - (a) shall not be recognised if there is no present obligation to pay the levy at the end of the interim reporting period; and
  - (b) shall be recognised if a present obligation to pay the levy exists at the end of the interim reporting period.
- An entity shall recognise an asset if it has prepaid a levy but does not yet have a present obligation to pay that levy.

14. SUMMARY :

Provisions	Contingent liability	Contingent asset

• Present legal or constructive obligation as a result of a past event
• Probable outflow of economic benefits to settle the obligation
• Obligation can be estimated reliably
	• Possible obligations arising from a past event to be confirmed by future events not wholly within the control of the entity, or
	• Present obligations arising from a past event
	  • of which the outflow of economic benefits is not probable, or
	  • that cannot be measured reliably
		• Possible assets arising from a past event to be confirmed by future events not wholly within control of entity

Decision tree



15. 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 ....

Rahul Malkan

CHAPTER

5

IND AS 113 – FAIR VALUE MEASUREMENT

CONCEPTS COVERED

1. WHAT IS FAIR VALUE?
2. OBJECTIVE
3. SCOPE
4. DEFINITIONS
5. ASSET OR LIABILITY SPECIFIC FAIR VALUE
6. UNIT OF ACCOUNT
7. THE TRANSACTIONS
    - PRINCIPAL MARKET
    - MOST ADVANTAGEOUS MARKET
8. MARKET PARTICIPANTS
9. THE PRICE
10. APPLYING FAIR VALUE RULES ON NON-FINANCIAL ASSETS
11. APPLYING FAIR VALUE RULES TO LIABILITIES AND AN ENTITY'S OWN EQUITY INSTRUMENTS
12. APPLYING FAIR VALUE RULES TO FINANCIAL ASSET & FINANCIAL LIABILITY WITH OFFSETTING POSITION IN MARKET RISK OR COUNTERPARTY RISK

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1. WHAT IS FAIR VALUE :

Normally assets and liabilities are being exchanged between parties at their agreed terms and conditions based on the prices which might be related to the entity or event based or in other words which is not at arm's length prices. To define Fair Values one has to ensure that the values reflect all assumptions/ adjustments to change from transaction specific/ entity specific to normal transaction which is common for all interested parties.

In other words, it is a market based value rather than an entity specific prices and this price should be received to sell an asset or paid to transfer a liability in a normal transaction (e.g. other than any stressed sale etc). Fair Value is an exit price and not a price at which an Asset/ liability sells/ purchases otherwise.

2. 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.

3. SCOPE :

There are many Ind AS which require measuring assets/ liabilities at fair value and whenever it is required to be fair valued, one looks at Ind AS 113. It means that this Standard will cover all such requirements of another standard where fair value measurement and disclosure is needed. However, there are some specific scope exclusions. It applies to initial measurement and subsequent measurement as required by respective Accounting Standard.

Example :

- Fair value less cost to sell as required under Ind AS 105 for assets held for sale.
- Fair value through Profit & Loss as required under Ind AS 109 for Financial Instruments.
- Property, plant & equipment measured using revaluation modal as required under Ind AS 16.
- Biological assets measure at fair value under Ind AS 41 for biological assets.

What is not covered ?

Measurement and Disclosure exclusion

(a) share-based payment transactions within the scope of Ind AS 102, Share based Payment;

(b) leasing transactions within the scope of Ind AS 17, Leases; and

(c) measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2, Inventories, or value in use in Ind AS 36, Impairment of Assets.

Disclosure exclusion :

(a) plan assets measured at fair value in accordance with Ind AS 19, Employee Benefits;

(b) assets for which recoverable amount is fair value less costs of disposal in accordance with Ind AS 36.

4. 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

5. 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.

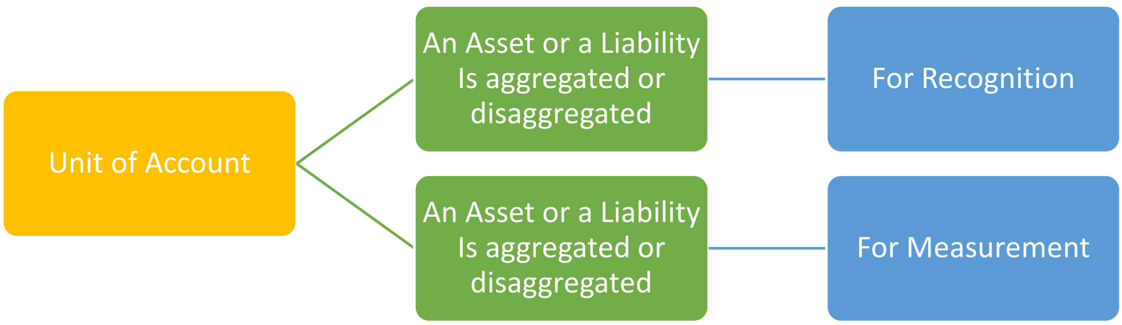
Question 2 – A manufacturing company

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.

6. 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.

7. 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.

7.1 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.

7.2 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.

8. 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.

9. 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.

9.1 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.

9.2 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.

10. 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.

10.1 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.

Analysis of Highest and best use for non-financial asset

- The highest and best use would determine an indicative price for a non-financial asset which usually do not have any frequently traded market unlike for other financial products.
- The concept emphasis that in order to find a fair value of such non-financial products, one has to define its best possible use which makes the non-financial

asset separate from any specific entity who would like to use such asset in their own specific purposes which may or may not be its best use.

- To find out the best possible use, one has to identify its market participants and then to find best legitimate use of this non- financial asset which one would normally do.
- All restrictions specific to any market participant would not be considered while finding out fair value of the non-financial asset.
- It is imperative to understand the best use while evaluating such fair values, as there is no need to exhaust all possible uses of such non-financial assets before concluding highest and best use,
- In the absence of potential best use which is not easily available, its current use would be considered as best use.

Example :

An entity bought some land which is intended to be used for business purposes. However, the entity now wants to sell this piece of land at its fair value. One has to evaluate all possible use of this land before concluding its fair value. The land could be used to make a commercial palace, which could be more in value comparing when it is used for business purposes. The commercial palace value would be considered its highest and best use if the same is allowed in its near location and conditions.

10.2 VALUATION PREMISE :

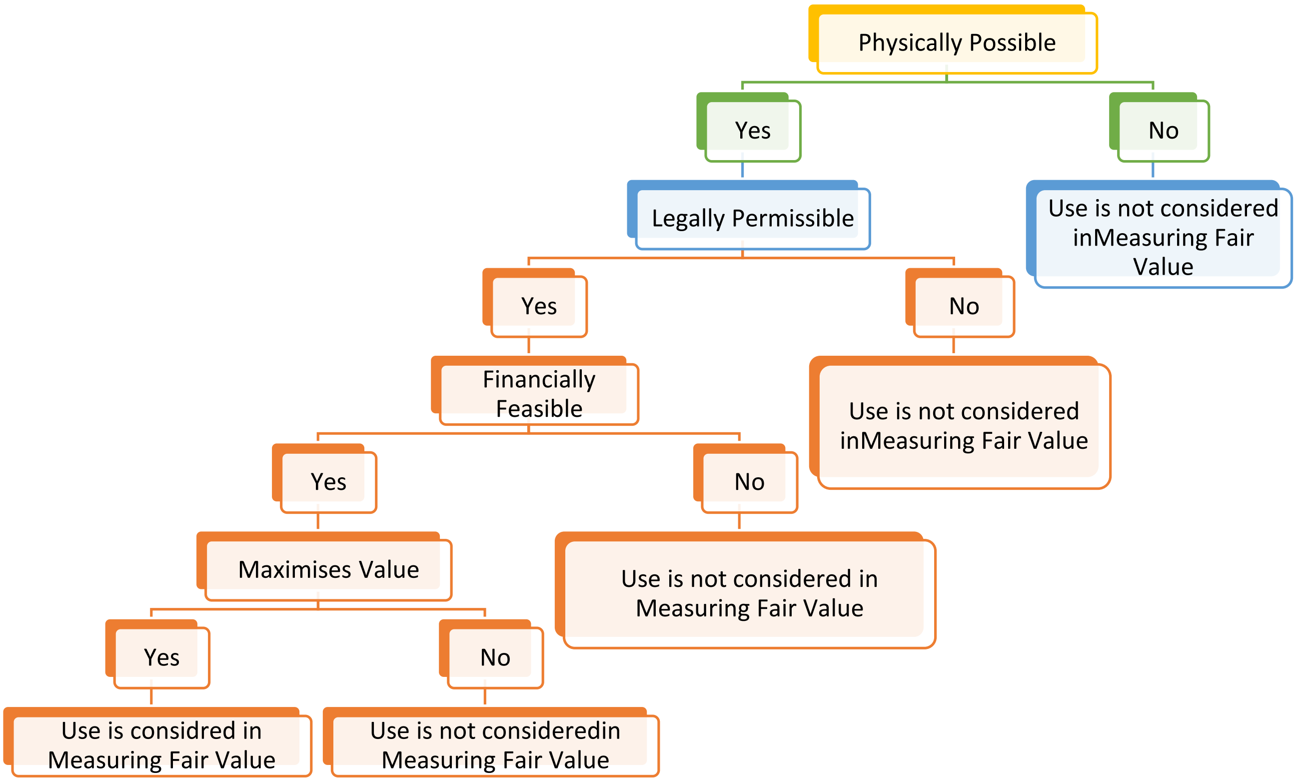
Fair value measurement of non-financial assets would be based on either

1) In combination with other assets, or
2) At stand alone basis,

Standard requires to use best used value if such non-financial asset is used in combination with some other assets and it is demonstrated that the such combination is widely used by other market participants also in order to find best use for the non-financial asset.

Example :

To find the Fair Value of a customer relations where a right to receive all future technological updates/ researches are being provided as complementary (which are in a way other intangible assets) to the customers. The customer relationship would be valued together with the research/ updates as it is likely to have less or no value for the customer relations without considering such technological updates/ researches which are being provided free to them.



11. APPLYING FAIR VALUE RULES TO LIABILITIES AND AN ENTITY'S OWN EQUITY INSTRUMENTS :

A fair value measurement assumes that a financial or non-financial liability or an entity's own equity instrument (e.g. equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date.

Often times a liability or an equity instrument of an entity is being transferred to some other market participant as part of a transaction e.g. a business combination etc., where certain liabilities or equity instruments are being issued in consideration of such acquisitions.

Observable Inputs : Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.

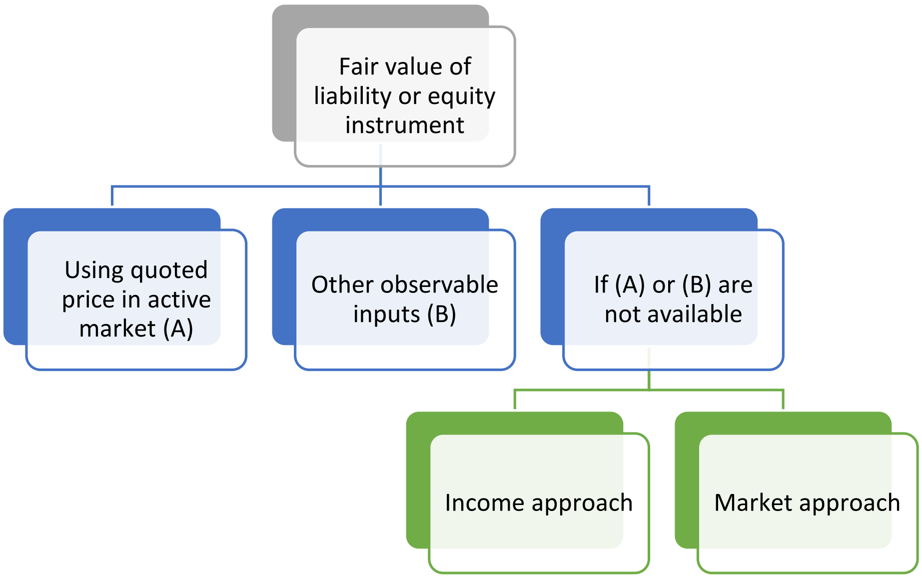
Unobservable Inputs : Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

11.1 When liability and equity Instruments are held by other parties as assets :

When direct quoted prices are not available for liabilities or equity instruments, then an entity should use an identical price of similar liabilities or equity instruments which is held by market participants as an asset. The quoted prices of such assets at the measurement date should be used. However, if quoted prices are not available then observable inputs can be used. In the absence of observable inputs, the valuation techniques such as income approach or market approach etc. may be used.

11.2 When liability and equity Instruments are not held by other parties as assets :

When these are not held by other parties then valuation techniques from the perspective of a market participant that owes the liability or has issued the claim on equity would be used to evaluate such fair values.



12. APPLYING FAIR VALUE RULES TO FINANCIAL ASSET & FINANCIAL LIABILITY WITH OFFSETTING POSITION IN MARKET RISK OR COUNTERPARTY RISK :

Assets and liabilities that are being managed by an entity would be affected by its market risk i.e. interest rate risk, currency risk etc. and credit risk relating to its respective counterparties. There are many situations where a group of assets and liabilities are being managed on net basis rather on individual basis by an Entity.

Analysis of applying offsetting position in market or credit risk

- This exception is allowed only in case the other market participants also manage the similar risk on net basis.
- There should ideally be same information and market practice available for making these assets/ liabilities on net basis.

  Example : All open position for derivatives are being normally evaluated on net exposure basis from each counterparty.
- Once the exception to fair value certain assets/ liabilities on net basis is being used, then unit of account to measure fair value would be considered as net.
- Market risk should be same while combining certain asset/ liability.

  Example : An interest rate risk can not be netted with a commodity price risk.
- Duration of a market risk should be identical to use the exception for valuing assets/ liabilities on net basis.

  Example : An interest rate swap of longer period will only be allowed to value at net basis upto the duration of financial instrument of the same duration.

Example :
Certain Interest rate risk from counterparty Z is being managed on net basis considering the changes in interest rate amount receivable and amounts payable to counterparty Z from normal sale/ purchase basis. Hence such net exposure would be used to evaluate fair values as required by this standard. The netting should normally be followed by other market participants as well and should not be an entity specific.

13. FAIR VALUE AT INITIAL RECOGNITION :

When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

(a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

(b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

(c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another Ind AS, or the transaction price includes transaction costs.

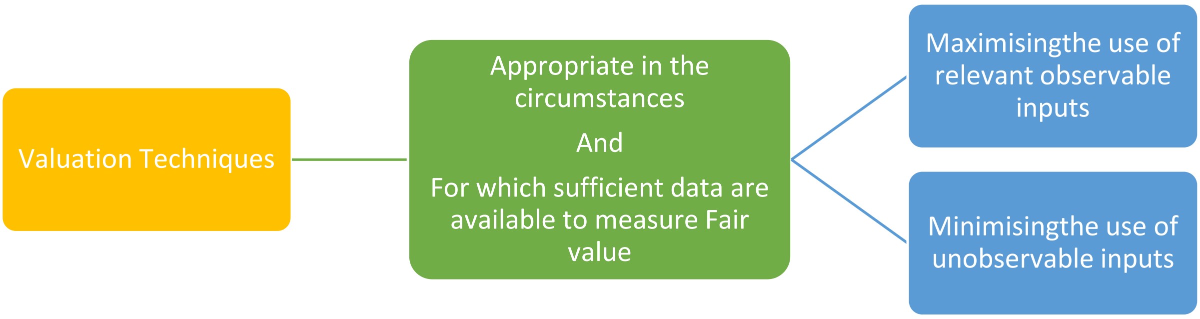
(d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

If another Ind AS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that Ind AS specifies otherwise.

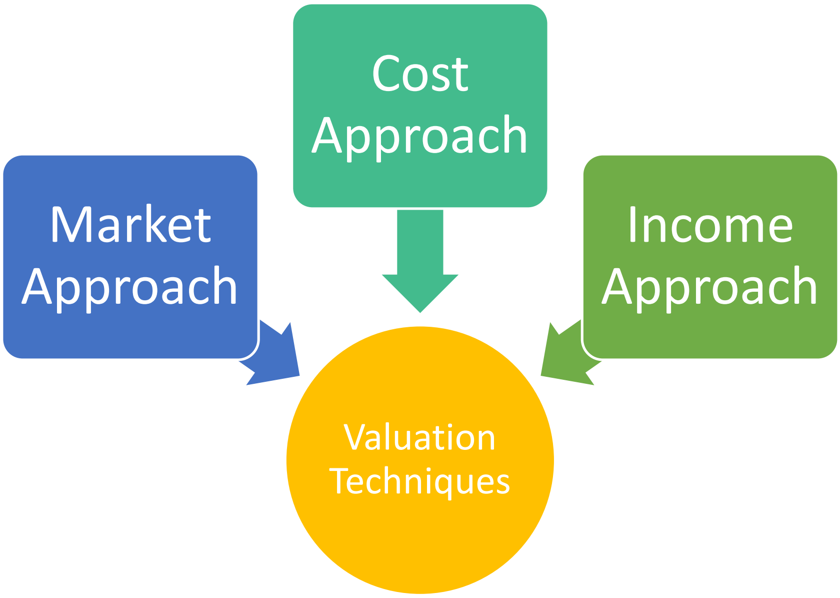
14. VALUATION TECHNIQUE :

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.

15. 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

16. 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.

17. DISCLOSURE :

An entity shall disclose information that helps users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

18. 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 ….

CHAPTER

6

IND AS 10 – EVENTS AFTER REPORTING PERIOD

CONCEPTS COVERED

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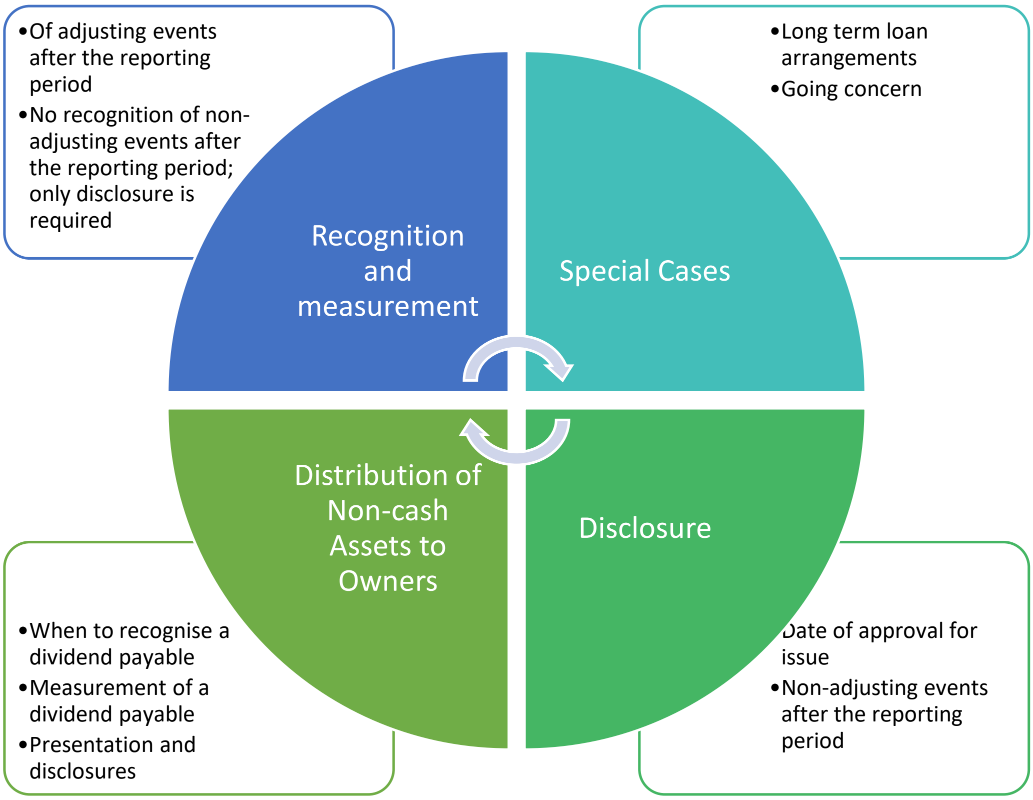
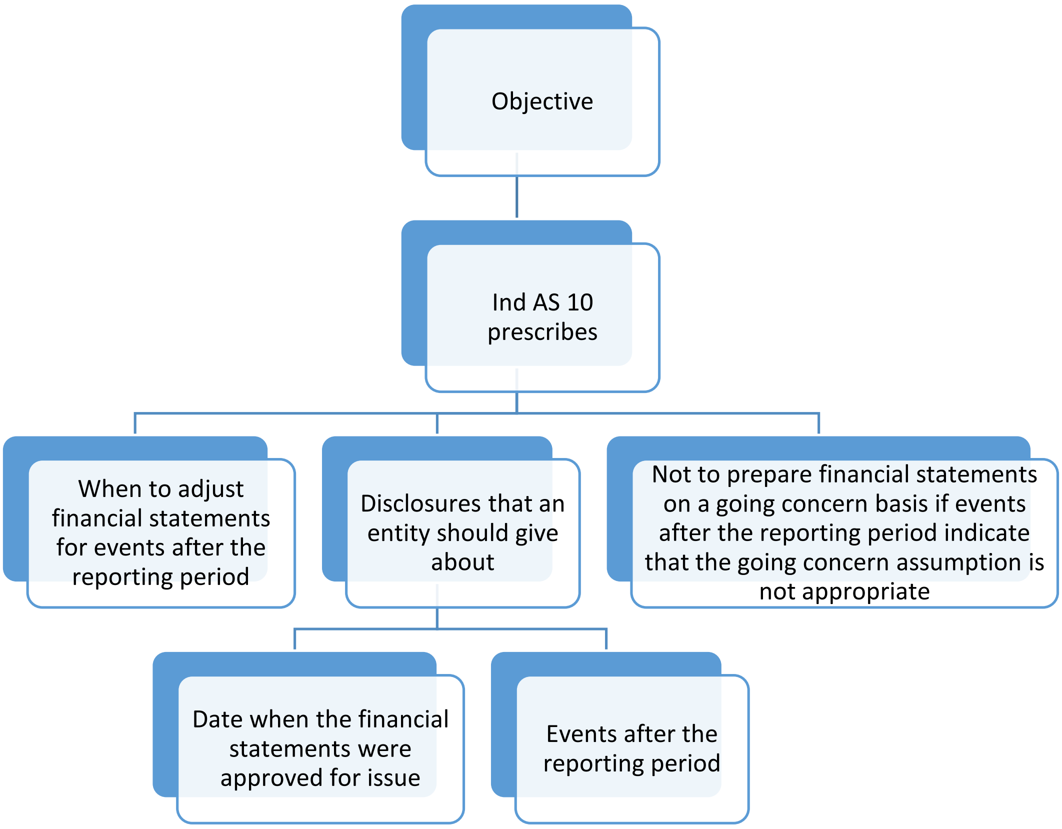
1. INTRODUCTION :



2. OBJECTIVE :



3. SCOPE :

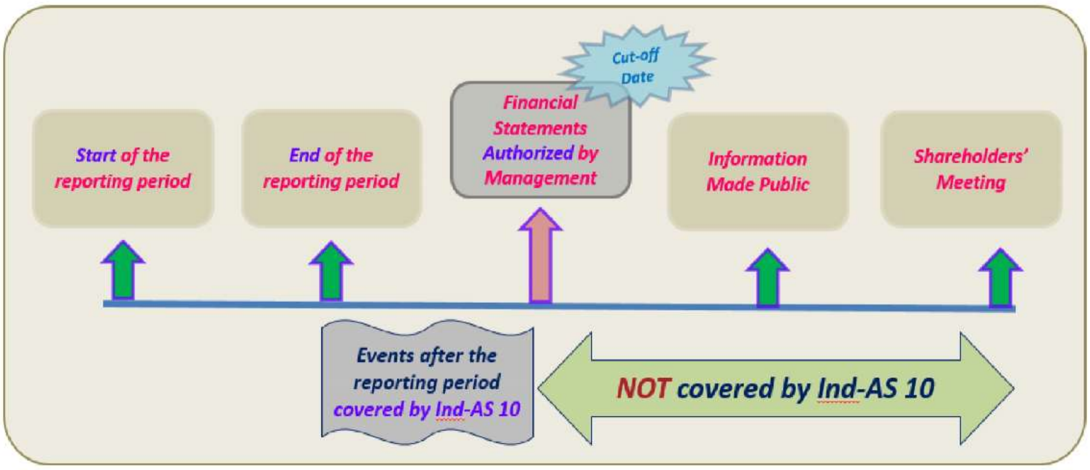
4. DEFINITION :

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.

Example :

The financial year ends on 31st March, 2017. A company can conduct the AGM any time before 30th September, 2017. However, the company needs to publish the results for quarter ended 30th June, 2017 as interim results. The board of the directors (BOD) approves the financial statements on 30th August, 2017. As BOD is approving the accounts on 30th August, 2017, 'after the reporting period' will be the period between 31st March, 20X7 and 30th August, 2017. However, in between, the partial financial information has already been published.

Now the question arises that if any information is revealed after the release of interim results for the quarter ended 30th June, 2017, but before 30th August, 2017, should it be considered for the purposes of Ind AS 10 or not since partial information has already been published without considering the event that was revealed after publishing some financial information? Will taking the cognizance of the additional information confuse the stakeholders? Will it be misleading?

In such a situation, Ind AS 10 requires that even if partial information has already been published, events after the reporting period should be considered.

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?

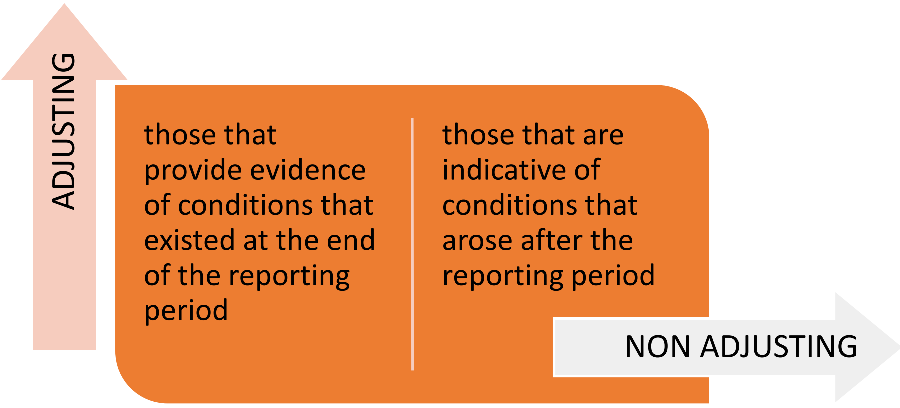
The standard clearly states that events can be favourable as well as unfavourable

5. 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).



6. 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

Examples of Adjusting Events :

(a) The settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' or recognises a new provision.

The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of Ind AS 37.

(b) The receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted.

(c) The sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period.

(d) The determination after the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(e) The determination after the reporting period of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events before that date (see Ind AS 19, Employee Benefits).

The careful reading of the above provision brings forth following two points:
(i) There is a legal or constructive obligation at the end of reporting period
(ii) The obligation is based on profit sharing or bonus payments.

Here one would understand that before the year end, one cannot determine the amount of profit. Unless one determines the final amount of profit, one cannot finalise the amount of profit sharing as the latter is related to the former. Therefore, such events must be considered for the adjustments in financial statements, provided, the contract already exists on the last day of reporting period.

(f) The discovery of fraud or errors that show that the financial statements are incorrect.

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?

7. 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.

8. SPECIAL CASES :

8.1. 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.

8.2 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?

9. 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?

10. DISCLOSURE :

- An entity shall disclose the date when the financial statements were approved for issue and who gave that approval. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

- It is important for users to know when the financial statements were approved for issue, because the financial statements do not reflect events after this date.

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

(a) the nature of the event; and

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

11. 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 ….

CHAPTER

7

IND AS 20 – ACOUNTING FOR GOVT. GRANT & DISCLOSURE OF GOVT. ASSISTANCE

CONCEPTS COVERED

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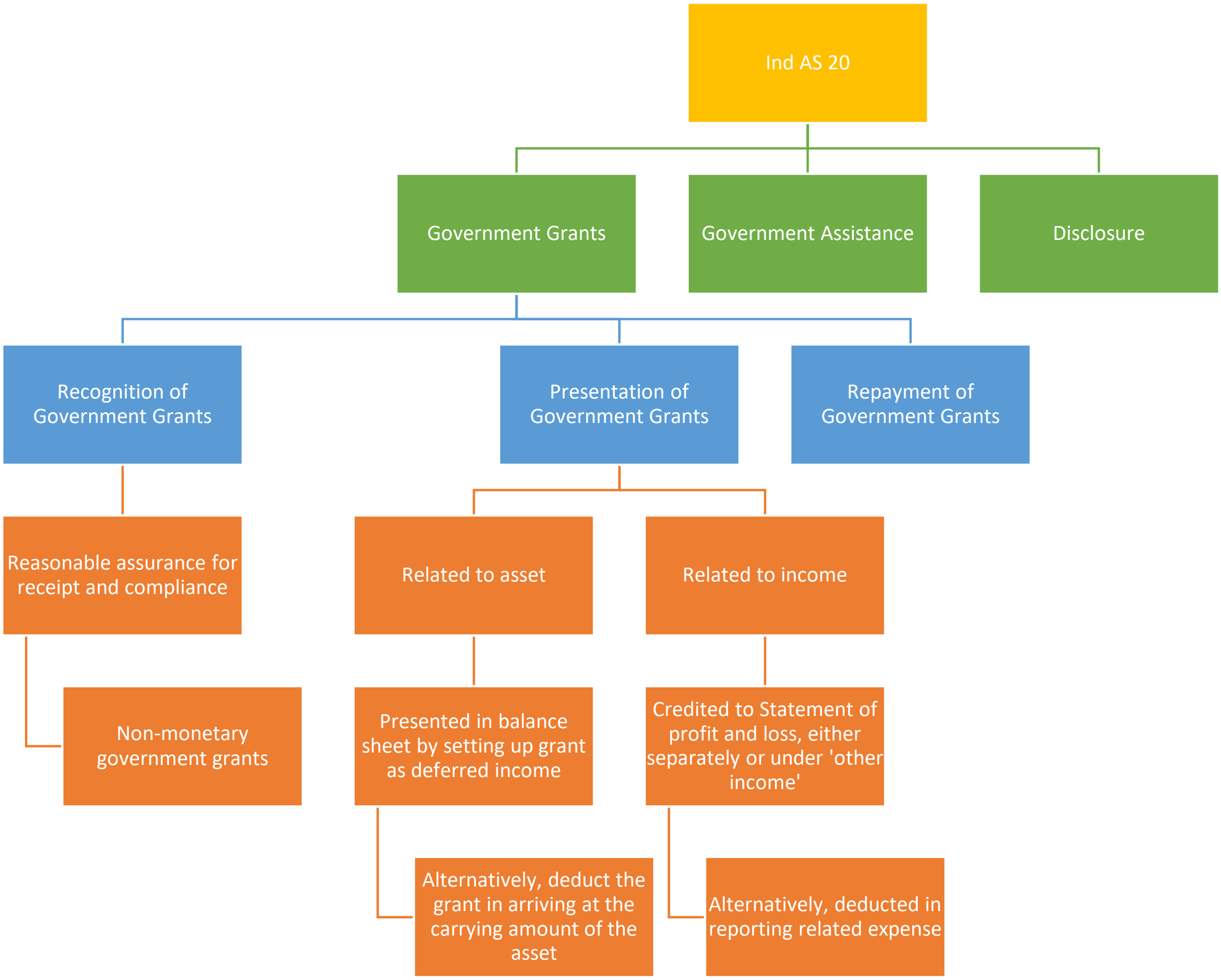
1. INTRODUCTION :

The government gives grants to entities for various purposes including for industrial, geographic and social development, to facilitate the flow of foreign investments, to promote entrepreneurship, as subsidies to reduce the prices of goods and services offered by these entities.

The grant could be in different forms, e.g., monetary or non-monetary government grants.



2. SCOPE :

Ind AS 20 should be applied for:

(a) accounting and disclosure of government grants; and

(b) disclosure of other forms of government assistance.

Ind AS 20 does not deal with:

(a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;

(b) government assistance that is provided for an entity in the form of benefits tha t are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability;

Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation.

(c) government participation in the ownership of the entity;

(d) government grants that will be covered by Ind AS 41, *Agriculture*.

3. 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.

Government assistance for the purpose of Ind AS 20 does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

The receipt of government assistance by an entity may be significant for the preparation of the financial statements for two reasons:

- Firstly, if resources have been transferred, an appropriate method of accounting for the transfer must be found.
- Secondly, it is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period. This facilitates comparison of an entity's financial statements with those of prior periods and with those of other entities.

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.

They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Government grants are sometimes called by other names such as subsidies, subventions, or premiums.

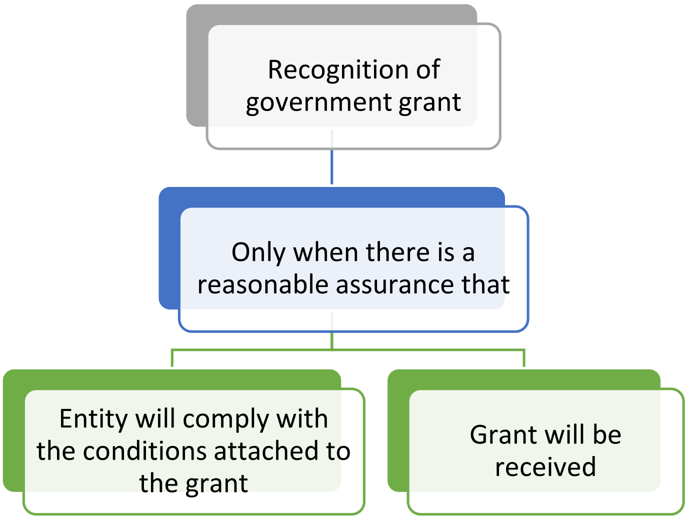
4. Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they 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*).

4. RECOGNITION OF GOVT GRANTS :



Government grants, including non-monetary grants at fair value, should be recognised only when there is reasonable assurance that:

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

(b) the grants will be received.

A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

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.

5. ACCOUNTING FOR GOVT GRANTS :

5.1 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.

5.2 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.

5.3 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.

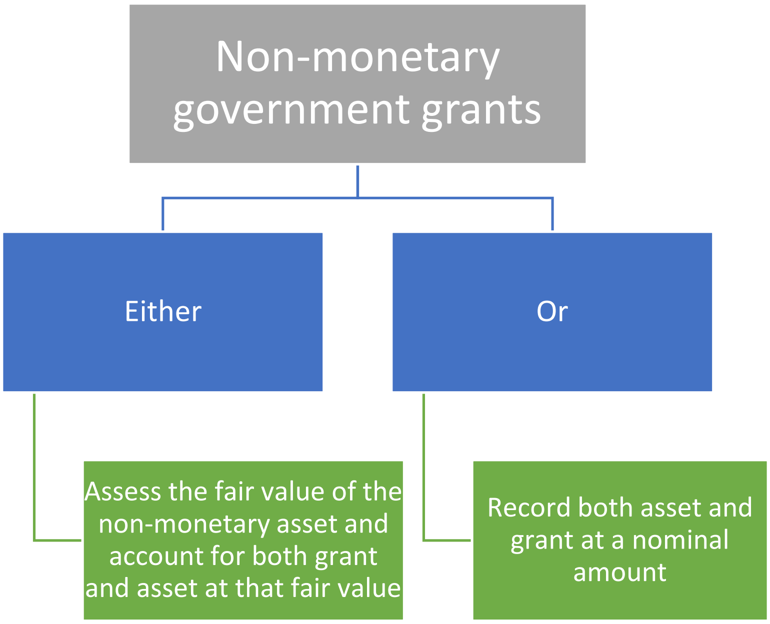
5.4 Grant for expenses or losses already incurred :

Such grants are recognised in P/L in the period in which entity becomes eligible to receive the grant.

5.5 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.

5.6 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.

5.7 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.

6. PRESENTATION OF GRANTS RELATED TO ASSETS :

6.1 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.

6.2 Disclosure in the statement of cash flows :

Question 9 –

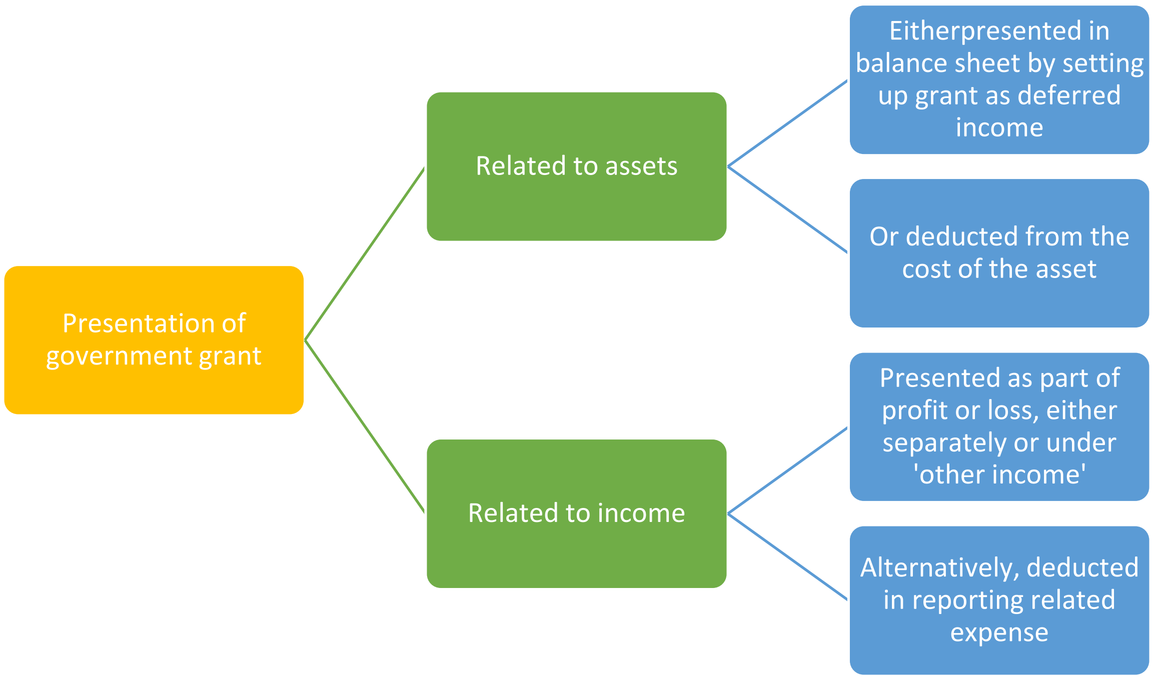
Continuing with the facts given in the Illustration 7 above, state how the same will be disclosed in the Statement of cash flows.

7. 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?

8. REPAYMENT OF GOVERNMENT GRANTS :

Repayment of government grant

Related to income

First applied towards any unapplied deferred credit and then charged to profit and loss account immediately

Related to asset

*Either recognised by increasing the carrying amount of the asset

*The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be recognised immediately in profit or loss.

*Check the possible impairment of the new carrying amount of the asset.

Or by reducing the deferred income balance by the amount payable

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?

9. DISCLOSURE :

The following should be disclosed:

(a) the accounting policy adopted for government grants;

(b) the methods of presentation adopted for government grants in the financial statements;
(c) the nature and extent of government grants recognised in the financial statements;
(d) an indication of other forms of government assistance from which the entity has directly benefited. At times, the significance of the benefit of government assistance may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements may not be misleading; and
(e) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

10. 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 ....

Rahul Malkan

CHAPTER

8

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.

2. SCOPE :

The objective of this Standard is to prescribe the accounting treatment for income taxes. Income taxes for the purpose of this Standard includes:

(a) all domestic and foreign taxes which are based on taxable profits;

(b) taxes, such as withholding taxes (Tax Deducted at Source), which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

- Items of current tax or defer tax recognized in profit and loss are subject to two exceptions:
  1. An item of current tax or defer tax pertaining to other comprehensive income should be recognized in other comprehensive income
  2. An item of current tax or defer tax pertaining to direct equity should be recognized in direct equity

- In addition, the Standard deals with the:
  (a) recognition of deferred tax assets arising from unused tax losses or unused tax credits;
  (b) presentation of income taxes in the financial statements; and
  (c) disclosure of information relating to income taxes.

- The Standard however, does not deal with the methods of accounting for government grants (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance) or investment tax credits. However, it deals with the accounting for temporary differences that may arise from such grants or investment tax credits.

3. 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.

4. 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.

5. CURRENT TAX, ITS RECOGNITION, MEASUREMENT AND PRESENTATION :

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

RECOGNITION :

A) Current tax liability :

- Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability.
- The exact liability of current tax crystallises only on preparation and finalisation of financial statements at the end of the reporting period.
- Any excess of this liability over the prepaid taxes (advance tax) and withhold taxes (TDS) is to be treated as current liability. This liability may be for the current reporting period or may relate to earlier reporting periods.

B) Current tax assets :

If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognised as an asset.

MEASUREMENT :

(a) Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted.

(b) Uncertain tax position interpretations

- An entity computes its current income-taxes in accordance with the provisions contained in the taxation laws. Taxation laws provide certain benefits or require enhancements in accordance with the fiscal, economic and other policies of the country. These at times are prone to varying interpretations and settled by the appellate authorities after a considerable period from the reporting period. The taxability remains uncertain.
- Ind AS 12 requires that current tax liabilities or assets for the current period or the period should be computed based on the amount it expects to pay. It is suggested that statistical tools may be used in computing the current tax with respect to the uncertain tax interpretations.
- Thus, computation of current tax at best is an estimate. Any change in this estimate based on subsequent developments should be treated as a change in estimate in accordance with Ind AS 8.

(c) Enacted or substantive enacted

- The tax rates in computing the current tax should be based on taxation laws that have enacted or substantively enacted.
- A proposed legislation is enacted when all the formalities with respect to the legislation is completed. In India, the enactment occurs when the legislation is notified in the gazette on and from the date it comes into force as mentioned in the said gazette notification.
- Implicit in the word 'substantively enacted' is the emphasis that in the relevant situation the enactment process is not fully completed. The process of enactment of a taxation laws in India is as under:
  - — Finance bill is presented in Lok Sabha of Indian Parliament.
  - — It is discussed and passed by the Lok Sabha.
  - — It then moves to Rajya Sabha of Indian Parliament.
  - — It is discussed in the Rajya Sabha.
  - — It is then presented before the President for assent.
  - — It is then notified in the gazette of India.
- Now, at which stage an entity should conclude that the legislation is substantively enacted becomes a key consideration. More so, the finance bill in India is normally presented on the last day of February and is enacted by the 3rd week of May. The reporting period of most of the entities ends on 31st March and listed entities attempt to issue their financial statements within 4-6 weeks of the reporting date.
- Ind AS 12 does not provide any guidance.
- It is therefore suggested that the entity should explicitly disclose in its financial statements the accounting policy with respect to the adoption of tax rates based on the principle of 'substantive enactment'. Needless to add, the policy should be applied consistently. If material, the variation due to adoption of rates based on 'substantive enactment' should also be disclosed.

Accounting of Current Tax Effects :

(a) The accounting of current tax effects of a transaction of an event is consistent with the accounting for that transaction or event.

(b) The current tax effects of a transaction shall follow its accounting treatment if the item is recognised in statement of profit or loss, its current tax effect will be recognised in statement of profit or loss.

(c) For further discussion on this topic, refer Accounting for Deferred Tax.

Offsetting Current Tax Assets and Current Tax Liabilities :

(a) An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:

- has a legally enforceable right to set off the recognised amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(b) Although current tax assets and liabilities are separately recognised and measured they are offset in the balance sheet subject to criteria similar to those established for financial instruments in Ind AS 32. An entity will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation laws permit the entity to make or receive a single net payment.

(c) In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group if, and only if, the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

6. 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

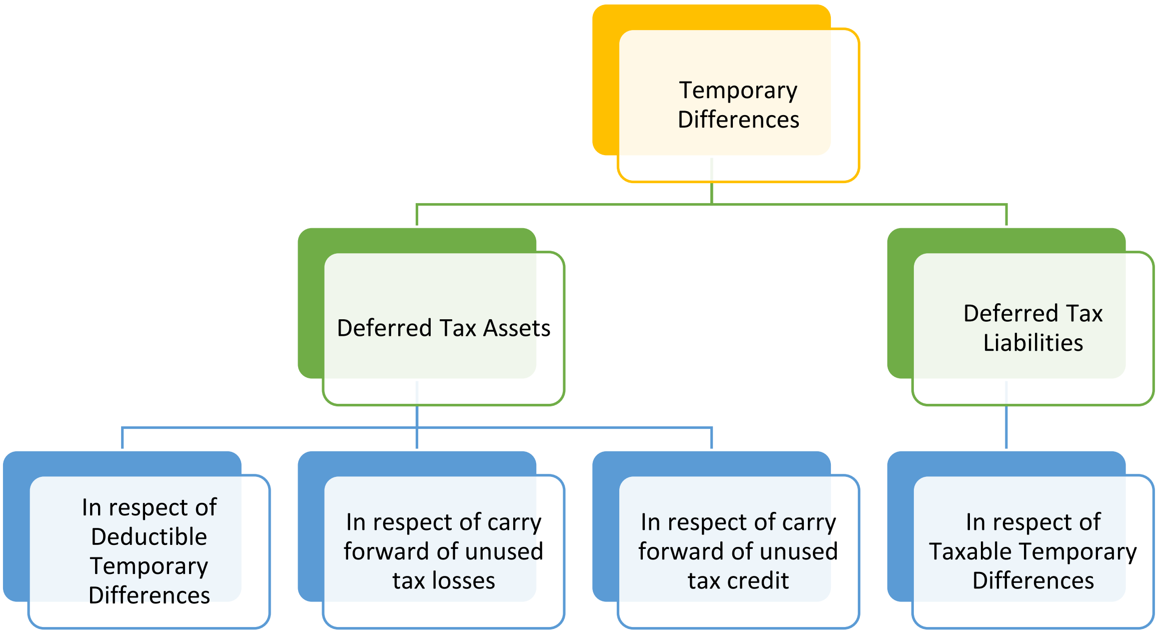
Public issue expenses. The entity may have written off the public issue expenses in the very first year. But since tax laws permit deduction over 5 years, the temporary differences will exist till complete deduction is claimed in taxation laws.

- **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.

7. 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 ....

Rahul Malkan

CHAPTER

9

IND AS 24 – RELATED PARTY DISCLOSURE

CONCEPTS COVERED

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1. INTRODUCTION :

An entity in the course of its commerce and business enters into numerous transactions and gets impacted by various related party relationships. It is a normal feature of business and commerce to have related party relationships. Entities frequently carry on their business activities through subsidiaries, joint ventures or associates. The entity has the ability to affect the financial and operating policy of a subsidiary as it has control over it. In the case of joint venture it has joint control whereas in the case of an associate it has significant influence.

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.

Therefore, the users of the financial statements of any entity should have:

(a) the knowledge of:
- related party relationships of an entity;
- entity's transactions, outstanding balances, commitments etc. with such related parties;

(b) as it may affect the users assessments:
- of operations of the entity and
- the risks and opportunities facing the entity.

2. OBJECTIVE :

The objective of the Standard is to ensure that the financial statements of an entity contains necessary disclosures with respect to:

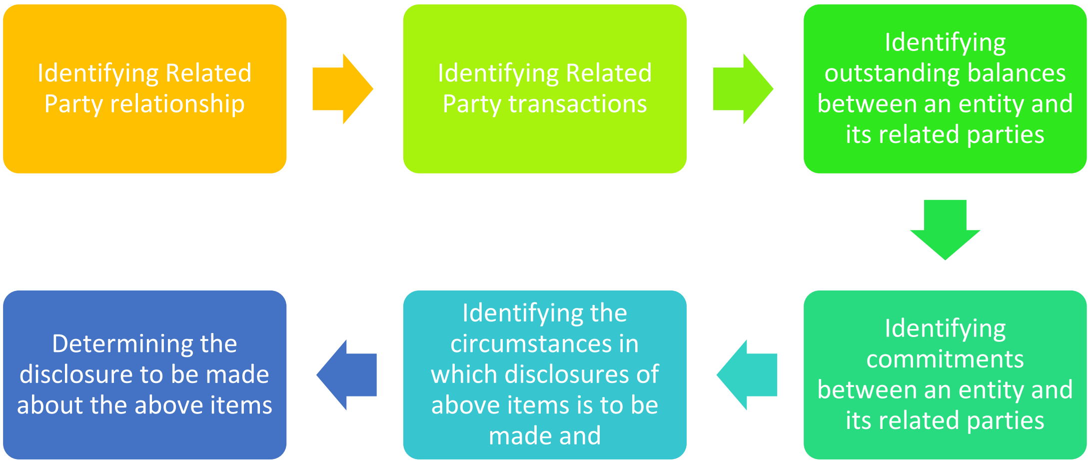
OBJECTIVES

- (a) related party relationships;
- (b) related party transactions;
- (c) outstanding balances with related parties; and
- (d) commitments with related parties.

The disclosures are necessary so that users' attention could be drawn to the possibility that financial statements may be affected by such related party relationships and other items as mentioned above.

3. SCOPE :

The standard is applied to



The disclosures are to be made in:

(a) Individual financial statements of the entity.

(b) Consolidated and separate financial statements of a parent, venturer or an investor prepared in accordance with Ind AS 110 'Consolidated Financial Statements' or Ind AS 27, 'Separate Financial Statements'.

Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements, however, intra-group related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements of the group.

Exception:
If the above intra group related party transactions & outstanding balances are measured at fair value through profit or loss, then not eliminated

Disclosures not required when either

- such disclosures are in conflict with the entity's duties of confidentiality in terms of a statute, regulator or similar competent authority governing the entity; or
- the entity is prohibited by the statute, regulator or similar competent authority to disclose certain information otherwise required to be disclosed as per this Standard.

Example :
Banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Standard would not override the obligation to preserve the confidentiality of customers' dealings.

4. 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.

5. UNDERSTANDING WHICH ARE RELATED PARTY AND WHICH ARE NOT :

3. 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.

4. **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.

5. 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 :

6. 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.

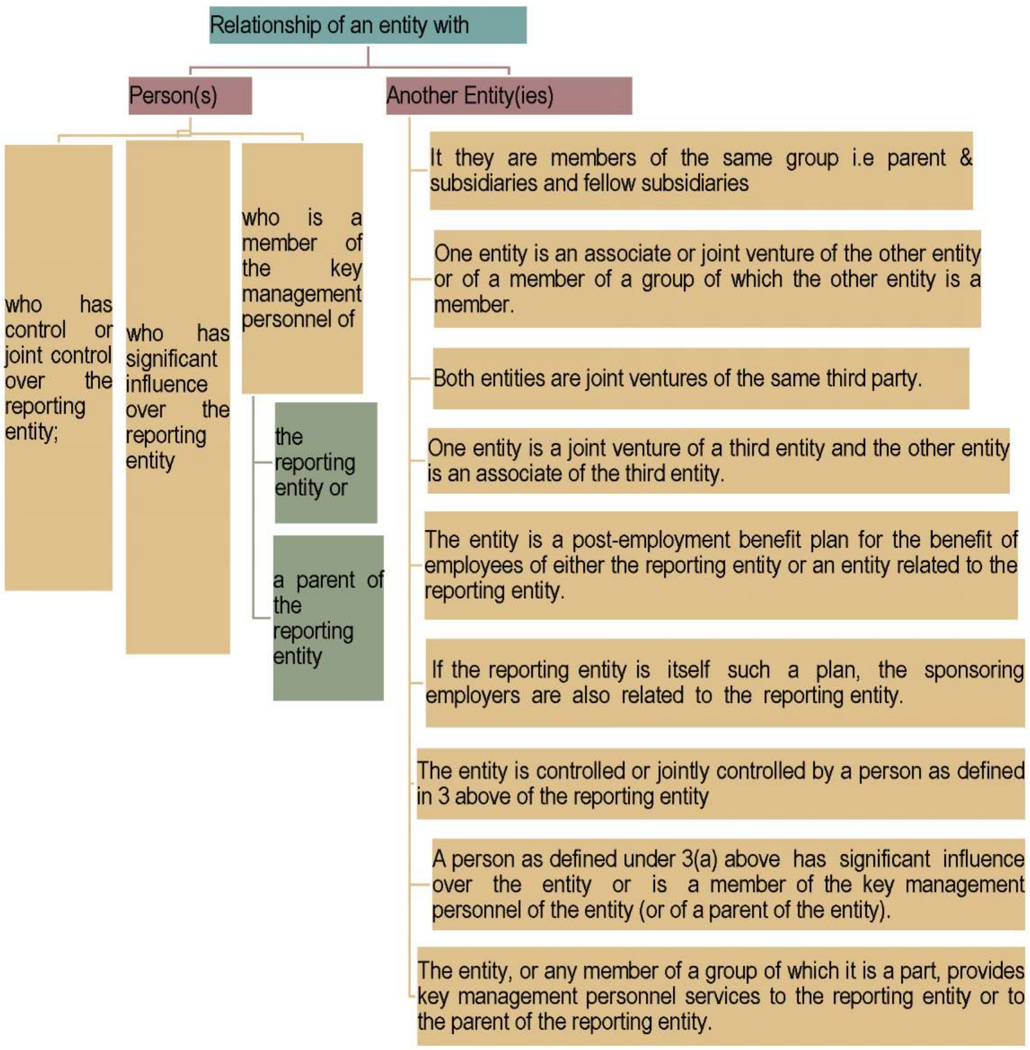
(g) A person identified above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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.

The aforesaid definition is wide and exhaustive. It is quite possible that the identification of related parties may become an onerous task. The Standard therefore, as has been stated above, lays emphasis on the substance of the relationship rather than legal form. For example, there may be a special purpose entity in which the reporting entity may not have any ownership interest but where it may exercise control being the sole customer. This special purpose entity could fall in the definition of related party as envisaged by this Standard.



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.

7. **Control** is the power over the investee when it is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns.

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

9. **Significant influence** is the power to participate in the financial and operating policy decisions of the investee, but is not control of those policies. The terms 'control', 'joint control' and 'significant influence' are discussed in detail in chapters on Ind AS 110, Consolidated Financial Statements, Ind AS 111 'Joint Arrangements' & Ind AS 28, Investments in Associates & Joint Ventures.

10. **Key management personnel** are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Analysis :

The definition includes executive as well as non-executive directors who have responsibility for the management and direction of a significant part of the business. It is not necessary that these people should have the 'director' designation. The term also includes members of the management committee(s), if those committee(s) have the authority for planning, directing and controlling the entity's activities.

The Standard further states that in the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture.

Example :
R Limited has an associate B Limited. B Limited has a subsidiary S Limited, a joint venture J Limited and an associate A Limited. R Limited is the reporting entity. It identifies B Limited and S Limited as its related parties. J Limited and A Limited are not related parties of R Limited.

6. 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.

Understanding related party transactions :

11. A **related party transaction** is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Examples :

(a) purchases or sales of goods (finished or unfinished);
(b) purchases or sales of property and other assets;
(c) rendering or receiving of services;
(d) leases;
(e) transfers of research and development;
(f) transfers under licence agreements;
(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);
(h) provision of guarantees or collateral;
(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts1 (recognised and unrecognised);
(j) settlement of liabilities on behalf of the entity or by the entity on behalf of that related party; and
(k) management contracts including for deputation of employees.

Note: It is not necessary for any consideration to be passed for related party transactions.

Also, participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties.

12. **Compensation** includes all employee benefits (as defined in Ind AS 19, Employee Benefits) including employee benefits to which Ind AS 102, Share-based Payments, applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:
    a. short-term employee benefits, monetary such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non—monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
    b. post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;
    c. other long-term employee benefits, including long service leave or sabbatical leave, jubilee or other long service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;
    d. termination benefits; and
    e. share-based payment.

13. **Government** refers to government, government agencies and similar bodies whether local, national or international.

14. A **government-related entity** is an entity that is controlled, jointly controlled or significantly influenced by a government.

7. DISCLOSURE :

The disclosure requirements can be broadly classified into two categories.

a. Category 1 – Where the relationship is as a result of control - requires disclosures of relationships even though there are no related party transactions between the disclosed related parties.
b. Category 2 – In other related party relationship - requires disclosures of relationships and items only when there are related party transactions.

Disclosure- Relationships between parent and subsidiaries ;

The following disclosures of relationships, if exist, must be made irrespective of the fact whether there have been related party transactions by the entity:

Under this an entity is required to disclose the name of its parent and, if different, the ultimate controlling party. It may be noted that the ultimate controlling party may be a person.

Example :
S4 Limited (reporting entity) is a subsidiary of S3 Limited. S3 Limited is a subsidiary of S2 Limited. S2 Limited is a subsidiary of S1 Limited. S1 Limited is a subsidiary of H Limited. S4 Limited must disclose the name and relationship with S3 Limited and H Limited.

If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

Example :
S4 Limited (reporting entity) is a subsidiary of S3 Limited. S3 Limited is a subsidiary of S2 Limited. S2 Limited is a subsidiary of S1 Limited. S1 Limited is a subsidiary of H Limited. Only S2 Limited and S1 Limited produces consolidated financial statements for public use. S4 Limited must disclose the name and relationship with S3 Limited, S2 Limited and H Limited.

Example :
S4 Limited (reporting entity) is a subsidiary of S3 Limited. S3 Limited is a subsidiary of S2 Limited. S2 Limited is a subsidiary of S1 Limited. S1 Limited is a subsidiary of H Limited. S3 Limited, S2 Limited, S1 Limited and H Limited all produces consolidated financial statements for public use. S4 Limited must disclose the name and relationship with S3 Limited and H Limited.

The Standard clarifies that the requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in Ind AS 110, Consolidated Financial Statements, Ind AS 28, Investments in Associates, and Joint Ventures.

Category 2 Disclosure :
Under this category, two types of disclosures are required. The first requires disclosures related to compensation to key management personnel. The second requires other disclosures where there have been related party transactions during the year.

Disclosures of compensation to key management personnel :
An entity is required to disclose
(i) total compensation to key management personnel and
(ii) Compensation for each of the following categories:
  (a) short–term employee benefits;
  (b) post–employment benefits;
  (c) other long-term benefits;
  (d) termination benefits;
  (e) share–based payments.

If an entity obtains key management personnel services from another entity (the 'management entity'), the entity is not required to apply the requirements to the compensation paid or payable by the management entity to the management entity's employees or directors.

Disclosures where there have been related party transactions during the year :

1. Where an entity has had related party transactions during the periods covered by the financial statements, it shall disclose, in addition to disclosures listed above, the following for the users to understand the potential effect of these relationships and transactions on the financial statements:
   (a) the nature of the related party relationship;
   (b) the information about these related party transactions and outstanding balances, including commitments.

2. The disclosures, at a minimum, shall include:
   a. the amount of the transactions;
   b. the amount of outstanding balances, including commitments, and:
      - their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
      - details of any guarantees given or received;
   c. provisions for doubtful debts related to the amount of outstanding balances; and
   d. the expense recognized during the period in respect of bad or doubtful debts due from related parties.

3. Amounts incurred by the entity for the provision of key management personnel services that are provided by a separate management entity shall be disclosed.

4. The aforesaid disclosures shall be made separately for each of the following categories:
   (a) the parent;
   (b) entities with joint control or significant influence over the entity;
   (c) subsidiaries;
   (d) associates;
   (e) joint ventures in which the entity is a joint venturer;
   (f) key management personnel of the entity or its parent; and
   (g) other related parties.

5. The classification of amounts payable to, and receivable from, related parties in the different categories is an extension of the disclosure requirements in Ind AS 1, Presentation of Financial Statements, for information to be presented either in the balance sheet or in the notes. The categories are extended to provide a more comprehensive analysis of related party balances and apply to related party transactions.

6. However, disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions should be made only if such terms can be substantiated.

7. Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

8. Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions.

Example :
Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.

8. 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.

- However, it shall disclose:
  (a) the name of the government;
  (b) the nature of the government's relationship with the entity (whether the government has control, joint control or significant influence over the entity);
  (c) to enable the users of the entity's financial statements to understand the effect of related party transactions on its financial statements, the following information in sufficient details:
    - the nature and amount of each individually significant transaction;
    - for other transactions that are not significant individually but are significant when aggregated, either a qualitative or quantitative indication of their extent.

- Thus the reporting entity is expected to apply its judgment to determine the level of details it is required to disclose as per above. To enable the reporting entity to arrive at decision, it shall consider:
  (a) the closeness of the related party relationship;
  (b) whether the transaction is significant in size;
  (c) whether the transaction is carried out on non-market terms;
  (d) whether these are outside the normal day to day business operations;
  (e) whether they are disclosed to regulatory or supervisory authorities;
  (f) whether they are reported to senior management;
  (g) whether they are subject to shareholder approval.

Disclosure requirements when exemption applies :
In Entity A's financial statements, an example of disclosure to comply for individually significant transactions could be:

Example of disclosure for individually significant transaction carried out on non-market terms

On 15, January 20X1 Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, sold a 10-hectare piece of land to another governmentrelated utility company for Rs. 5 million. On 31, December 20X0 a plot of land in a similar location, of a similar size and with similar characteristics, was sold for Rs. 3 million. There had not been any appreciation or depreciation of the land in the intervening period. See note X [of the financial statements] for disclosure of government assistance as required by Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, and notes Y and Z [of the financial statements] for compliance with other relevant Accounting Standards.

Example of disclosure for individually significant transaction because of size of transaction

In the year ended December 20X1 Government G provided Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, with a loan equivalent to 50 percent of its funding requirement, repayable in quarterly instalments over the next five years. Interest is charged on the loan at a rate of 3 per cent, which is comparable to that charged on Entity A's bank loans.

relevant Accounting Standards

☐ See

Example of disclosure of collectively significant transactions in Entity A's financial statements, an example of disclosure to comply with for collectively significant transactions could be:

Government G, indirectly, owns 75 per cent of Entity A's outstanding shares. Entity A's significant transactions with Government G and other entities controlled, jointly controlled or significantly influenced by Government G are [a large portion of its sales of goods and purchases of raw materials] or [about 50 per cent of its sales of goods and about 35 per cent of its purchases of raw materials]. The company also benefits from guarantees by Government G of the company's bank borrowing. See note X [of the financial statements] for disclosure of government assistance as required by Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, and notes Y and Z [of the financial statements] for compliance with other relevant Accounting Standards.

9. 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 ....

Rahul Malkan

CHAPTER

10

IND AS 21 – THE EFFECTS OF CHANGES IN FOREIGN RATES

CONCEPTS COVERED

1. INTRODUCTION
2. OBJECTIVE
3. DEFINITIONS
4. SCOPE
5. FUNCTIONAL CURRENCY
6. MONETARY VS NON – MONETARY ITEMS
7. ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS
8. USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY
9. TRANSLATION OF FOREIGN OPERATIONS
10. DIFFERENCE IN THE REPORTING DATES
11. INTRA-GROUP TRANSACTIONS

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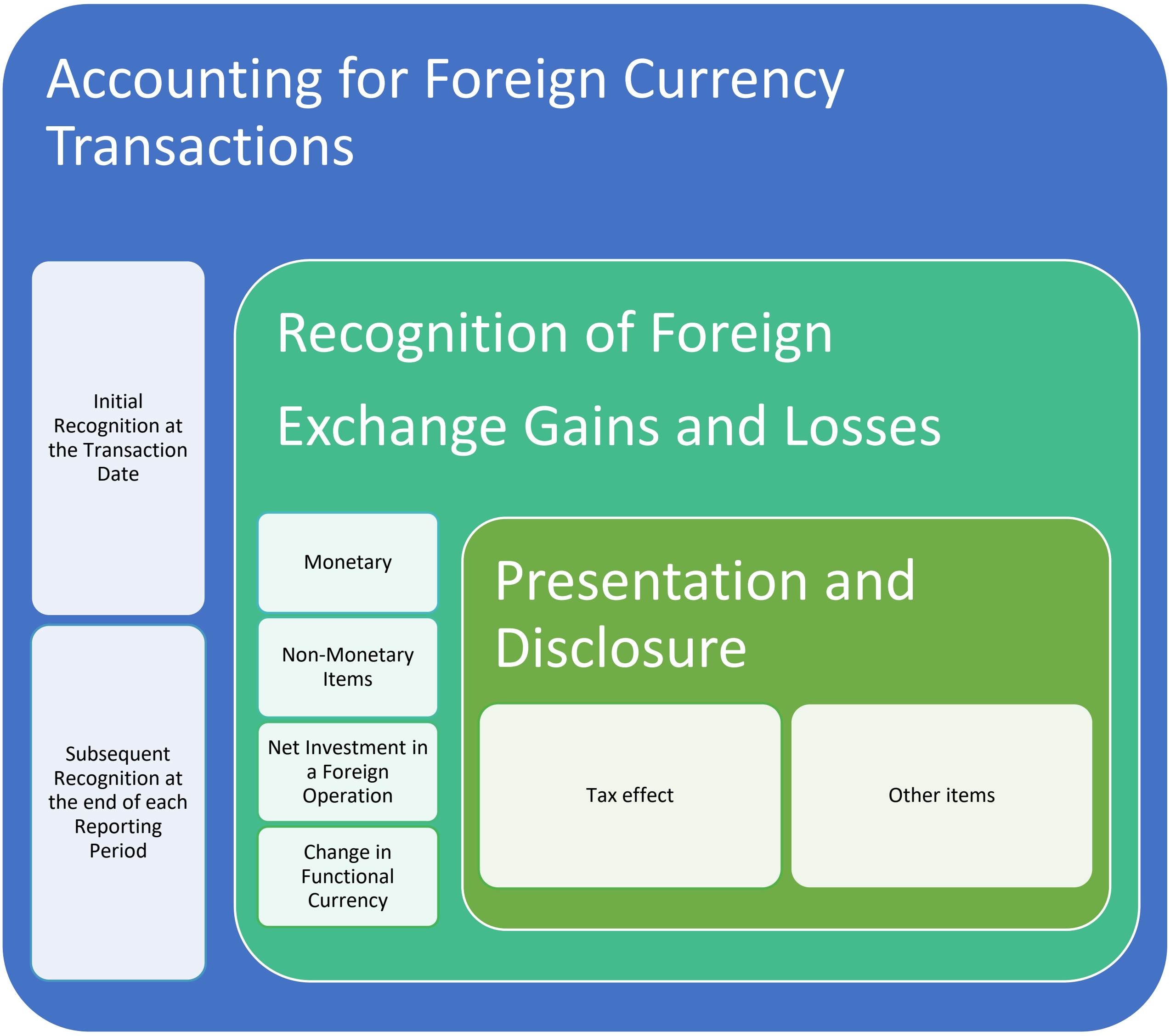
1. INTRODUCTION :



2. OBJECTIVE :

The objective of the Standard is to address the accounting for foreign activities which include:

- transactions in foreign currencies; or
- foreign operations.

Considering that an entity may present its financial statements in a foreign currency, the Standard also seeks to prescribe how to translate financial statements into a presentation currency.

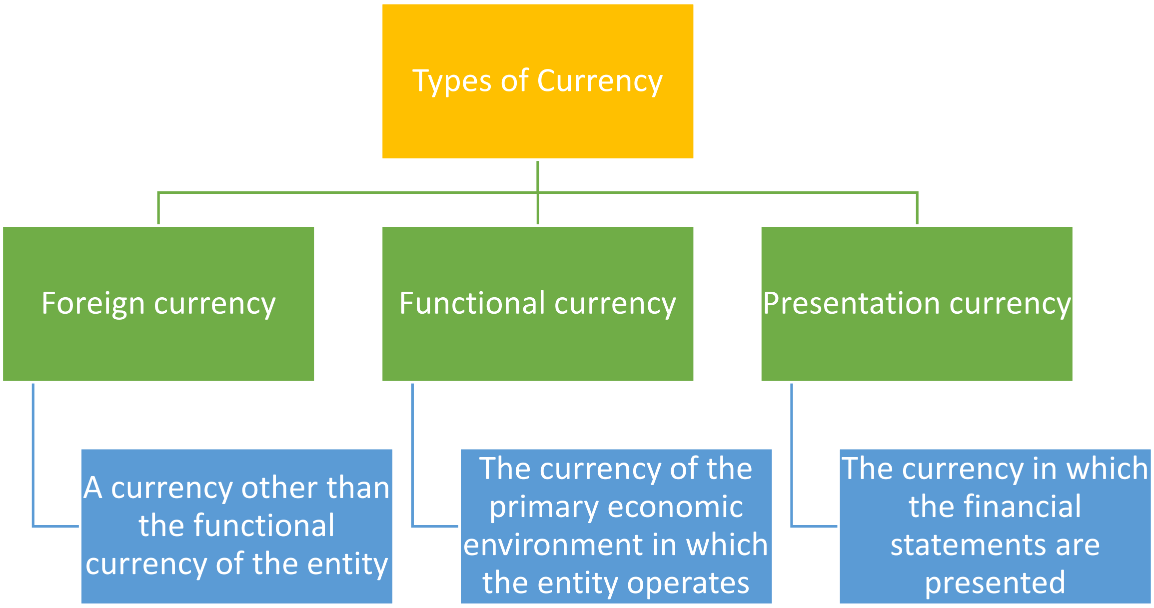
3. DEFINITIONS :

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.



4. SCOPE :

- **Ind AS 21 applies to:**

  (a) in accounting for transactions and balances in foreign currencies, except for derivative transactions and balances covered by Ind AS 109.

  Foreign currency derivatives not covered by Ind AS 109 (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard.The Standard also applies for translation of amounts relating to derivatives from functional currency to presentation currency.

  (b) in translating the results and financial position of foreign operations; and

  (c) in translating an entity's results and financial position into a presentation currency.

- **Ind AS 21 does not apply to :**

  (a) hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation; Ind AS 109 should be applied for hedge accounting;

  (b) presentation of cash flows from transactions in a foreign currency or to translation of cash flows of a foreign operation in the statement of cash flows (refer to Ind AS 7).

- This standard also does not apply to long term foreign currency items for which an entity has opted for the exemption as per Ind AS 101.

Such an entity may continue to apply the accounting policy as opted for such long term foreign currency monetary items.

5. 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.

- If an entity is a foreign operation, additional factors are set out in the Standard which should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:
  (a) whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy.
  If the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it, this will be an example of the former. An example of the latter is when the foreign operations accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency;
  (b) transactions with the reporting entity as a proportion of the foreign operation's activities;
  (c) impact of cash flows from the activities of the foreign operations on the cash flows of the reporting entity and whether such cash flows are readily available for remittance;

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

In practice, the functional currency of a foreign operation that is integral to the group will usually be the same as that of the parent.

- Management will be required to use its judgment to determine the functional currency for which they have to give priority to the primary indicators before considering the other indicators which are designed to provide additional supporting evidence to determine an entity's functional currency.

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.

6. 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

- 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.

7. ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS :

Initial Recognition at the Transaction Date :

- A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency (i.e., a currency other than the functional currency of the entity), including transactions arising when an entity:
  (a) buys or sells goods or services whose price is denominated in a foreign currency;
  (b) borrows or lends funds with amounts denominated in a foreign currency; or
  (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- 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).
- An average exchange rate for a specific period may be used as an approximate rate if the exchange rate does not fluctuate significantly.
- The date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.
- If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

Subsequent Recognition at the end of each Reporting Period :

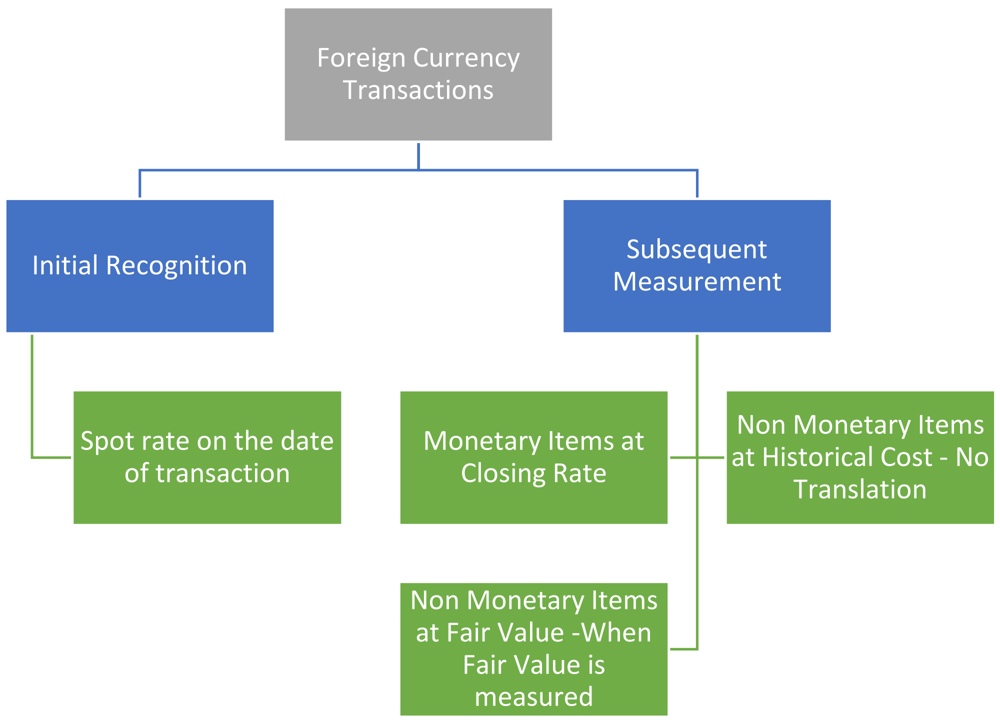
- At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:
  (a) monetary items are translated at the exchange rate at the reporting date i.e., closing rate;
  (b) non-monetary items measured at historical cost are not retranslated and instead remain 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.

- The carrying amount of the item to be translated is determined applying the relevant Accounting Standard.

  For example, property, plant and equipment may be measured at fair value or historical cost as per Ind AS 16, Property, Plant and Equipment.
- The carrying amount so determined, be it on the basis of historical cost or fair value, if in foreign currency, is translated into the functional currency in accordance with this Standard.
- In some cases, the carrying amount of items is determined by comparing two or more amounts e.g.:
  - Inventories - measured at lower of cost and net realisable value.
  - Asset subject to impairment loss - lower of an asset's carrying amount and its recoverable amount.
- If such an asset is non-monetary and measured in a foreign currency, then for the comparison:

  (a) the cost or carrying amount, as appropriate, is translated at the exchange rate at the date when that amount was determined; and

  (b) the net realisable value or recoverable amount, as appropriate, is translated at the exchange rate at the date when that value was determined.
- The above may result in an impairment loss being recognised in the functional currency but not in the foreign currency, or vice versa.
- Where a country has multiple exchange rates, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.



Recognition of Foreign Exchange Gains and Losses :

- When an entity directly enters into foreign currency transactions, it is exposed to the cash flow effects of changes in value of the foreign currency. An entity is required to convert foreign currency items into its functional currency for recording those items in its books of account as per the requirements of this Standard. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. Once recorded, exchange differences will arise where changes in exchange rates affect the recorded balances.
- Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.
- When the transaction occurs and settles within the same accounting period, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference is recognised in each period till settlement date based on change in exchange rates during each period.

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.

  For example, revaluation gain or loss on property, plant and equipment is recognised in other comprehensive income as per Ind AS 16. When such an asset is measured in a foreign currency and its revalued amount is translated as per this Standard using the rate at the date the value is determined, the resulting exchange gain or loss is also 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.

3. Net Investment in a Foreign Operation :

- The Standard defines net investment in a foreign operation as the amount of the reporting entity's interest in the net assets of that operation. A monetary item receivable from or payable to a foreign operation may form part of the net investment in the foreign operation if the settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

- The entity that has the monetary item receivable or payable may be the reporting entity or any subsidiary in the group (i.e., parent and all its subsidiaries). However, an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that operation because an associate is not a group entity.
- Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation have to be recognised in profit or loss in the separate financial statements of the reporting entity and/or the individual financial statements of the foreign operation, as appropriate:
    - If such an item is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements.
    - If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements.
    - If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements.
- In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a subsidiary, associate or joint venture), such exchange differences are recognised initially in other comprehensive income and then reclassified from equity to profit or loss on disposal of the net investment.

Question 5 –

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

Question 6 –

Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where should the exchange differences be recognised?

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:
  - All items are translated into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.
  - Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.
  - Exchange gain or loss from long-term monetary items accumulated in equity (where such option is exercised) are not transferred to profit or loss immediately on change of the entity's functional currency; the balance would be transferred to profit or loss as per the manner provided by the option.
- Since entities prefer to present financial statements in their functional currency, a change in currency functional currency may be accompanied by a change in presentation currency. A change in presentation currency is accounted for as a change in accounting policy.

8. USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY :

- An entity measures items in its financial statements in its functional currency; but it may decide to present its financial statements in a currency or currencies other than its functional currency.

  For example, an entity with INR functional currency may choose to present its financial statements in US Dollar because its primary business is in the United States.
- There can be situations wherein a group comprises operations with a number of functional currencies. Under Ind AS 21, there is no concept of a "group" functional currency. Rather the group has a presentation currency only. Each entity in the group prepares financial statements in its functional currency and translates these financial statements into the group presentation currency (if different) for consolidation purposes.
- The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency as follows:

  (a) assets and liabilities for each balance sheet presented (i.e., including comparatives) are translated at the closing rate at the date of that balance sheet;

  (b) income and expenses are translated at exchange rates at the dates of relevant transactions; weighted average rates may be used if they are a reasonable approximation;

  (c) all resulting exchange differences should be recognised in other comprehensive income as they have little or no direct effect on the present and future cash flows from operations and are presented in a separate component of equity until disposal of the foreign operation.

- When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, an appropriate proportion of the exchange difference arising on translation of the foreign operation must be allocated to the non-controlling interest, if applicable.
- In case of an entity whose functional currency is the currency of a hyperinflationary economy, the translation into a different presentation currency, also being the currency of a hyperinflationary economy, is done by translating all amounts (i.e., assets, liabilities, equity items, income and expenses, including comparatives) at the closing rate at the date of the most recent balance sheet.

9. TRANSLATION OF FOREIGN OPERATIONS :

- The guidance provided on determining an entity's functional currency equally applies to determine the functional currency of a foreign operation of the entity.
- Effectively, the translation procedures those for translating foreign operations are the same as those followed when an entity presents its financial statements in a presentation currency that is different from its functional currency:
  (a) assets and liabilities are translated at the exchange rate at the reporting date;
  (b) items of income and expense are translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;
  (c) the resulting exchange differences are recognised in other comprehensive income and are presented in a separate component of equity (generally referred to as the foreign currency translation reserve or currency translation adjustment) until disposal of the foreign operation; and
  (d) cash flows are translated at exchange rates at the dates of the relevant transactions, although an appropriate average rate may be used.
- In addition to the exchange difference as stated above, the foreign currency translation reserve may include exchange differences arising from loans that form part of the parent's net investment in the foreign operation and gains and losses related to hedges of a net investment in a foreign operation.

10. DIFFERENCE IN THE REPORTING DATES :

When there is difference in the year end of foreign operation and that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When such financial statements are not prepared, Ind AS 27 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. A similar approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with Ind AS 28, Investment in Associates and Joint Ventures.

11. INTRA-GROUP TRANSACTIONS :

- Although intra-group balances are eliminated on consolidation, any related foreign exchange gains or losses will not be eliminated. This is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.

- Accordingly, in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra group transactions is recognised in the statement of profit or loss account unlessit arises from on a monetary item that forms part of a reporting entity's net investment in a foreign operation in which case it is taken to other comprehensive income and accumulated in a separate component of equity and reclassified to profit or loss only on disposal of the foreign operation;

Question 7 –

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements?

12. GOODWILL AND FAIR VALUE ADJUSTMENTS ARISING FROM A BUSINESS COMBINATION:

- Goodwill and fair value acquisition accounting adjustments arising from a business combination are treated as assets and liabilities of the foreign operation.
- Hence they are expressed in the functional currency of the foreign operation and should be translated at the closing exchange rate as is the case for other assets and liabilities.

13. DISPOSAL OR PARTIAL DISPOSAL OF FOREIGN OPERATIONS :

- A disposal may arise, for example, through sale, liquidation or repayment of share capital. On disposal of the foreign operation, the cumulative exchange differences relating to that foreign operation recognised in other comprehensive income and accumulated separately in equity are reclassified to profit or loss (reclassification adjustment) when the gain or loss on disposal is recognised.
- On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the non- controlling interests forms part of the non-controlling interests that is derecognised and is included in the calculation of the gain or loss on disposal, but it is not reclassified to profit or loss.
- In addition to the disposal of an entity's entire interest in a foreign operation, the following are accounted for as disposals even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity:
  - the loss of control of a subsidiary that includes a foreign operation;
  - the loss of significant influence over an associate that includes a foreign operation; and
  - the loss of joint arrangement over a jointly controlled entity that includes a foreign operation.

Example :

Parent P owns 100 percent of subsidiary S. P sells 70 percent of its investment and loses control of S. The entire balance in the foreign currency translation reserve in respect of S is reclassified to profit or loss.

Partial Disposal :

A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except for those reductions that are accounted for as disposals.

In the case of the partial disposal of a subsidiary that includes a foreign operation, the entity reattributes the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the NCI in that foreign operation.

In any other partial disposal of a foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

Example :

Parent P owns 100 percent of subsidiary S. P sells 10 percent of its investment and retains control over S. Therefore, 10 percent of the balance in the foreign currency translation reserve is reclassified to NCI.

Example :

Parent P owns 35 percent of Associate B. P sells a 5 percent stake and retains significant influence over B. Therefore, one-seventh (5/35) of the balance in the foreign currency translation reserve is reclassified to profit or loss.

A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

14. TAX EFFECT OF ALL EXCHANGE DIFFERENCES :

Ind AS 12 applies to tax effects of gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency.

15. DISCLOSURES :

Ind AS 21 requires the following disclosures:

(a) amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109;

(b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, along with the reconciliation of the amount at the beginning and end of the period;

(c) if the presentation currency is different from the functional currency - that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency;

(d) in case of change in functional currency of either the reporting entity or a significant foreign operation:
   (i) fact of such change;
   (ii) reason for the change and;
   (iii) date of change in functional currency;

(e) if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with. However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:
   (i) the information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;
   (j) the currency in which the supplementary information is displayed should be disclosed; and

(iii) the entity's functional currency and the method of translation used to determine the supplementary information should be disclosed.

16. SELF PRACTICE QUESTIONS :

Question 8 – 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 9 – 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 10 – 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 11 – 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 12 – 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 13 – 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 14 – 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 ….

CHAPTER

11

IND AS 33 – EARNING PER SHARE

CONCEPTS COVERED

1. INTRODUCTION
2. OBJECTIVE
3. SCOPE
4. DEFINITIONS
5. MEASUREMENT
6. MEASUREMENT OF BASIC EARNINGS PER SHARE
7. DILUTED EARNINGS PER SHARE
8. RETROSPECTIVE ADJUSTMENTS
9. PRESENTATION
10. ADDITIONAL TOPICS
11. SELF PRACTICE QUESTIONS

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1. INTRODUCTION :

Earnings per share (EPS) is an important measure of the performance of the company. The equity shareholders (ordinary shareholders as per Ind AS 33) invest their money in the entity as owners of the company. They undertake business risks and financial risks along with all allied systematic and non-systematic risks of the company. Naturally they expect a higher than normal return on their investments. EPS is a ratio that is widely used by financial analysts, investors and other users to gauge an entity's profitability and to value its shares. Its purpose is to indicate how effective an entity has been in using the resources provided by the ordinary shareholders, and to assess the entity's current net earnings. EPS also forms the basis for calculating the price-earnings ratio, which is widely used by investors and analysts to value shares.

2. OBJECTIVE :

(i) To prescribe principles for the determination and presentation of earnings per share

(ii) To facilitate performance comparisons between different entities in the same reporting period

(iii) To facilitate performance comparisons between different reporting periods for the same entity

3. SCOPE :

This standard is applicable, i.e. EPS should be disclosed while preparing CFS and SFS. Information to be used should be from respective financial statements

4. DEFINITIONS :

1. An **ordinary share** is an equity instrument that is subordinate to all other classes of equity instruments. Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated. An entity may have more than one class of ordinary shares. Ordinary shares of the same class have the same rights to receive dividend.

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

2. **A potential ordinary share** is a financial instrument or other contract that may entitle its holder to ordinary shares.

   Examples of potential ordinary shares are:

   (a) financial liabilities or equity instruments, including preference shares, that are convertible into ordinary shares;

   (b) options and warrants.

3. **Options, warrants and their equivalents** are financial instruments that give the holder the right to purchase ordinary shares.

4. **Put options** on ordinary shares are contracts that give the holder the right to sell ordinary shares at a specified price for a given period.

5. **Dilution** is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

6. **Antidilution** is an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Example :
ABC Ltd. convert some high-interest debt to ordinary shares. The interest saved (earnings) increases the earnings per share, even allowing for the additional shares in issue.

7. A contingent share agreement is an agreement to issue shares that is dependent on the satisfaction of specified conditions.

Example :
ABC Ltd. has provided staff with share options. If they work for you for 3 years, they will be able to buy shares at a discount. This is a contingent share agreement.

8. Contingently issuable ordinary shares are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions in a contingent share agreement.

Example :
ABC Ltd. buys a XYZ Ltd.'s business in exchange for ABC Ltd.'s shares. If the share price falls by more than 25% in the first 6 months, ABC Ltd. will issue more shares (free) to the vendor, as compensation

5. MEASUREMENT :

Measurement can be divided into following categories:

a. Measurement of Basic Earnings Per Share
   - Measurement of Earnings
   - Measurement of Number of Shares
   - Measurement of Weighted Average number of shares

b. Measurement of Diluted Earnings per share c. Measurement of Earnings for diluted EPS

d. Measurement of Number of Shares for diluted EPS

e. Measurement of Dilutive potential ordinary shares

f. Measurement of Options, warrants and their equivalents

g. Measurement of Convertible Instruments

h. Measurement of Contingently issuable shares

i. Measurement of contracts that may be settled in ordinary shares or cash

j. Measurement of purchased options and written put options

k. Dealing with retrospective adjustments

Let us study these measurements one by one.

6. MEASUREMENT OF BASIC EARNINGS PER SHARE :

6.1 Meaning and Formula :

Meaning :

An entity shall calculate basic earnings per share for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Formula :

$$= \frac{Profit/Loss\ attributable\ to\ Equity\ share\ holders}{Weighted\ average\ number\ of\ Equity\ shares\ outstanding\ during\ the\ period}$$

6.2 Measurement of Earnings :

For the purpose of calculating basic earnings per share, the amounts attributable to ordinary equity holders of the parent entity in respect of

(a) profit or loss from continuing operations attributable to the parent entity; and

(b) profit or loss attributable to the parent entity

- Where any item of income or expense, which is otherwise required to be recognised in profit or loss in accordance with Indian Accounting Standards, is debited or credited to securities premium account/other reserves, the amount in respect thereof shall be deducted from profit or loss from continuing operations for the purpose of calculating basic earnings per share.
- All items of income and expense attributable to ordinary equity holders of the parent entity that are recognised in a period, including tax expense and dividend on preference shares classified as liabilities are included in the determination of profit or loss for the period attributable to ordinary equity holders of the parent entity (see Ind AS 1).
- The amount of dividends declared in respect of the year should be deducted in arriving at the profit attributable to ordinary shareholders for preference dividends that are non-cumulative.
- The dividend for the period should be taken into account, whether or not it has been declared for cumulative preference dividends. If an entity is unable to pay or declare a cumulative preference dividend, the undeclared amount of the cumulative preference dividend (net of tax, if applicable) should still be deducted in arriving at earnings for the purpose of the EPS calculation. The amount paid is not deducted in arriving at earnings for the purpose of the EPS calculation in the period in which arrears of cumulative preference dividends are paid.
- Preference shares that provide for a low initial dividend to compensate an entity for selling the preference shares at a discount, or an above-market dividend in later periods to compensate investors for purchasing preference shares at a premium, are sometimes referred to as increasing rate

preference shares. Any original issue discount or premium on increasing rate preference shares is amortised to retained earnings using the effective interest method and treated as a preference dividend for the purposes of calculating earnings per share (irrespective of whether such discount or premium is debited or credited to securities premium account in view of requirements of any law).

6.2.1 Redemption/Repurchase of preference shares at premium :

Preference shares may be repurchased under an entity's tender offer to the holders. The excess of the fair value of the consideration paid to the preference shareholders over the carrying amount of the preference shares represents a return to the holders of the preference shares and a charge to retained earnings for the entity. This amount is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity.

Example :

ABC Ltd. had issued preference shares at Rs.100 each 10 years ago. Now ABC Ltd. buy backs the shares for Rs.120 each. Rs.20 premium for each share is charged to retained earnings. No amount is recorded in the statement of profit and loss for this transaction. However, for EPS purposes, Rs 20 for each share is charged to the statement of profit or loss for the period of the transaction.

6.2.2 Early conversion of Preference shares at premium :

Early conversion of convertible preference shares may be induced by an entity through favourable changes to the original conversion terms or the payment of additional consideration. The excess of the fair value of the ordinary shares or other consideration paid over the fair value of the ordinary shares issuable under the original conversion terms is a return to the preference shareholders, and is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity.

6.3 Shares :

For the purpose of calculating basic earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares outstanding during the period.

The weighted average number of ordinary shares outstanding during the period is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor.

The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

6.3.1 Deciding the date for issue of shares :

Shares are usually included in the weighted average number of shares from the date consideration is receivable (which is generally the date of their issue)

6.3.2 Contingently issuable shares :

- Contingently issuable shares are treated as outstanding and are included in the calculation of basic earnings per share only from the date when all necessary conditions are satisfied (i.e. the events have occurred).
- Shares that are issuable solely after the passage of time are not contingently issuable shares, because the passage of time is a certainty.
- Outstanding ordinary shares that are contingently returnable (ie subject to recall) are not treated as outstanding and are excluded from the calculation of basic earnings per share until the date the shares are no longer subject to recall.

Example :

ABC Ltd. buys a company for shares in 2011. If the profits for calendar years 2011 and 2012 meet budget, ABC Ltd. will issue more shares to the vendor in February 2013. These additional shares will be included in the weighted-average calculation from 1 January 2013 (considering reporting date as December end), if the targets are met.

6.3.3 Change in the number of shares without change in value of capital :

Ordinary shares may be issued, or the number of ordinary shares outstanding may be reduced, without a corresponding change in resources. Examples include:

(a) a capitalisation or bonus issue (sometimes referred to as a stock dividend);

(b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;

(c) a share split; and

(d) a reverse share split (consolidation of shares).

6.3.4 Rights issues :

$$= \frac{Fair\ value\ per\ share\ immediately\ before\ the\ exercise\ of\ rights}{Theoretical\ ex{-}rights\ fair\ value\ per\ share}$$

where,

Theoretical ex-rights fair value per share

$$= \frac{Fair\ value\ of\ all\ outstanding\ shares\ before\ exercise\ of\ right + Total\ amount\ received\ from\ exercise\ of\ rights}{No\ of\ shares\ outstanding\ before\ exercise + No\ of\ shares\ issued\ in\ exercise}$$

Question 1 – (Dividend to Preference based on EIR)

Calculate Basic EPS for RM Limited from the following information

1.	No of shares		100 lakhs
2.	8% cumulative preference shares		
	a.	Face Value	Rs. 100 each
	b.	Issued at	Rs. 92 each
	c.	Maturity	5 years
	d.	Date of issue	1/4/17
	e.	Number of shares of issue	10 lakhs
	f.	EIR	10.12 %
	g.	Dividend Distribution Tax	17%
3.	PAT		280 lakhs

Question 2 – (Premium on Redemption)

RM Ltd. issues 10000 11% preference shares of Rs.100 each @ 102 each. Other details are as follows

Maturity	5 years
Dividend Distribution Tax	17%
EIR	10.47 %
PAT	3,00,000
No of equity shares	1,00,000

RM Ltd redeems the preference shares early at year end @ Rs.104.

Calculate Basic EPS?

Question 3 – An entity

An entity has following preference shares in issue at the end of 2014:

- 5% redeemable, non-cumulative preference shares: These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – Rs.100,000.
- Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 2010, with a cumulative dividend rate from 2015 of 10%: The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 2015. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, Rs.18,000. These shares are classified as equity – Rs.200,000.
- 8% non-redeemable, non-cumulative preference shares: At the beginning of the year, the entity had Rs.100,000 8% preference shares outstanding but, at 30

June 2014, it repurchased Rs.50,000 of these at a discount of Rs.1,000 – Rs.50,000.

- 7% cumulative, convertible preference shares (converted in the year): These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of Rs.300 – Nil.

The profit attributable to ordinary equity holders for the year 2014 is Rs.150,000. Determine the adjustments for the purpose of calculating EPS.

Question 4 – ABC Ltd.

ABC Ltd. issues 9% preference shares of fair value of Rs.10 each on 1.4.2011. Total value of the issue is Rs.10,00,000. The shares are issued for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at Rs.11 each.

At the end of the year 3, i.e. on 31.3.2014, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at Rs.12 each instead of original agreement of Rs.11. Comment on the earnings for the year 2013-2014. Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.

Question 5 – A (Fresh issue and Buy Back)

Calculate EPS for 2017-18 and 2018-19 from the following information

Shares outstanding on 1/4/17	100 lakhs
Fresh Issue on 1/10/17	100 lakhs
Buy back 1/10/2018	20 lakhs
PAT (2017-18)	1000 lakhs
PAT (2018-19)	1300 lakhs

Question 6 – XYZ

Following is the data for company XYZ in respect of number of equity shares during the financial year 2011-2012. Find out the number of shares for the purpose of calculation of basic EPS as per Ind AS 33.

No.	Date	Particulars	No of shares

1	1/4/2011	Opening balance of outstanding equity shares	100,000
2	15/6/2011	Issue of equity shares	75,000
3	8/11/2011	Conversion of convertible preference shares in Equity	50,000
4	22/2/2012	Buy back of shares	(20,000)
5	31/3/2012	Closing balance of outstanding equity shares	205,000

Question 7 – (Bonus Issue)

PAT for 17/18	Rs.60,00,000
PAT for 18/19	Rs.75,00,000
No of shares on 31/12/18	1,50,000 shares
Bonus on 1/1/19	1 : 2

Calculate basic EPS for 17/18 and 18/19.

Question 8 –

On 31 March, 2012, the issued share capital of a company consisted of Rs.100,000,000 in ordinary shares of Rs.25 each and Rs.500,000 in 10% cumulative preference shares of Re 1 each. On 1 October, 2012, the company issued 1,000,000 ordinary shares fully paid by way of capitalization of reserves in the proportion 1:4 for the year ended 31 March, 2013.

Profit for 2011-2012 and 2012-2013 is Rs.450,000 and Rs.550,000 respectively.

Calculate the basic EPS for 2011-2012 and 2012-2013.

Question 9 – X Ltd.

X Ltd.

1 January	1,000,000 shares in issue
28 February	Issued 200,000 shares at fair value
31 August	Bonus issue 1 share for 3 shares held
30 November	Issued 250,000 shares at fair value

Calculate the number of shares which would be used in the basic EPS calculation. Consider reporting date as December end.

Question 10 – (Bonus Issue)

PAT for 17/18	Rs.10,00,000
PAT for 18/19	Rs.12,00,000
No of shares on 1/4/17	10,000 shares

Issue 1/1/18	5000 shares for cash
Issue 1/7/18	3000 shares for cash
Bonus on 1/12/18	1 : 1

Calculate basic EPS for 17/18 and 18/19

Question 11 – (Bonus Issue)

No of shares on 1/1/18	10,000 shares
Issue on 1/4/18	2,000 Bonus
Issue on 1/7/18	2,000 for cash
Issue on 1/10/18	3,000 Bonus

Calculate No of shares.

Question 12 –

At 31 December 2011, the issued share capital of a company consisted of 1.8 million ordinary shares of Rs.10 each, fully paid. The profits for the year ended 31 December 2011 and 2012 amounted to Rs.630,000 and Rs.875,000 respectively. On 31 March 2012, the company made a rights issue on a 1 for 4 basis at Rs.30. The market price of the shares immediately before the rights issue was Rs.60. Calculate EPS.

Question 13 – (Right Issue)

Calculate Basic EPS from the following information

No of shares at the beginning	1,00,000 shares
Right issue (After 3 months)	Ratio 1 : 5 @ 20
Fair Value before right issue	Rs.30
PAT for current year	18,00,000
PAT for Previous Year	14,00,000

Question 14 – (Stock Split)

Calculate EPS from the following information

PAT for Current Year	Rs.10,00,000
PAT for Previous Year	Rs.5,00,000
No of shares on 1/4/17	1,00,000 shares

Split on 1/11/17 in the ratio of 10 : 1

Deciding the date for issue of shares

Shares are usually included in the weighted average number of shares from the date consideration is receivable (which is generally the date of their issue), for example:

Situation of issuance of ordinary shares	Ordinary shares are included in the weighted average number of shares from the date
When issued in exchange for cash	When cash is receivable
When issued on voluntary reinvestment of dividends (on ordinary or preference shares)	When dividends are reinvested
When issued as a result of conversion of a debt instrument to ordinary shares	When Interest ceases to accrue
Issued in place of interest or principal on other financial instruments	When Interest ceases to accrue
Issued in exchange for the settlement of a liability	On settlement date
Issued as consideration for the acquisition of an asset other than cash	When the acquired asset is recognised
Issued for rendering of services to the entity	When the services are rendered
Issued as a part of the consideration transferred in a business combination	From the date of acquisition
Issued upon the conversion of a mandatorily convertible instrument	From the date of entering into the contract

7. DILUTED EARNINGS PER SHARE :

7.1 SCOPE, MEANING AND FORMULA :

- An entity shall calculate diluted earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.
- For the purpose of calculating diluted earnings per share, an entity shall adjust profit or loss attributable to ordinary equity holders of the parent entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.
- Dilution is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Example :
One may convert some low interest debt to ordinary shares. The interest saved (earnings) decreases the earnings per share, as the additional shares in issue increase substantially.

- Potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares. Contracts that might result in the issue of ordinary shares of the entity to the holder of the contract, at the option of the issuer or the holder, are potential ordinary shares.

Example
ABC & Co has issued preference shares with the option to convert these into an equal no of ordinary shares in 2 years' time. They represent potential ordinary shares, even though you do not know whether the holders will convert them (it will depend on the prices of each class of share at the time). If the price of the ordinary share is higher than that of the preferred share, the holders will convert, and will make a profit. If the price is lower, they will not.

- The objective of diluted earnings per share is consistent with that of basic earnings per share—to provide a measure of the interest of each ordinary share in the performance of an entity—while giving effect to all dilutive potential ordinary shares outstanding during the period. As a result:
  - ✓ profit or loss attributable to ordinary equity holders of the parent entity is increased by the after-tax amount of dividend and interest recognised in the period in respect of the dilutive potential ordinary shares and is adjusted for any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares; and
  - ✓ the weighted average number of ordinary shares outstanding is increased by the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

The formula can be mathematically expressed as follows:

$$\frac{\text{Profit/Loss attributable to Equity share holders when dilutive potential shares are converted into ordinary shares}}{\text{Weighted average number of Equity shares + Weighted average number of dilutive potential ordinary shares}}$$

7.2 EARNINGS :

- For the purpose of calculating diluted earnings per share, an entity shall adjust profit or loss attributable to ordinary equity holders of the parent entity, by the after-tax effect of:
  - (a) any dividend or other items related to dilutive potential ordinary shares is deducted in arriving at profit or loss attributable to ordinary equity holders of the parent entity;
  - (b) any interest recognised in the period related to dilutive potential ordinary shares; and
  - (c) any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.
- After the potential ordinary shares are converted into ordinary shares, the new ordinary shares are entitled to participate in profit or loss attributable to ordinary equity holders of the parent entity. Therefore, profit or loss attributable to ordinary equity holders of the parent entity is adjusted for the items and any related taxes. The expenses associated with potential ordinary shares include transaction costs and discounts accounted for in accordance with the effective interest method (see Ind AS 109).

7.3 SHARES :

7.3.1 Base for calculation :

For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares.

7.3.2 Calculation of Weighted average to be done independently for every period :

- Dilutive potential ordinary shares shall be determined independently for each period presented. The number of dilutive potential ordinary shares included in the year-to-date period is not a weighted average of the dilutive potential ordinary shares included in each interim computation.
- Potential ordinary shares are weighted for the period they are outstanding. Potential ordinary shares that are cancelled or allowed to lapse during the period are included in the calculation of diluted earnings per share only for the portion of the period during which they are outstanding. Potential ordinary shares that are converted into ordinary shares during the period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the

resulting ordinary shares are included in both basic and diluted earnings per share.

- All potential ordinary shares are assumed converted into ordinary shares at the beginning of the period or, if not in existence at the beginning of the period, at the date of issue of the potential ordinary shares. The date of issue is the date the financial instrument was issued or the granting of the rights by which they are generated. This is sometimes referred to as the 'if converted' method.
- The conversion into ordinary shares should be determined from the terms of the financial instrument or the rights granted. This determination should assume the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential ordinary shares.
- Only potential ordinary shares that are dilutive are considered in the calculation of diluted EPS. Potential ordinary shares should be treated as dilutive only when their conversion to ordinary shares would decrease profit per share or increase loss per share from continuing operations attributable to ordinary equity holders.
- The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS. An entity might have a number of different types of potential ordinary shares in issue. Each one would need to be considered separately rather than in aggregate.
- Convertible preference shares are dilutive where the amount of dividend on such shares, declared or accrued in the period per ordinary share obtainable on conversion, is below basic EPS for continuing operations. If the amount exceeds basic EPS, the convertible preference shares are anti-dilutive.

7.3.3 EMPLOYEE STOCK OPTIONS :

Employee share options with fixed or determinable terms and non-vested ordinary shares are treated as options in the calculation of diluted earnings per share, even though they may be contingent on vesting. They are treated as outstanding on the grant date. Performance-based employee share options are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.

7.3.4 CONVERTIBLE INSTRUMENTS :

- The dilutive effect of convertible instruments shall be reflected in diluted earnings per share.
- Convertible preference shares are antidilutive whenever the amount of the dividend on such shares declared in or accumulated for the current period per ordinary share obtainable on conversion exceeds basic earnings per share. Similarly, convertible debt is antidilutive whenever its interest (net of tax and other changes in income or expense) per ordinary share obtainable on conversion exceeds basic earnings per share.
- The redemption or induced conversion of convertible preference shares may affect only a portion of the previously outstanding convertible preference

shares. In such cases, any excess consideration is attributed to those shares that are redeemed or converted for the purpose of determining whether the remaining outstanding preference shares are dilutive. The shares redeemed or converted are considered separately from those shares that are not redeemed or converted.

7.3.5 CONTINGENTLY ISSUABLE SHARES :

- As in the calculation of basic earnings per share, contingently issuable ordinary shares are treated as outstanding and included in the calculation of diluted earnings per share if the conditions are satisfied (i.e. the events have occurred). Contingently issuable shares are included from the beginning of the period (or from the date of the contingent share agreement, if later). If the conditions are not satisfied, the number of contingently issuable shares included in the diluted earnings per share calculation is based on the number of shares that would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires.
- If attainment or maintenance of a specified amount of earnings for a period is the condition for contingent issue and if that amount has been attained at the end of the reporting period but must be maintained beyond the end of the reporting period for an additional period, then the additional ordinary shares are treated as outstanding, if the effect is dilutive, when calculating diluted earnings per share. In that case, the calculation of diluted earnings per share is based on the number of ordinary shares that would be issued if the amount of earnings at the end of the reporting period were the amount of earnings at the end of the contingency period. Because earnings may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares until the end of the contingency period because not all necessary conditions have been satisfied.
- The number of ordinary shares contingently issuable may depend on the future market price of the ordinary shares. In that case, if the effect is dilutive, the calculation of diluted earnings per share is based on the number of ordinary shares that would be issued if the market price at the end of the reporting period were the market price at the end of the contingency period. If the condition is based on an average of market prices over a period of time that extends beyond the end of the reporting period, the average for the period of time that has lapsed is used. Because the market price may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares until the end of the contingency period because not all necessary conditions have been satisfied.
- The number of ordinary shares contingently issuable may depend on future earnings and future prices of the ordinary shares. In such cases, the number of ordinary shares included in the diluted earnings per share calculation is based on both conditions (i.e. earnings to date and the current market price at the end of the reporting period). Contingently issuable ordinary shares are

not included in the diluted earnings per share calculation unless both conditions are met.

7.3.6 CONTRACTS THAT MAY BE SETTLED IN ORDINARY SHARES OR CASH :

- When an entity has issued a contract that may be settled in ordinary shares or cash at the entity's option, the entity shall presume that the contract will be settled in ordinary shares, and the resulting potential ordinary shares shall be included in diluted earnings per share if the effect is dilutive.
- When an issued contract that may be settled in ordinary shares or cash at the entity's option may give rise to an asset or a liability, or a hybrid instrument with both an equity and a liability component under Ind AS 32, the entity should adjust the numerator (profit or loss attributable to ordinary equity holders) for any changes in the profit or loss that would have resulted during the period if the contract had been classified wholly as an equity instrument.
- For contracts that may be settled in ordinary shares or cash at the holder's option, the more dilutive of cash settlement and share settlement shall be used in calculating diluted earnings per share.

Question 15 – Entity A

Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax. Entity A's results for 20X2 showed a profit before tax of Rs.80,000 and a profit after tax of ` 64,000 (for simplicity, a tax rate of 20% is assumed in this example). Calculate Earnings for the purpose of diluted EPS.

Question 16 – ABC Ltd.

ABC Ltd. has 1,000,000 Rs.1 ordinary shares and 1,000 Rs.100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period. ABC Ltd.'s share price is Rs.4.50 per share and earnings for the period are Rs.500,000. The tax rate applicable to the entity is 21%. Calculate earnings per incremental share for the convertible bonds.

Question 17 – (Convertible Debentures)

	Situation 1	**Situation 2**
PAT 2016 – 17	7,50,000	7,50,000
No	1,50,000	1,50,000
EPS	5	5
No of convertible debentures of Rs.100 each	10,000	10,000
Conversion Ratio	3 : 2	1 : 2

No of Shares on conversion	15,000	5,000
Interest	1,00,000	1,00,000
Income Tax (35%)	35,000	35,000

Question 18 –

At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of Rs.1 each. On 1 October 20X1, the entity issued Rs.1,250,000 of 8% convertible loan stock for cash at par. Each Rs.100 nominal of the loan stock may be converted, at any time during the years ended 20X6 to 20X9, into the number of ordinary shares set out below:

30 June 20X6: 135 ordinary shares;
30 June 20X7: 130 ordinary shares;
30 June 20X8: 125 ordinary shares; and
30 June 20X9: 120 ordinary shares.

If the loan stocks are not converted by 20X9, they would be redeemed at par. There are two different ways of assessing these instruments under Ind AS 32: the conversion option, to convert to a number of shares which varies only with time, could be viewed as either an option to convert to a variable or a fixed number of shares and recognised as either a liability or equity respectively.

This illustration assumes that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of Rs.2,500 and Rs.2,650 respectively. It is assumed that there are no tax consequences arising from these losses.

The profit before interest, fair value movements and taxation for the year ended 30 June 20X2 and 20X3 amounted to Rs.825,000 and Rs.895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%. Calculate Basic and Diluted EPS.

Question 19 – RM - A (Shares issued at less than FV)

RM has given option to its employee to subscribe 1,00,000 Equity shares @ 15 each within a period of 1 year. Fair value = Rs.25 at present.

The company has 5,00,000 Equity shares O/S and NP of current year is Rs.16,00,000. Calculate Basic and Diluted EPS from the following information.

Question 20 –

At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of Rs.25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at Rs.70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax,

attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to Rs.500,000 and Rs.600,000 respectively (wholly relating to continuing operations).
Average market price of share: Year ended 31 December 20X7 = Rs.120 Year ended 31 December 20X8 = Rs.160 Calculate basic and diluted EPS.

Question 21 – Effects of share options on diluted earnings per share

Profit attributable to ordinary equity holders of the parent entity for year 20X1	Rs.1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	Rs.20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	Rs.15.00

Calculate basic and diluted EPS.

Question 22 – RM Limited - (Hierarchy of dilution)

RM Limited has provided the following information for your reference. Calculate Basic and Diluted EPS from the given information

1. No of shares outstanding at the beginning 10,00,000
2. Fair value = Rs.75
3. Net Profit = Rs.35,00,000
4. Potential Equity
    A. 1,00,000 10% Preference shares of Rs.100 converted into 2 equity
    B. Option to buy 2,50,000 shares @ 60 each
    C. 2,00,000 12% convertible debentures convertible into 3 shares
5. Dividend tax 10%
6. Income tax 30%

Question 23 – RM Limited - (Contingently Issuable Shares)

On 1/4/18 RM Ltd offers 10 shares as ESOP to each employee if PAT of 18/19 exceeds Rs.5000 crores.
Shares on ESOP shall be issued on 31/12/19.
As on 31/3/19 PAT is 5100 crores. Shares to be issued on ESOP works out to be 50 lakhs shares.
Shares outstanding on 31/3/16 = 100. Calculate Basic EPS.

Question 24 –

Ordinary shares outstanding during 20X1	1,000,000 (there were no options, warrants or convertible instruments outstanding during the period)

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

5,000 additional ordinary shares for each new retail site opened during 20X1

1,000 additional ordinary shares for each Rs.1,000 of consolidated profit in excess of Rs.2,000,000 for the year ended 31 December 20X1

Retail sites opened during the year	:	one on 1 May 20X1
		one on 1 September 20X1

Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:

Rs.1,100,000 as of 31 March 20X1

Rs.2,300,000 as of 30 June 20X1

Rs.1,900,000 as of 30 September 20X1 (including a Rs.450,000 loss from a discontinued operation)

Rs.2,900,000 as of 31 December 20X1

Calculate basic and diluted EPS.

Question 25 – An entity

An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of Rs.1,000 per bond, giving total proceeds of Rs.2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is Rs.3. Income tax is ignored.

Calculate basic and diluted EPS when

Profit attributable to ordinary equity holders of the parent entity Year 1 Rs.1,000,000

Ordinary shares outstanding 1,200,000

Convertible bonds outstanding 2,000

8. RETROSPECTIVE ADJUSTMENTS

- Diluted EPS of any prior period presented should not be restated for changes in the assumptions used (such as for contingently issuable shares) or for the conversion of potential ordinary shares (such as convertible debt) outstanding at the end of the previous period. These factors are already taken into account in calculating the basic and, where applicable, the diluted EPS for the current period. Prior period's EPS data should be restated for the effects of errors and adjustments resulting from changes to accounting policies accounted for retrospectively.

- Basic and diluted EPS figures for the current period and for prior periods should include bonus issues, share splits, share consolidations and other similar events occurring during the period that change the number of shares in issue without a corresponding change in the resources of the entity (that is, retrospective application).

9. PRESENTATION :

- An entity shall present in the statement of profit and loss basic and diluted earnings per share for profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity and for profit or loss attributable to the ordinary equity holders of the parent entity for the period for each class of ordinary shares that has a different right to share in profit for the period. An entity shall present basic and diluted earnings per share with equal prominence for all periods presented.
- Earnings per share is presented for every period for which a statement of profit and loss is presented. If diluted earnings per share is reported for at least one period, it shall be reported for all periods presented, even if it equals basic earnings per share. If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line in the statement of profit and loss.
- If company does not have any potential ordinary shares, then company's basic and diluted EPS will be same. In such case company need not mention Basic EPS and Diluted EPS separately on two different lines. It can just mention on one line

	20X1	20X0
Basic and Diluted EPS	3.60	2.45

- An entity that reports a discontinued operation shall disclose the basic and diluted amounts per share for the discontinued operation either in the statement of profit and loss or in the notes. An entity shall present basic and diluted earnings per share, even if the amounts are negative (ie a loss per share).

10. ADDITIONAL TOPICS :

10.1 PARTICIPATING EQUITY INSTRUMENTS AND TWO-CLASS ORDINARY SHARES :

- The equity of some entities includes:
  - (a) instruments that participate in dividend with ordinary shares according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share).
  - (b) a class of ordinary shares with a different dividend rate from that of another class of ordinary shares but without prior or senior rights.
- For the purpose of calculating diluted earnings per share, conversion is assumed for those instruments that are convertible into ordinary shares if the effect is dilutive. For those instruments that are not convertible into a class of ordinary shares, profit or loss for the period is allocated to the different classes of shares and participating equity instruments in accordance with their dividend rights or other rights to participate in undistributed earnings. To calculate basic and diluted earnings per share:

(a) profit or loss attributable to ordinary equity holders of the parent entity is adjusted (a profit reduced and a loss increased) by the amount of dividend declared in the period for each class of shares and by the contractual amount of dividend (or interest on participating bonds) that must be paid for the period (for example, unpaid cumulative dividend).

(b) the remaining profit or loss is allocated to ordinary shares and participating equity instruments to the extent that each instrument shares in earnings as if all of the profit or loss for the period had been distributed. The total profit or loss allocated to each class of equity instrument is determined by adding together the amount allocated for dividend and the amount allocated for a participation feature.

(c) the total amount of profit or loss allocated to each class of equity instrument is divided by the number of outstanding instruments to which the earnings are allocated to determine the earnings per share for the instrument.

- For the calculation of diluted earnings per share, all potential ordinary shares assumed to have been issued are included in outstanding ordinary shares.

10.2 PARTLY PAID SHARES :

- Where ordinary shares are issued but not fully paid, they are treated in the calculation of basic earnings per share as a fraction of an ordinary share to the extent that they were entitled to participate in dividend during the period relative to a fully paid ordinary share.
- To the extent that partly paid shares are not entitled to participate in dividend during the period they are treated as the equivalent of warrants or options in the calculation of diluted earnings per share. The unpaid balance is assumed to represent proceeds used to purchase ordinary shares. The number of shares included in diluted earnings per share is the difference between the number of shares subscribed and the number of shares assumed to be purchased.

11. SELF PRACTICE QUESTIONS :

Question 26 – (Different Class of shares)

Calculate EPS for both the class of shares from the following information

Type A : No of shares with voting rights	3000 shares (FV 100)
Type B : No of shares without voting rights	2000 shares (FV 100)

Shares without voting rights shall receive 50% more dividend than type A shares

PAT	Rs.1,40,000

Question 27 – An entity

An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares
- 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of Rs.5 per share before any dividends are paid on the ordinary shares. Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above Rs.2 at a rate of 50% of any additional dividend payable on an ordinary share.
The entity's profit for the year is Rs.100,000, and dividends of Rs.2 per share are declared on the ordinary shares.
Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Question 28 –

(This illustration does not illustrate the classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32).

Profit attributable to equity holders of the parent entity	Rs.100,000
Ordinary shares outstanding	10,000
Non-convertible preference shares	6,000
Non-cumulative annual dividend on preference shares	
(before any dividend is paid on ordinary shares)	Rs.5.50 per share

After ordinary shares have been paid a dividend of Rs.2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares.
Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares

Question 29 – (Paid up values)

Calculate Basic EPS from the following information

PAT	Rs.10,00,000
1/4/18	16500 FV 10 PU 7
1/7/18	10000 FV 10 PU 6
1/10/18	Calls received from 16400 shares @ 3 / share
1/11/18	Calls received from 10000 shares @ 4 / share

Question 30 – An entity

An entity issues 100,000 ordinary shares of Re 1 each for a consideration of Rs 2.50 per share. Cash of Rs.1.75 per share was received by the balance sheet date. The partly paid shares are entitled to participate in dividends for the period in proportion to the amount paid. Calculate number of shares for calculation of Basic EPS.

Question 31 – (EPS FOR SFS AND CFS)

On 31/3/18 RM holds 60% for Nish Ltd. Calculate Basic and Diluted EPS from the following information

	RM Ltd.	Nish Ltd.
PAT	130	30
No	5	2
Potential Equity	0.2	0.1

Question 32 – (Put option – Potential No)

Suppose an entity has entered into PUT option on 10,000 shares at exercise Price of Rs.100. Market Price = Rs.90. Find out Potential shares.

Question 33 – (Call Option – Potential No)

Suppose an entity has entered into call option on 10,000 shares at exercise price of Rs.100 @ 110. Calculate Potential Shares

Question 34 – RM Ltd. (Call Option – Potential No)

RM Ltd has outstanding 10,000 written put option on its ordinary shares with an exercise price of Rs.100. The average market price of its ordinary shares for the period is Rs..78. Find potential shares.

Thanks ....

CHAPTER

12

IND AS 7 – CASH FLOW STATEMENT

CONCEPTS COVERED

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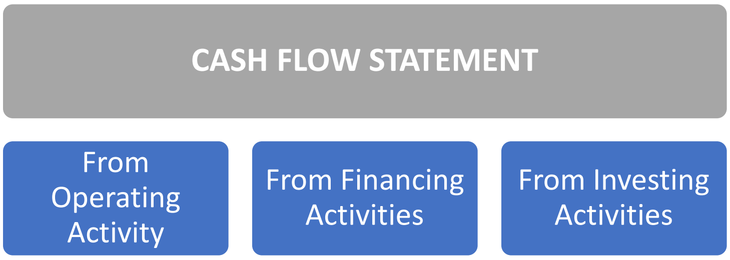
1. INTRODUCTION :

The balance sheet is a snapshot of entity's financial resources and obligations at a particular point of time and the statement of profit and loss reflects the financial performance for the period. These two components of financial statements are based on accrual basis of accounting. The statement of cash flows includes only inflows and outflows of cash and cash equivalents; it excludes transactions that do not affect cash receipts and payments.

2. MEANING :

Cash flow statement, in simple words is a statement, which provides the details about how the cash is generated by an entity during the particular reporting period and how it is applied.



3. OBJECTIVE :

1. To provide information about historical changes in cash and cash equivalents
2. To assess the ability to generate cash and cash equivalents
3. To understand the timing and certainty of their generation

4. BENEFIT OF CASH FLOW STATEMENT

1. Provides information enabling evaluation of changes in net assets and financial structure (Liquidity and solvency)
2. Assesses the ability to manage the cash
3. Assess and compare the present value of future cash flows
4. Compares the efficiency of different entities

5. SCOPE

An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

The Standard requires all entities to present a statement of cash flows.

Every organisation, whether it is small or big in size, whether it's a manufacturing organisation or trading concern or service organisation, needs cash for running its business. The cash is also needed for future investments. Cash would be needed for payment of dividends, repayment of loans as well. Thus any organisation is required to generate the cash and utilises cash continuously.

Banks and Financial institutions are also not an exception to the same. Even if they deal with financial products, accept deposits and give loans day in and day out, they need to generate the cash profit for their own organisation. They need to make investments in terms of new branches, set ups etc. Thus statement of cash flow is equally important for Banking and Financial Institutions as well.

6. DEFINITIONS :

The following terms are used in this Standard with the meanings specified:

1. Cash comprises cash on hand and demand deposits.
2. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
3. Cash flows are inflows and outflows of cash and cash equivalents.
4. Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
5. Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
6. Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

7. CASH AND CASH EQUIVALENTS

Cash Equivalent means investments which can be realised easily in cash in a short period from the date of investing the same.

1. **Purpose :** Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.
2. **Liquidity and Risk :** For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.
3. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents.

   For example, preference shares acquired within a short period of their maturity and with a specified redemption date.
4. Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.
5. **Cash Management :** Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Question 1 –

Company has provided the following information regarding the various assets held by company on 31st March 2011. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provided in Ind AS 7:

Sr No.	Name of Security	Additional Information
1	Government Bonds	5%, open ended, main purpose was to park the excess funds for temporary period
2.	Fixed deposit with SBI	12%, 3 years maturity on 1st Jan 2014
3.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30.06.2011
4.	Redeemable Preference shares in ABC ltd	The redemption is due on 30th April 2011
5.	Cash balances at various banks	All branches of all banks in India
6.	Cash balances at various banks	All international branches of Indian banks
7.	Cash balances at various banks	Branches of foreign banks outside India
8	Bank overdraft of SBI Fort branch	Temporary overdraft, which is payable on demand
9	Treasury Bills	90 days maturity

8. PRESENTATION OF STATEMENT OF CASH FLOWS :

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

Operating Activity :

Operating Cash Inflows	Operating Cash Outflows
Cash receipts from the sale of goods and the rendering of services	Cash payments to suppliers for goods and services
Cash receipts from royalties, fee, commission and other revenue	Cash payments to and on behalf of employees
Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits	Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
Cash receipts and payments from contracts held for dealing or trading purposes	

Question 2 –

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

No.	Nature of Transactions
1	Receipt from sale of mobile phones
2	Purchases of mobile phones from various companies
3	Employees expenses paid

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

Certain Specific Issues :

1. **Profit / Loss on Sale of Assets :** Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities.
2. **Properties built for let out :** Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.
3. **Operations of Financial companies and Banks :** An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue producing activity of that entity.

Investing Activity :

Investing Cash Inflows	Investing Cash Outflows
Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets	Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self constructed property, plant and equipment
Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes)	Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution)	Cash advances and loans made to other parties (other than advances and loans made by a financial institution)
Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities	Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities

Question 3 –

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

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

Financing Activity :

Cash Inflows from Financing Activity	Cash Outflows from Financing Activity
Cash proceeds from issuing shares or other equity instruments;	Cash payments to owners to acquire or redeem the entity's shares;
Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other	Cash repayments of amounts borrowed; and
Short-term or long-term borrowings;	Cash payments by a lessee for the reduction of the outstanding liability relating to
	A finance lease.

Question 4 –

From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transactions will be classified as operating Investing and Financing:

No.	Nature of transaction
1	Issued Preference Shares
2	Purchased the shares of 100% subsidiary company
3	Dividend received from shares of subsidiaries
4	Dividend received from other companies
5	Bonus shares issued
6	Purchased license for manufacturing of special drugs
7	Royalty received from the goods patented by the company
8	Rent received from the let out building (letting out is not main business)
9	Interest received from the advances given
10	Dividend paid
11	Interest paid on security deposits
12	Purchased goodwill
13	Acquired the assets of a company by issue of equity shares (not parting any cash)
14	Interim dividends paid
15	Dissolved the 100% subsidiary and received the amount in final settlement

9. REPORTING CASH FLOWS FROM OPERATING ACTIVITY :

- An entity shall report cash flows from operating activities using either:
  1. the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  2. the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.
- Entities are encouraged to report cash flows from operating activities using the direct method.

Question 5 –

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

Operating statement of ABC Co for the year ended 31.3.2017

Particulars		**Rs**
Sales		500,000
Less :	Cost of goods sold	350,000
	Administration & Selling Overheads	55,000
	Depreciation	7,000
	Interest Paid	3,000

Loss on sale of asset	2,000
Profit before tax	83,000
Tax	(30,000)
Profit After tax	53,000

Balance Sheet as on 31st March

	2017	**2016**
Equity and Liabilities		
Shareholders' Funds	60,000	50,000
Non-current Liabilities	25,000	30,000
Current Liabilities		
Creditors	12,000	8,000
Creditors for Expenses	10,000	7,000
Provisions	8,000	5,000
Total	**115,000**	**100,000**
Assets		
Fixed Assets	75,000	65,000
Investment	12,000	10,000
Current Assets		
Inventories	12,000	13,000
Debtors	10,000	7,000
Cash	6,000	5,000
Total	115,000	100,000

10. FOREIGN CURRENCT CASH FLOW :

- Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.
- The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

  Example : Suppose the money is received on account of exports on 15th January 2017 in US $. The company prepares the accounts in rupees. In such case the exchange rate between USD and Rupee as on 15th January 2017 need to be applied for conversion.
- Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

11. INTEREST AND DIVIDENDS :

Cash flows from interest and dividends received and paid shall each be disclosed separately.

	Financing Company	Other company
Interest Paid	Cash flows arising from operating activities	Cash flows from financing activities
Interest and Dividend Received	Cash flows arising from operating activities	Cash flows from investing activities
Dividend Paid	Cash flows from financing activities	Cash flows from financing activities

Question 6 –

A firm invests in a five-year bond of another company with a face value of Rs.10,00,000 by paying Rs.5,00,000. The effective rate is 15%. The firm recognises proportionate interest income in its income statement throughout the period of bond. Based on the above information answer the following question:

a) How the interest income will be treated in cash flow statement during the period of bond?

b) On maturity, whether the receipt of Rs.10,00,000 should be split between interest income and receipts from investment activity.

12. TAXES ON INCOME :

Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate.

Question 7 – X Limited

X Limited has paid an advance tax amounting to Rs.5,30,000 during the current year. Out of the above paid tax, Rs.30,000 is paid for tax on long term capital gains. Under which activity the above said tax be classified in the cash flow statements of X Limited?

13. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES :

When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.

14. CHANGES IN OWNERSHIPS INTERESTS IN SUBSIDIARIES AND OTHER BUSINESSES :

Classification of Cash Flows as Investing Activity :

- The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities
- An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:
  - (a) the total consideration paid or received;
  - (b) the portion of the consideration consisting of cash and cash equivalents;
  - (c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and
  - (d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.
- The separate presentation of the cash flow effects of obtaining or losing control of subsidiaries or other businesses as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of losing control are not deducted from those of obtaining control.
- The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Classification of Cash Flows as Financing Activity :

- Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss.

- Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see Ind AS 110), unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss. Accordingly, the resulting cash flows are classified in the same way as other transactions with owners.

15. NON-CASH TRANSACTIONS :

- Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.
- Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.
- Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. Such non-cash items will not form part of the cash flow statement. Examples of non-cash transactions are:
  (a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;
  (b) the acquisition of an entity by means of an equity issue; and
  (c) the conversion of debt to equity

16. SELF PRACTICE QUESTIONS :

Question 8 – X Limited

X Limited acquires fixed asset of Rs.10,00,000 from Y Limited by accepting the liabilities of Rs.8,00,000 of Y Limited and balance amount it paid in cash. How X Limited will treat all those items in its cash flow statements?

Question 9 – An entity

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

Question 10 – ABC Ltd.

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

	2012	2011
Cash	4,000	14,000

Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	27,0000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500
Sales	2,00,000	
Cost of Goods Sold	(1,23,000)	
Depreciation	(15,000)	
Insurance Expense	(11,000)	
Wages	(50,000)	
Net Profit	1,000	

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

During 2012, ABC Ltd. paid Rs.46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 2012.

Question 11 – XYZ Ltd.

From the following summary cash account of XYZ Ltd., prepare cash flow statement for the year ended March 31, 2011 in accordance with Ind AS 7 using direct method.

Summary of Bank Account for the year ended March 31, 2011

	Rs.000'0		**Rs.000'0**
Balance on 1.4.2010	50	Payment to creditors	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Payroll	100
		Tax Payment	250
		Dividend	50
		Repayment of Bank loan	300
		Balance on 31.3.2011	150
	3,250		**3,250**

Question 12 – Z Ltd.

Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US $ 100,000 and US $ 102,000 respectively. The exchange rate on December 31, 2017 was US $ 1 = Rs.45. The same on 31.12.2018 was US $ 1 = Rs.50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at Rs.45,00,000 in the balance sheet as on December 31, 2017. It was reported at Rs.51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7?

Thanks ....

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