Case Studies on Excellency in Financial Reporting

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Research Committee

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

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Foreword

The implementation of Indian Accounting Standards (Ind AS) was a historic step in the field of accountancy in India. A right step in the direction of adopting globally uniform financial reporting for befitting the Indian economy and industries. The Institute of Chartered Accountants of India (ICAI) played a prominent role in standardizing, adopting, establishing, and implementing Ind AS in line with the expectations of all stakeholders.

Today, Ind AS issued by the Institute have come way forward, and unequivocally adopted by the industry. Seemingly there are some common oversights in treatment of these standards, and therefore, to enhance the understanding and application, ICAI through its Research Committee has come up with this publication on case studies for a better clarity of implementation of these standards.

The pursuit of this publication is to provide the stakeholders with the cases of contextual issues, events, and conditions, citing several practices and theories, to bring clarity of the subject and to update the knowledge.

With this publication an effort is made to edify the auditors, preparers, academicians, and others in the field of accounting, through certain preposition based on study of variables in essence of Ind AS, with an urge to enhance in fundamentals.

My sincere appreciation to CA. (Dr.) Anuj Goyal, Chairman, Research Committee, CA. Cotha S Srinivas, Vice chairman, Research Committee and all members of the Committee for bringing out the publication. I also acknowledge the contribution of the entire professional resources involved in preparation of this publication on Case Studies on Excellency in Financial Reporting.

I hope that this edition of the publication will be useful to a great extent to the members of the institute in discharging their duties, preparers of financial statements and other stakeholders at large.

CA. Aniket Sunil Talati
President, ICAI

New Delhi

June 21, 2023

Preface

It is important to include your own analysis before you start to chomp numbers, for that, it is critical to develop an understanding of fundamental events. Therefore, for this purpose, the Research Committee of the ICAI through this publication has concentrated upon bridging the gap between elemental understanding of IND AS and the imprecise errors in its application.

A diligent attempt has been made by Research Committee to crack misapprehensions and provide essential clarity to enhance the understanding and knowledge on implementing the Ind AS. With the mere intention to nip the issues in the bud itself, Research Committee, through several case studies has attempted to demonstrate in this publication the reasonable way to interpret the available financial information. The objective is to keep learning and be informed about the operations of these standards, as they play a vital role in maintaining the integrity of the financial information of a company, which also promotes the trust upon our members.

I would like to thank CA. Aniket Sunil Talati, Hon'ble President, ICAI and CA. Ranjeet Kumar Agarwal, Hon'ble Vice President, ICAI for their direction and guidance in effective functioning of the Research Committee. I am also thankful to CA. Cotha S Srinivas, Vice Chairman of the Research Committee, for his consistent guidance. I would like to thank all the stakeholders and experts of the Research Committee especially for their time and inputs.

Further, my appreciation to the team of Research Committee for their continuous efforts and support for carrying out the activities of Research Committee. I would like to thank CA. Ankit Maheshwari, CA. Kuldeep Kothari, CA. Kartik Jindal and CA. Himanshu Agarwal, the resource persons for their valuable contribution in preparation of this publication.

I also acknowledge the assistance, co-operation and untiring efforts made by Dr. Amit Kumar Agrawal, Secretary, Research Committee, CA. Neha Bansal, Assistant Secretary, CA. Saloni Jain, Professional, CA. Rahul Jain, Professional and CA. Abhishek Sharma, Professional in finalising the publication.

I hope this publication would be of immense use and continued interest to the preparers, auditors, and other stakeholders.

CA. (Dr.) Anuj Goyal
Chairman, Research Committee

New Delhi
June 21, 2023

Introduction

The discipline of this publication falls within the sphere of fast paced professional environment. The case-studies provided within, offers collection of in-depth analysis, of practices adopted in implementation of IND AS and common errors made thereby.

This publication covers a wide range of factors, viz:

Effective corporate governance: Correct corporate financial disclosures provide a clear framework for the objectives of a company, which circumscribe realm of every management and it is important for performance measurement. Therefore, establishing robust governance structures promotes to devious corporate governance.

Disclosure of best practices: Most of the preparers of the financial accounts have exceptional clarity and understanding of these standards, but sometimes the approach of application and quantitative aspect of disclosure is missing. This publication edifies on providing clear, concise, and relevant disclosures that meet the needs of various stakeholders, including investors, regulators, and analysts.

Risk management and internal controls: We need to understand making significant corporate decisions are depended upon having a robust risk management frameworks and internal control system to mitigate risks of loss of any financial information and ensure compliance.

By delving into these case studies, readers will gain valuable knowledge and inspiration to improve their own financial reporting practices.

We sincerely hope that this publication inspires to strive for excellence in financial reporting and ultimately contribute to the growth, trust, and stability of the ever-evolving financial landscape.

Happy reading and learning!

Note: The case studies presented in this publication are fictional and intended for illustrative purposes only.

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IND AS- 2 "Inventories"

Case Study 1: Valuation of Inventories

Problem: ABC Ltd., is in the paper publishing business, has a normal capacity of printing 1,00,000 paper. At the end of the reporting period, the entity has some finished goods stock. It incurred following expenditure during the period:

- Paper cost: Rs.2 per unit
- Ink cost: Rs.25,000 for every 40,000 units
- Glues/Adhesives: Rs.40,000 for every 40,000 units
- Printing machine maintenance cost: Rs.2,40,000
- Electricity cost : Rs.1,60,000 (for 80,000 units) and Rs.2,20,000 (for 1,20,000 units). This includes fixed charges of Rs.40,000
- Shop rent: Rs.3,00,000
- Labour cost: Rs.3,60,000 (fixed irrespective of production)
- Packaging cost: Rs.0.5 per unit

During the period, if printing production was:

(i) 80,000 units

(ii) 1,20,000 units

At the end of the period, 20,000 units were in stock. The entity is facing difficulty in determining the cost of inventory. (Ignore NRV)

Solution: Para 6 of Ind AS 2, "*Inventories are assets:*

(a) held for sale in the ordinary course of business.

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

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

Further, **Para 10 of Ind AS 2** states that "*the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition".*

In the stated case, purchase of paper and ink will be considered as costs of purchase.

As per Para 12 of Ind AS 2, "*the costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production….*

In accordance with Para 12 in the stated case, printing machine maintenance cost, labour cost and electricity cost (fixed charges) will remain constant irrespective of volume of production. Hence, it will be classified as fixed production overhead. Cost of Glues and electricity cost (based on units consumed) will be classified as variable production overhead since the cost will vary with the volume of production.

Para 16 of Ind AS 2 states that "*Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are :*

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs."

In the given case, shop rent and packaging do not contribute to bringing inventories to their present location and condition and therefore, in view of Para 16, these shall be excluded from the cost of inventories. These costs shall be recognized as expenses in profit or loss.

Para 13 of Ind AS states that "*the allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities…."*

"The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above."

So, in conclusion, it can be said that for determining the fixed production overhead per unit, fixed production overhead cost should be divided by higher of normal production capacity or actual production.

Treatment of Fixed Production Overhead as per Para 13:

S.No.	Particulars	Scenario (i)	Scenario (ii)
a.	Normal production capacity	1,00,000 units	1,00,000 units
b.	Actual production	80,000 units	1,20,000 units
c.	Higher of (a) and (b)	1,00,000 units	1,20,000 units
d.	Fixed production overhead cost (Machine maintenance cost, electricity cost, labour cost)	Rs.6,40,000 (2,40,000 +40,000 +3,60,000)	Rs.6,40,000 (2,40,000 +40,000 +3,60,000)
e.	**Cost per unit** (d/c)	**Rs.6.4**	**Rs.5.33**
f.	**Allocated cost** to production(b*e)	**Rs.5,12,000**	**Rs.6,40,000**
g.	**Unallocated cost** to be recognized as expense in Statement of Profit & Loss (d-f)	**Rs.1,28,000**	**-**

As per **Para 25 of Ind AS 2**, *the cost of inventories, other than those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.*

Valuation of inventory as per Ind AS 2:

S.No.	Particulars	Scenario (i)	Scenario (ii)
a.	Actual production	80,000 units	1,20,000 units
b.	Purchase cost – Paper	Rs.1,60,000 (80,000*2)	Rs.2,40,000 (1,20,000*2)
c.	Purchase cost – Ink	Rs.50,000	Rs.75,000
d.1.	Variable production overhead – Glues (Indirect material)	Rs.80,000	Rs.1,20,000
d.2.	Variable production overhead	Rs.1,20,000	Rs.1,80,0000

	– electricity cost (based on consumption)	(1,60,000 – 40,000)	(2,20,000 – 40,000)
e.	Fixed production overhead – Printing machine maintenance cost (calculated above)	Rs.5,12,000	Rs.6,40,000
f.	Total Cost (b+c+d.1+d.2+e)	Rs.9,22,000	Rs.12,55,000
g.	**Cost per unit (f/a)**	**Rs.11.525**	**Rs.10.458**
h.	**Valuation of closing stock**	**Rs.2,30,500** (20,000*11.525)	**Rs.2,09,167** (20,000*10.458)

As per **Para 36 of Ind AS 2**, the company ABC limited shall disclose its accounting policy for inventories i.e.:

Stock of finished goods is valued at cost on Weighted Average Basis or Net Realizable Value, whichever is lower.

IND AS- 8 "Accounting Policies, Changes in Accounting Estimates and Errors"

Case Study 2: Prior Period Errors

Problem: PQR Ltd is in the business of manufacturing electronics items and supplying them across the globe. While preparing the financial statements for the year ended 31st March 2023, PQR Limited has observed an issue in the previous year financial statements (i.e. 31st March 2022) which are as follows:

PQR Ltd. has obtained a term loan of Rs.50 crores for the complete renovation and modernization of its factory in May 2020. A machinery costing Rs.35 crores was acquired under the modernization scheme and installation was completed in June 2021. Management of PQR Ltd considers the 12 months period as substantial period of time to get the asset ready for its intended use. Therefore, entity has capitalized the interest cost for the period May 2020 to March 2021 in machinery account as per Ind AS 23. However, entity has also capitalized the interest cost of whole financial year 2021-2022 in the cost of machinery since management opined that term loan is for special purpose and its finance cost should be capitalized to the related asset during the whole tenure of loan. Considering the prior period error, the management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March 2022) by de-recognizing the finance cost from machinery and recognizing the finance cost in the profit or loss for the period July 2021 to March 2022.

Would this reclassification of finance cost in the comparative amounts will be considered as correction of an error under Ind AS 8? Would PQR Ltd. need to present a third balance sheet?

Solution: As per **Para 22 of Ind AS 23**, *"An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete."*

In the given case, finance cost till June 2021 should be capitalized in machinery and thereafter the entity shall cease capitalizing borrowing cost since substantially all the activities necessary to prepare the qualifying asset are completed.

Therefore, finance cost for the period July 2021 to March 2022 shall be recognized in profit or loss as per Ind AS 23.

Para 5 of Ind AS 8 defines **prior period errors** as *"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."

In the given case, capitalizing the borrowing cost after the cessation is a misstatement in the financial statements as this information was available at the time of approval of those financial statements. Therefore, it will be classified as prior period errors due to application of incorrect accounting policy and contravention with the requirement of Para 22 of Ind AS 23 as stated above.

A per Para 5 of Ind AS 8, the term "Material" used in this Standard shall have the same meaning as assigned to it in paragraph 7 of Ind AS 1.

Para 7 of Ind AS 1 defined the term **'Material'** as follows: "*Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."*

In the given case, finance cost is not recognized in the profit or loss instead capitalized in the value of machinery in the year 2021-2022, therefore profit for the period is overstated which could reasonably be expected to influence decisions of the users of financial statements. Hence, this will be classified as material prior period error.

Para 42 of Ind AS 8 *states "Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:*

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented."

In accordance with Para 42 of Ind AS 8, in the financial statements for the year ended 31st March 2023, the comparative amounts for the year ended 31st March 2022 would be restated to reflect the correct recognition.

Para 40A of IND AS 1 states, "*An entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:*

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period."

In the given case, the retrospective restatement has no effect on the information in the balance sheet at the beginning of the preceding period (i.e., 1st April 2021). Therefore, PQR Ltd. is not required to present a third balance sheet.

IND AS- 10 "Events after the reporting period"

Case Study 3: Distribution of Non-Cash Assets to Owners

Problem: X Ltd (company registered under Companies Act) manufacturers and sells plastic products. On 5th May 2022, Directors of the company decided to give bottles as dividend to its shareholders for the year 2021-2022. The company has 1,00,000 outstanding equity shares. The same was approved by the shareholders in AGM held on 2nd September 2022. The bottles are actually distributed on 5th September 2022. The carrying value (at cost) of inventory of bottle was Rs.100 per pen. The same bottle was sold in the market at Rs.150.

X Ltd is facing difficulty in determining the accounting treatment of inventory paid as dividend?

Solution: As per **Para 10 of Appendix A of Ind AS 10**, *"The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, which is the date:*

(a) when declaration of the dividend, e.g. by management or the board of directors, is approved by the relevant authority, e.g. the shareholders, if the jurisdiction requires such approval, or

(b) when the dividend is declared, e.g. by management or the board of directors, if the jurisdiction does not require further approval."

In the given case, X Ltd is registered under the Companies Act,2013 and as per the Companies Act, dividend is finalised by shareholders at AGM. The shareholders have approved the dividend in AGM held on 2nd September 2022 and therefore, dividend is no longer at the discretion of the entity. Hence, X Ltd shall recognise the dividend payable on 2nd September 2022.

As per **Para 11 of Appendix A of Ind AS 10**, "*An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed."*

In the given case, the bottle is sellable in the market at Rs.150. Therefore, X Ltd shall recognise its liability of dividend at Rs.1,50,00,000 (1,00,000 shares * Rs.150 per bottle).

Particulars	Debit (Rs.)	Credit (Rs.)
Retained Earnings A/c Dr.	1,50,00,000	
To Dividend Payable A/c		1,50,00,000
(Being dividend payable recognized)		

As per **Para 14 of Appendix A of Ind AS 10**, "*When an entity settles the dividend payable, it shall recognise the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.*"

In the given case, X Ltd settles the dividend payable on 5th September 2022. On that date, carrying value of a bottle was Rs.100 and the fair value of the bottle was Rs.150, therefore Rs.50 shall be recognised in profit or loss.

Total amount to be recognised in profit or loss = Rs.50,00,000 (1,00,000 * 50)

Particulars	Debit (Rs.)	Credit (Rs.)
Dividend Payable A/c Dr.	1,50,00,000	
To Inventory A/c		1,00,00,000
To Profit or Loss A/c		50,00,000
(Being dividend paid and income recognized)		

Further, as per **Para 15 of Appendix A of Ind AS 10,** *"An entity shall present the difference described in paragraph 14 as a separate line item in profit or loss."*

Accordingly, an entity shall present the above difference of Rs.50,00,000 as a separate line item in profit or loss.

***

Case Study 4: Non-adjusting event after the reporting period

Problem: On 20th April 2023, short circuit happened at one of the HN Ltd.'s warehouse. The inventory lying at warehouse got damaged. This inventory had been manufactured prior to 31st March 2023 costing Rs. 10 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs. 12.40 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs. 3 lakhs on repairing and repackaging of the inventory.

The inventory was sold on 15th May 2023 for proceeds of

Case A: Rs. 11 lakhs

Case B: Rs. 9 lakhs

The accountant of HN Ltd. treats this event as an adjusting event considering this as material event and taking place between the year end and date of approval of financials. The company adjusted this event to the value of inventory in its financial statements for the year 2022-2023. Board of directors have approved the financial statements on 15th June 2023.

Analyse whether the above accounting treatment made by the accountant of HN Ltd. in regard to financial year ending on 31st March 2023 is in compliance of the Ind AS.

Solution: As per the definition given in **Para 3 of Ind AS 10**, "*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 by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:*

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."

In the given case, the event (i.e., short circuit) occurred on 20th April, 2023 which causes the damage to the inventory. Event occurred between the end of reporting period (31st March 2023) and the date when the financial statements were approved by Board of Directors (15th June 2023).

However, there is no evidence of conditions that existed at the end of the reporting period. Hence, the event should have been classified by the company as non-adjusting event after the reporting period.

As per **Para 10 of Ind AS 10**, *"An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period".*

Further, as per **Para 21 of Ind AS 10**, *"If non-adjusting events after the reporting period are material, non-disclosure could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. 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."

Solution of Case A: Therefore, in view of Para 10 of Ind AS 10, HN Ltd. shall not adjust the financial statements to reflect non - adjusting events after the reporting period and HN Ltd. The company shall disclose the event and its financial effects in Notes to Accounts as per Para 21.

Hence, accounting treatment adopted by the HN Ltd. is in violation of Ind AS 10.

In view of Ind AS 2, inventory shall be recognised as lower of cost or net realizable value. In the given case, HN Ltd should recognise the inventory as on 31st March 2023 at Rs.10,00,000 (lower of Rs.10,00,000 or Rs.12,40,000).

Solution of Case B: Therefore, in view of Para 10 of Ind AS 10, it is a non - adjusting event after the reporting period. However, as per para 9 of Ind AS 2, "Inventories", Inventory shall be measured at lower of Cost or NRV. In the given case, the value of sold inventory on 15th May is Rs. 9 lakhs which is below the closing inventory cost value i.e. Rs. 10 lakh, the company should have recognized the inventory as on 31st March, 2023 at Rs 9 lakh as it has reliable evidence before the financial statements were approved for issue.

IND AS- 12 "Income Taxes"

Case Study 5: Deferred Tax on Revaluation of Assets

Problem: A Ltd is into an FMCG business and to expand the manufacturing, it has purchased a machinery of Rs.1,00,00,000 on 1st April 2020. For accounting purposes, useful life of machine is estimated as 20 years and the salvage value is expected as Rs.5,00,000. A Ltd follows SLM method of depreciation as per Ind AS 16. On 1st April 2022, it revalued the machinery by increasing 20% to carrying amount as on that date and revised salvage value is estimated as Rs.8,00,000.

Assume that, as per income tax act, depreciation rate is 15% on WDV basis and applicable tax rate is 30%.

A Ltd is facing difficulty, how do the revaluation of machinery would impact the deferred tax calculation for the year 2022-2023.

Solution: Calculation of carrying amount and tax base of machinery as on 1st April 2022 is as follows:

Particulars	Carrying Amount (Rs.)	Tax Base (Rs.)
Original Value as on 1st April 2020	1,00,00,000	1,00,00,000
Depreciation charged for the year:		
- 2020-2021	4,75,000	15,00,000
- 2021-2022	4,75,000	12,75,000
Value as on 1st April 2022	**90,50,000**	**72,25,000**

Para 5 of Ind AS 12 defines "Temporary Differences" and "Tax Base" as follows:

Temporary Differences: *Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:*

(a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Tax Base: *The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.*

Taxable Temporary Differences as on 1st April 2022 = Rs.18,25,000 (Rs.90,50,000-Rs.72,25,000)

Balance of Deferred Tax Liability (DTL) as on 1st April 2022 = Taxable Temporary Difference * Tax rate i.e. Rs.5,47,500 (Rs.18,25,000*30%)

As per **Para 20 of Ind AS 12**, *"Ind ASs permit or require certain assets to be carried at fair value or to be revalued (see, for example, Ind AS 16, Property, Plant and Equipment, Ind AS 38, Intangible Assets and Ind AS 109, Financial Instruments and Ind AS 116, Leases). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:*

(a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

(b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets".

Further, **Para 61A of Ind AS 12** states "*Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:*

(a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).

(b) directly in equity, shall be recognised directly in equity (see paragraph 62A)".

In the given case, A Ltd has revalued the machinery and as per Ind AS 16, revaluation gain is recognized in Other Comprehensive Income (OCI). Therefore, in view of Para 20 and 61A, DTA/DTL on revaluation surplus shall be recognized in OCI.

Computation of Revaluation Surplus and its Deferred Tax:

- Revaluation Gain = Rs.18,10,000 (Rs.90,50,000*20%)
- DTL on revaluation gain = Rs.5,43,000 (Rs.18,10,000*30%)

Journal Entry of revaluation on 1st April 2022 is as follows:

Particulars	Debit (Rs.)	Credit (Rs.)
Machinery A/c Dr. To Revaluation Reserve A/c (OCI) (Being revaluation gain recognized)	18,10,000	 18,10,000
Deferred Tax Expense A/c Dr. To Deferred Tax Liability A/c (Being DTL created)	5,43,000	 5,43,000
OCI Dr. To Deferred Tax Expense A/c (Being expense recognized in OCI)	5,43,000	 5,43,000

Computation of carrying amount, tax base and deferred tax on machinery as on 31st March 2023 and its journal entry are as follows:

Particulars	Carrying Amount (Rs.)	Tax Base (Rs.)
Revised Value as on 1st April 2022	1,08,60,000 (90,50,000+18,10,000)	72,25,000
Depreciation charge for the year 2022-2023	5,58,889 (10860000-800000)/18 years	10,83,750
Value as on 31st March 2023	**1,03,01,111**	**61,41,250**

- Taxable temporary differences as on 31st March 2023 = Rs.41,59,861 (1,03,01,111 – 61,41,250)

- DTL balance required as on 31st March 2023 = Rs.12,47,958 (41,59,861*30%)
- DTL to be created = Rs.7,00,458 (12,47,958 – 5,47,500)
- DTL on revaluation gain (recognized in OCI) as on 1st April, 2022 = Rs.5,43,000 (18,10,000*30%)
- Remaining DTL (recognized in profit or loss) = Rs1,57,458 (7,00,458 – 5,43,000)

Particulars	Debit (Rs.)	Credit (Rs.)
Deferred tax expense A/c Dr. To Deferred tax liability (DTL) A/c (Being deferred tax liability recognized)	1,57,458	 1,57,458
Statement of Profit & Loss Dr. To Deferred tax expense A/c (Being deferred tax expense recognized in P&L)	1,57,458	 1,57,458

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Case Study 6: Deferred tax at the time of business combination

Problem: A Ltd and B Ltd is in the business of rubber manufacturing business. On 1st April 2023, A Ltd acquired B Ltd at the consideration of Rs.1,000 lakhs. The following assets and liabilities are acquired in the business combination:

Particulars	Carrying Amount (Rs. in lakhs)	Fair Value (Rs. in lakhs)
Plant & Machinery	230	250
Land & Building	470	530
Inventory	80	105
Debtors	155	155
Creditors	90	90

A Ltd is facing difficulty in determining the accounting treatment of deferred tax at the time of business combination? Assume tax rate is 30%.

Solution: As per **Para 19 of Ind AS 12**, *"With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair*

values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).”

Further, as per **Para 66 of Ind AS 12**, “*As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination. In accordance with Ind AS 103, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.”*

In the given case, A Ltd acquired B Ltd in a business combination, so as per Ind AS 103, A Ltd has to recognize assets and liabilities at the fair value on the acquisition date. However, there will be no change in the tax base, since as per the income tax act, cost to previous owner will be the cost to assessee. Consequently, deferred tax asset/liability will arise.

Computation of temporary differences:

Particulars	**Carrying Amount (Rs. in lakhs)**	**Fair Value (Rs. in lakhs)**	**Temporary Difference**
Plant & Machinery	230	250	20
Land & Building	470	530	60
Inventory	80	105	25
Debtors	155	155	-
Creditors	(90)	(90)	-
Total	**845**	**950**	**105**

In the given case, fair value is greater than the carrying amount of net assets, therefore, deferred tax liability will arise.

Deferred tax liability = **Taxable Temporary Difference * Tax rate**

= Rs.31.5 lakhs (Rs.105 lakhs * 30%)

Particulars	**Debit (Rs. in lakhs)**	**Credit (Rs.in lakhs)**
Plant & Machinery A/c	250	
Land & Building A/c	530	
Inventory A/c	105	
Debtors A/c	155	
Goodwill A/c (balancing figure)	81.5	
To Creditors A/c		90
To Bank A/c		1,000
To Deferred Tax Liability		31.5
(Being assets and liabilities recognized at fair value on the date of acquisition)		

IND AS- 16 “Property, Plant and Equipment”

Case Study 7: Decommissioning, Restoration and Similar Liabilities

Problem: XYZ Ltd is in the business of generating electricity through uranium. On 1st April 2019, the entity purchased a nuclear reactor costing Rs.200 crores which has estimated useful life of 10 years. Entity follows SLM method of depreciation. The entity has a statutory obligation of decommissioning and site restoration at the end of 10th year (i.e.,31st March 2029), which is estimated to be Rs.20 crores. Entity follows the cost model of accounting for PPE.

On 31st March 2023, the entity expects that the estimated cost of decommissioning and site restoration on 31st March 2029 will be Rs.30 crores.

XYZ Ltd is facing difficulty in determining the accounting treatment of changes in decommissioning and site restoration liability? Assume the market discount rate to be 10%.

Solution: As per **Para 15 of Ind AS 16**, *“An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.”*

Para 16 of Ind AS 16 states that *“The cost of an item of property, plant and equipment comprises…. (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.”*

Para 45 of IND AS 37 states that *“Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.”*

In the given case, at the time of purchase of asset, the decommissioning cost is estimated to be Rs.20 crores. The discounted present value of such cost as on 1st April 2019 is Rs.7.7 crores [20/ $(1.10)^{10}$] $\frac{FV}{(1+r)^n}$

Therefore, cost of nuclear reactor shall be recognized as Rs.207.7 crores (Rs.200 crores + Rs.7.7 crores).

Particulars	Debit (Rs. in crores)	Credit (Rs. in crores)
PPE A/c Dr.	207.7	
To Bank A/c		200
To Provision for Decommissioning Liability A/c		7.7
(Being PPE recognized at cost)		

Accordingly, Depreciation of Rs.20.77 crores (Rs.207.7 crores / 10 years) shall be charged each year.

XYZ Ltd shall accrue the interest @ 10% each year in the decommissioning liability account and shall recognize it as finance cost as per IND AS 37.

Computation of carrying amount of PPE as on 31st March 2023:

- Cost as on 1st April 2019 : Rs.207.7 crores
- Depreciation charged for 1st April 2019 to 31st March 2023 : Rs.83.08 crores (207.7/10*4)
- Carrying amount as on 31st March 2023 : Rs.124.62 crores (207.7 – 83.08)

Computation of balance of decommissioning liability as on 31st March 2023:

Year	Opening Balance (Rs. in crores)	Interest @10% (Rs. in crores)	Closing Balance (Rs. in crores)
2019 – 2020	7.70	0.77	8.47
2020 – 2021	8.47	0.85	9.32
2021 – 2022	9.32	0.93	10.25
2022 - 2023	10.25	1.02	11.27

As per **Para 4 of Appendix A of Ind AS 16**, *"Changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs 5–7 below ."*

Further, as per **Para 5 of Appendix of Ind AS 16**, "*If the related asset is measured using the cost model:*

(a) *subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.*

(b) *the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.*

(c) *if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind AS 36."*

In the given case, the entity is following cost model, therefore entity shall remeasure the decommissioning liability considering the revised estimated cost of decommissioning cost and changes in liability shall be adjusted to carrying amount of PPE.

Adjustment in decommissioning liability on 1st April 2023 is as follows:

- Estimated Decommissioning Cost : Rs.30 crores
- Remaining useful life of asset : 6 years
- Discounted present value : Rs.16.92 crores [$30/(1.10)^6$]
- Increase in liability due to change in estimated cost : Rs.5.65 crores (16.92 – 11.27)

Particulars	Debit (Rs. in crores)	Credit (Rs. in crores)
PPE A/c Dr.	5.65	
To Provision for Decommissioning Liability A/c		5.65
(Being adjustment made for remeasurement in decommissioning liability)		

Subsequent Depreciation:

As per **Para 7 of Appendix A of Ind AS 16**, *"The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur. This applies under both the cost model and the revaluation model."*

- Adjusted carrying amount as on 1st April 2023 : Rs.130.27 crores (124.62 + 5.65)
- Remaining useful life of asset : 6 years
- Depreciation to be charged each year : Rs.21.71 crores (130.27/6)

As per **Para 8 of Appendix A of Ind AS 16,** *"The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted."*

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Case Study 8: Compensation for Loss

Problem: Entity X is the business of manufacturing shoes and have three manufacturing plants and ten warehouses across the India. All the fixed assets of the entity are insured under a fire insurance policy. On 1st April 2023, a major fire broke out at one of manufacturing unit situated in Himachal Pradesh. The carrying value of fixed assets in that manufacturing unit as on 1st April 2023 is Rs.100 crores. On 20th April 2023, the insurance company determined the amount payable under the insurance policy is Rs.90 crores. Insurance company paid the amount on 15th May 2023. On 1st June 2023, Entity X purchased new fixed assets for the manufacturing unit at the cost of Rs.120 crores.

Entity X is facing difficulty in determining the accounting treatment to be adopted for loss of PPE, insurance claim amount and recognition of new asset.

Solution: As per **Para 65 of Ind AS 16**, *"Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable."*

Further, as per **Para 66 of Ind AS 16**, "*Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:*

(a) impairments of items of property, plant and equipment are recognised in accordance with Ind AS 36;

(b) derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;

(c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and

(d) *the cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard."*

In accordance with above paragraphs, derecognition of existing PPE, compensation from insurance company and recognition of new PPE shall be accounted for separately as follows:

Derecognition of existing PPE:

As per Para 67 of Ind AS 16, *The carrying amount of an item of property, plant and equipment shall be derecognised:*

(a) *on disposal; or*

(b) *when no future economic benefits are expected from its use or disposal.*

In the given case, due to fire, asset got destroyed. Hence, no future economic benefits will arise.

As per **Para 68 of Ind AS 16**, *"The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 116, Leases, requires otherwise on a sale and leaseback). Gains shall not be classified as revenue."*

In the given case, PPE having carrying amount of Rs.100 crores shall be derecognized and consequent loss of Rs.100 crores shall be recognised in profit or loss.

Particulars	**Debit (Rs. in crores)**	**Credit (Rs. in crores)**
Profit or Loss A/c Dr.	100	
To PPE A/c		100
(Being PPE written off due to fire break out)		

Compensation from insurance company:

In the given case, Insurance claim receivable of Rs.90 crores shall be recognised on 20th April 2023 and consequent income of Rs.90 crores shall be recognised in profit or loss (to be included in Other Income).

Particulars	Debit (Rs. in crores)	Credit (Rs. in crores)
Insurance Claim Receivable A/c Dr.	90	
To Profit or Loss A/c		90
(Being insurance claim receivable recognised)		

Recognition of new PPE:

As per **Para 15 of Ind AS 16,** "*An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.*"

In the given case, Entity X purchased fixed asset costing Rs.120 crores on 1st June 2023. Therefore, PPE shall be recognised on 1st June 2023 at the cost of Rs.120 crores.

Particulars	Debit (Rs. in crores)	Credit (Rs. in crores)
PPE A/c Dr.	120	
To Bank A/c		120
(Being purchase of PPE recognised)		

IND AS- 20 "Accounting for Government Grants and Disclosure of Government Assistance"

Case Study 9: Forgivable Loan from government

Problem: Satyam Ltd.is a stationary Manufacturing company. It has received a loan of Rs.20,00,000, in the year 2018-19 from Delhi State Govt. The purpose of loan is for selling stationary items at lower price to poor children for two years.

However, in the year 2019-20, it was found that Satyam Ltd. has not been able to give loan repayment due to fire took place in stationary factory. Satyam Ltd described the situation in front of Delhi State Govt. After careful consideration Delhi State Govt. decided to forgive loan amount of Rs.20,00,000.

The company is confused whether such waiving of loan by the government will be considered as government grant? If yes, then what will be the accounting treatment in the books of Satyam Ltd.

Solution: Para 10 of Ind AS 20 states, *a forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.*

As per the given facts in the question, waiving of loan of Satyam Ltd. from Delhi state government is treated as a Government grant.

Presentation of grants related to income:

Para 29 of Ind AS 20 states, *Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.*

Accounting treatment in books of Satyam ltd. will be as follows:

Date	Particulars	Dr.	Cr.
31.03.2020	Loan from Delhi Govt. Dr.	20,00,000	
	To Profit & Loss A/c		20,00,000
	(Being Loan waived, treated as government grant)		

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Case Study 10: Interest Free loan by Government

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

- If a manufacturer installs certain pre-approved wastewater treatment plant, the government will provide an interest free loan equal to 50% of the cost of the plant;
- Such loan will be repayable to the government in 5 years from the date of disbursal;
- The manufacturer availing the benefit of this scheme must treat the wastewater of its factory using the specified plant before releasing it to the river. If this condition is violated, the entire loan shall become immediately repayable to the government along with a penalty of Rs.20 lakh.

Cost of the wastewater treatment plant to be installed to avail the benefit of the scheme is 100 lakh. Star Limited decided to utilise this scheme because, if it were to obtain the similar loan from a bank, it would be available at a market interest rate of 12% per annum. Accordingly, Star Limited applied for and obtained the government loan of Rs.50 lakh on 1st April, 20X1. Star Limited purchased and installed the plant such that it becomes ready for use on the same date.

Star Limited has an accounting policy of recognising government grant in relation to depreciable assets in the proportion of depreciation expense. It has determined that the plant will be depreciated over a period of 5 years using straight-line method. In the month of March, 20X3, government officials conducted a surprise audit, and it was found that Star Limited was not using the wastewater treatment plant as prescribed. Accordingly, on 31st March, 20X3, the government ordered Star Limited to repay the entire loan along with penalty. Star Limited repaid the loan with penalty as per the order on 31st March, 20X3.

Star Limited is little confused about determining the nature of government grant & its accounting treatment.

As you are the consultant of the Star Ltd, suggest the applicable treatment.

Solution: As per **Para 7 of Ind AS 20**, "*Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:*

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

(b) grants will be received."

Para 10A of Ind AS 20 states, *The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with Ind AS 109, Financial Instruments. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate*.

Initial recognition of grant as on **1st April, 20X1:**

Fair value of loan = 50,00,000 x 0.567 (PVF @ 12%, 5th year) = 28,35,000

Star Limited will recognize 21,65,000 (50,00,000 – 28,35,000) as the government grant and will make the following entry on receipt of loan:

Date	Particulars	Dr.	Cr.
1.4.20X1	Bank account Dr.	50,00,000	
	To Deferred Grant		21,65,000
	To Loan account		28,35,000
	(Being grant initially recorded at fair value)		

Accounting treatment for year ending 31st March, 20X2

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

Presentation of Grant Related to Assets:

As per **Para 24-28 of Ind AS 20**, *Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.*

Star Ltd. follows the policy to recognise the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

In the given case, the Depreciation for the year (20X1-20X2) = 100,00,000 /5 years = 20,00,000

Since the depreciation is provided on straight line basis by Star Limited, it will credit 4,33,000 (21,65,000 / 5) equally to its statement profit and loss over the 5 years.

Date	Particulars	Dr.	Cr.
31.3.20X2	Depreciation (Profit or Loss A/c) Dr.	20,00,000	
	To Property, Plant & Equipment		20,00,000
	(Being depreciation provided for the year)		
	Deferred grant income Dr.	4,33,000	
	To Profit or Loss		4,33,000
	(Being deferred income adjusted)		

Simultaneously, in the books, interest will be charged on loan amount at the rate of 12%.

Impact on profit or loss due to revocation of government grant as on 31st March 20X3

As per **Para 32 of Ind AS 20**, "*A government grant that becomes repayable shall be accounted for as a change in accounting estimate (see Ind AS 8, Accounting Policies, Change in Accounting Estimates and Errors). Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss. Repayment of a grant related to an asset shall be recognised by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable….*"

Amount payable to Government on account of principal loan = 50,00,000 Amount payable to Government on account of penalty = 20,00,000

Date	Particulars	Dr.	Cr.
31.03.2020	Loan account (W.N.1) Dr.	35,56,224	
	Deferred grant income (W.N.2) Dr.	12,99,000	
	Profit or Loss Dr.	1,44,776	

	To Government grant payable (Being refund of government grant)		50,00,000
	Profit or Loss Dr. To Government grant payable (Being penalty payable to government)	20,00,000	20,00,000

Therefore, total impact on profit or loss on account of revocation of government grant as on 31st March, 20X3 will be 21,44,776 (20,00,000 + 1,44,776).

Working Notes: Balance as on 31.03.2023 before revocation of government grant

1. Amortisation Schedule of Loan

Year	Opening balance of Loan	Interest @ 12%	Closing balance
31.03.20X2	28,35,000	3,40,200	31,75,200
31.03.20X3	31,75,200	3,81,024	35,56,224

2. Deferred Grant Income

Year	Opening balance	Adjustment	Closing balance
31.03.20X2	21,65,000	4,33,000	17,32,000
31.03.20X3	17,32,000	4,33,000	12,99,000

IND AS- 21 "The Effects of Changes in Foreign Exchange Rates"

Case Study 11: Impairment Loss in PPE ad Exchange Difference

Problem: XYZ Ltd (having business located in Delhi) purchased a building located in New York of USD 1,00,000 on 1st October 2022 from PQR Inc. Spot Exchange rate on 1st October 2022 is Rs.70/USD. The useful life of building is 10 years and the XYZ Ltd follows SLM method for charging the depreciation. On 31st March 2023, indicators for impairment exist and the recoverable amount of building is estimated to be USD 88,000 and the spot exchange rate on that date is Rs.71/USD.

XYZ Ltd is facing difficulty in determining the accounting treatment of foreign exchange differences and impairment loss (if any).

Solution: As per **Para 21 of Ind AS 21**, *"A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction*".

In the given case, XYZ Ltd purchased a building on 1st October 2022 at USD 1,00,000 and spot exchange rate on that date is Rs.70/USD. Therefore, initial recognition of building is measured at Rs.70,00,000 (1,00,000*70).

On 31st March 2023, depreciation charged by XYZ Ltd =

$$\frac{Carrying\ Amount}{No.\ of\ years\ (useful\ life)}$$

- Depreciation (in USD) = USD 5,000 [(1,00,000/10) *1/2]
- Depreciation (in INR) = Rs.3,50,000 (5,000*70)

Carrying amount of building after charging depreciation:

- In USD : USD 95,000 (1,00,000 – 5,000)
- In INR : Rs.66,50,000 (95,000*70)

As per **Para 23 of Ind AS 21**, "*At the end of each reporting period:*

(a) foreign currency monetary items shall be translated using the closing rate;

(b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and

(c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured."

Further, as per **Para 25 of Ind AS 21**, *"The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with Ind AS 2, Inventories. Similarly, in accordance with Ind AS 36, Impairment of Assets, the carrying amount of an asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:*

(a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e., the rate at the date of the transaction for an item measured in terms of historical cost); and

(b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g., the closing rate at the end of the reporting period).

The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa."

In view of Para 25, carrying amount of building is to be translated at the exchange rate at the date of transaction (measured in terms of historical cost) and the recoverable amount is translated at the closing rate at the end of the reporting period.

Computation of total loss:

- Carrying amount before impairment loss: Rs.66,50,000 (USD 95,000 * 70)
- Recoverable amount: Rs.62,48,000 (USD 88,000 * 71)
- Total loss to be recognized: Rs.4,02,000 (66,50,000 – 62,48,000)

Recognition of Foreign Exchange Difference and Impairment Loss:

- Foreign Exchange Gain = (Rs.71/USD – Rs.70/USD) * USD 95,000
  = Rs.95,000
- Impairment Loss = (USD 95,000 – USD 88,000) * Rs.71/USD
  = Rs.4,97,000

Particulars		Debit (Rs.)	Credit (Rs.)
Building A/c	Dr.	95,000	
To Foreign Exchange Gain A/c			95,000
(Being foreign exchange gain recognized)			
Impairment Loss A/c	Dr.	4,97,000	
To Building A/c			4,97,000
(Being impairment loss recognized)			

As per **Para 30 of Ind AS 21**, *"When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss shall be recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss."*

In the given case, impairment loss on building shall be recognized in profit or loss as per Ind AS 36, therefore, in view of Para 30, foreign exchange gain on building shall also be recognized in profit or loss as follows:

Particulars		Debit (Rs.)	Credit (Rs.)
Foreign Exchange Gain A/c	Dr.	95,000	
Profit or Loss A/c	Dr.	4,02,000	
To Impairment Loss A/c			4,97,000
(Being foreign exchange gain and impairment loss recognized in profit or loss)			

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Case Study 12: Advance Consideration in Foreign Currency

Problem: ABC Ltd is in the business of assembling the automotive machines and supplying them across the countries. On 1st January 2022, ABC Ltd enters into a contract to supply machinery to PQR Inc. for USD 50,000. As per the terms of the contract, an advance payment of 30% will be received on 1st February 2022. Balance payment will be received on 15th May 2023 after the delivery of machine on 10th May 2023.

Spot exchange rate is as follows:

Date	Exchange Rate (Rs./USD)
1st January 2023	67
1st February 2023	68
31st March 2023	70
10th May 2023	71.5
15th May 2023	72

ABC Ltd is facing difficulty in recognizing the liability of advance payment received and the revenue thereafter.

Solution: As per **Para 31 of Ind AS 115**, *"An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset."*

In the given case, Performance obligation of A Ltd is to supply machine to PQR Inc on 10th May 2023. Accordingly, ABC Ltd shall recognize the revenue as per Ind AS 115 on 10th May 2023.

Further, as per **Para 106 of Ind AS 115**, *"If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e., a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer."*

In the given case, ABC Ltd receives 30% of consideration as the advance payment on 1st February 2023 before the ABC Ltd transfers goods to PQR Inc. Accordingly, ABC Ltd shall recognize the contract liability on 1st February 2023 of the 30% consideration received.

As per **Para 20 of Ind AS 21**, *"A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:*

(a) buys or sells goods or services whose price is denominated in a foreign currency…"

In view of above, Sale of machine by ABC Ltd to PQR Inc wherein the transaction price is denominated in the foreign currency is classified as foreign currency transaction.

Para 21 of Ind AS 21 states as follows: "*A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.*"

Further, **Para 22 of Ind AS 21** states that "*The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with Ind AS …*"

Further, **Para 8 of Appendix B of Ind AS 21** states that *"Applying paragraphs 21-22 of Ind AS 21, 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 recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration."*

In the given case, "Date of transaction" is 1st February 2023 on which receipt of advance consideration took place resulted into recognition of the contract liability.

Recognition of Contract Liability on 1st February 2023:

- Recognition shall be made at spot exchange rate at 1st February 2023 i.e., Rs.68/USD.
- Amount of recognition of contract liability = Rs.10,20,000 (USD 50,000 * 30% * 68)

Particulars	Debit (Rs.)	Credit (Rs.)
Bank A/c Dr. To Contract Liability A/c (Being contract liability recognized on receipt of advance consideration)	10,20,000	 10,20,000

Reporting of contract liability as on 31st March 2023:

As per **Para 23(b) of Ind AS 21**,*"At the end of each reporting period, non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction."*

Since the contract liability is measured at historical cost, it shall be translated using the exchange rate at 1st February 2023 which is already recognized. Hence, no adjustment is required on 31st March 2023.

Recognition of Revenue on 10th May 2023:

As per **Para 46 of Ind AS 115**, *"When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation."*

- Transaction price = Rs.35,75,000 (USD 50,000 * Rs.71.5/USD)
- Contract liability already recognized = Rs.10,20,000
- Receivables to be recognized = Rs.25,55,000 (35,75,000 – 10,20,000)

Particulars	Debit (Rs.)	Credit (Rs.)
Contract Liability A/c Dr.	10,20,000	
Receivables A/c Dr.	25,55,000	
To Revenue A/c		35,75,000
(Being revenue recognized on satisfying the performance obligation)		

Exchange Difference as on 15th May 2023:

As per **Para 30 of Ind AS 21**, *"When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss shall be recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss."*

- Payment received on 15th May 2023 = Rs.25,20,000 (USD 50,000 *70% * Rs.72/USD)
- Receivables recognized = Rs.25,55,000
- Foreign Exchange Loss = Rs.35,000 (25,55,000 – 25,20,000)
- Foreign exchange loss is to be recognized in profit or loss

Particulars	Debit (Rs.)	Credit (Rs.)
Bank A/c Dr.	25,20,000	
Foreign Exchange Loss A/c Dr.	35,000	
To Receivables A/c		25,55,000
(Being remaining payment received)		
Profit or Loss A/c Dr.	35,000	
To Foreign Exchange Loss A/c		35,000
(Being exchange loss recognized in profit or loss)		

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Case Study 13: Functional Currency

Problem: The entity XYZ Limited is having its operations in India & is into mainly exporting business of toys and sets its pricing as per the foreign market of Europe. The company is confused whether the local currency i.e. Indian currency, where it is operating from will be its functional currency or not? If not, why & the relevance of functional currency as per Indian Accounting Standards.

Solution: As per **paragraph 8 of Ind AS 21**, *Functional currency is defined as 'the currency of the primary economic environment in which the entity operates.'*

An entity is required to measure its results and financial position in its functional currency. For most entities, the functional currency is the currency of the country in which the entity is located (the local currency). However, it cannot be assumed that the local currency will in all cases be the functional currency. For example, if pricing of most of the transactions of an entity are mostly influenced by the economic forces of another country that has a different currency, then its functional currency might be that other currency.

Ind AS 21 provides a number of factors or indicators that an entity considers in determining its functional currency.

Paragraph 9 and 10 of Ind AS 21 as stated below provide various indicators (primary and secondary) for identifying functional currency

Primary indicators of functional currency:

9. *The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash.*

An entity considers the following factors in determining its functional currency:

(a) the currency:

(i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and"

The Standard gives greater emphasis to the currency that most strongly influences the pricing of the entity's sale transactions, rather than focusing on the currency in which those transactions are denominated and settled. However, the currency will often be the same for both. A factor for determining the functional currency is the currency by which the sales prices are influenced.

"(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services."

Assuming sales prices of entity's products are most strongly influenced by international competition and regulation rather than local competition and by regulations and laws of entity's own country. In such a case, the currency of that foreign country is likely to be the functional currency subject to consideration of all indicators.

"(b) *the currency that mainly influences labour, material and other costs of providing goods and services (this will often be the currency in which such costs are denominated and settled)."*

In the above indicator, emphasis is given to the currency that most strongly influences the entity's expenditure, rather than focusing on the currency in which those expense transactions are denominated. Thus, if labour, material and other operating costs are primarily sourced and incurred in a particular country, then it is indicative of the currency of that country being the functional currency.

In the given case, the all relevant expenditures of manufacturing the toys were incurred in India i.e. home country.

Since indicators in paragraph 9 provide mixed response, **the indicators given in paragraph 10 of Ind AS 21 may provide supporting evidence.**

Secondary indicators of functional currency:

10. *The following factors may also provide evidence of an entity's functional currency:*

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated."

In the stated case, the entity is an Indian company, so majorly funds are from India.

(b) the currency in which receipts from operating activities are usually retained."

In the stated case, the company retained in INR the receipts received.

Considering the indicators in paragraph 10(a) & 10(b) provide additional support for considering INR as the functional currency.

Accordingly, in the given case based on facts provided, it is likely that XYZ Limited's functional currency is INR.

As per **Para 12 of IND AS 21,** *when the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity's functional currency*

Some points to highlight importance of Functional Currency are as follows:

1. As per Ind AS 21-

An entity is required to measure its results and financial position in its functional currency.

2. As per Ind AS 23-

Para 6A. *With regard to exchange difference required to be treated as borrowing costs in accordance with paragraph 6(e), the manner of arriving at the adjustments stated therein shall be as follows:*

(i) the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in ***functional currency*** *when compared to the cost of borrowing in a foreign currency.*

(ii) where there is an unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest."

IND AS- 24 "Related Party Disclosures"

Case Study 14: Disclosure of Remuneration of Key Managerial Personnel

Problem: Mr. Kamal is an independent director of a company Z Ltd. He plays a vital role in the Management of Z Ltd. and contributes in major decision making process of the organisation. Z Ltd. pays sitting fee of 1,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, Z Ltd. had 5 such meetings which was attended by Mr. Kamal.

Similarly, a non-executive director, Mr. Manish also attended 5 BOD meetings and charged 75,000 per meeting. The Accountant of Z Ltd. believes that they being not the employees of the organisation, their fees should not be disclosed as employee benefits in accordance with Ind AS 24.

Examine whether the contention of the accountant is correct?

Solution: As per definition given in **Para 9 of Ind AS 24**, Related Party Disclosures, *"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."*

Accordingly, key management personnel include any director of the entity who is having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, Mr. Kamal (Independent director) and Mr. Manish (Non-Executive Director) are covered under the definition of KMP in accordance with Ind AS 24.

Also, as per **Para 7 of Ind AS 19**, 'Employee Benefits', *"An employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, employees include directors and other management personnel."* Therefore, contention of the Accountant is wrong that they are not employees of Z Ltd.

Para 17 of Ind AS 24 requires that *"An entity shall disclose key management personnel compensation in total and for each of the following categories:*

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) share-based payment."

As per **Para 9 of Ind AS 19,** Employee Benefits, *"Short-term employee benefits include items such as the following, if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services:*

(a) wages, salaries and social security contributions;

(b) paid annual leave and paid sick leave;

(c) profit-sharing and bonuses; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees."

As per **ITFG Bulletin 11 Issue 9 -** *The sitting fees paid to directors will fall under the definition of "Short-term employee benefits" as per Ind AS 19 and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.*

Therefore, entity shall disclose key management personnel compensation as follows:

Key Managerial Personnel	Short Term Employee Benefits (in Rs.)	Post Employment Benefits (in Rs.)	Other Long Term Benefits (in Rs.)	Termination benefit (in Rs.)	Share-based payment (in Rs.)	Total Remuneration (in Rs.)
A. Non-Executive Directors						
1. Mr. Manish	3,75,000	-	-	-	-	3,75,000
B. Independent Directors						
1. Mr. Kamal	5,00,000	-	-	-	-	5,00,000

IND AS- 33 "Earnings per Share"

Case Study 15: Dilutive potential ordinary shares

Problem: PQR Ltd is having profits attributable to equity shares of Rs.1,00,00,000 for the year 2022-2023. The company has 20,00,000 outstanding equity shares during the whole financial year. Additional details are as follows:

(a) PQR Ltd has provided the option of 1,00,000 shares under ESOP scheme in October 2021. The employees are eligible to exercise the option in October 2024. The exercise price is Rs.60 per share and the average market price of an equity share during the year 2022-2023 is Rs.75

(b) PQR Ltd issued 8,00,000 9% convertible preference shares on 1st December 2021 at the face value of Rs.100. Conversion will be made by exchanging 2 equity shares by 1 preference share. No preference share is converted till 31st March 2023.

(c) PQR Ltd issued 1,00,00,000 10% convertible debentures on 1st March 2022 at the face value of Rs.10. Conversion will be made by exchanging 1 equity share by 5 debentures. No debenture is converted till 31st March 2023.

(d) Applicable tax rate is 30%.

While preparing financial statement, entity is facing difficulty in determining the Diluted EPS as per Ind AS 33 for the year 2022-2023?

Solution: As per **Para 10 of Ind AS 33**, *"Basic earnings per share shall be calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period."*

In the given case, profit attributable to ordinary equity holders is Rs.1,00,00,000 and weighted average number of ordinary shares outstanding is 20,00,000. Therefore, Basic EPS is computed as Rs.5 (1,00,00,000 / 20,00,000)

As per **Para 31 of Ind AS 33**, "*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."*

Para 5 of Ind AS 33 defines, "*A* ***potential ordinary share*** *is a financial instrument or other contract that may entitle its holder to ordinary shares."*

In the given case, potential ordinary shares are included in ESOP option, convertible preference shares and convertible debentures.

As per **Para 44 of Ind AS 33**, *"In determining whether potential ordinary shares are dilutive or antidilutive, each issue or series of potential ordinary shares is considered separately rather than in aggregate. The sequence in which potential ordinary shares are considered may affect whether they are dilutive. Therefore, to maximise the dilution of basic earnings per share, each issue or series of potential ordinary shares is considered in sequence from the most dilutive to the least dilutive, i.e. dilutive potential ordinary shares with the lowest 'earnings per incremental share' are included in the diluted earnings per share calculation before those with a higher earnings per incremental share. Options and warrants are generally included first because they do not affect the numerator of the calculation."*

Para 41 of Ind AS 33 states *"Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations."*

In view of Para 44, each potential ordinary share to be considered separately to determine the effect of dilution or antidilution and the sequence of potential ordinary shares to be most dilutive to least dilutive. To determine the sequence, earnings per incremental share needs to be calculated.

Para 33 of Ind AS 33 states "*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, as calculated in accordance with paragraph 12, by the after-tax effect of:*

(a) any dividends or other items related to dilutive potential ordinary shares deducted in arriving at profit or loss attributable to ordinary equity holders of the parent entity as calculated in accordance with paragraph 12;

(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."*

Para 36 of Ind AS 33 states *"For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares calculated in accordance with paragraphs 19 and 26, 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."*

Para 46 of Ind AS 33 states *"Options and warrants are dilutive when they would result*

in the issue of ordinary shares for less than the average market price of ordinary shares during the period. The amount of the dilution is the average market price of ordinary shares during the period minus the issue price. Therefore, to calculate diluted earnings per share, potential ordinary shares are treated as consisting of both the following:

(a) a contract to issue a certain number of the ordinary shares at their average market price during the period. Such ordinary shares are assumed to be fairly priced and to be neither dilutive nor antidilutive. They are ignored in the calculation of diluted earnings per share.

(b) a contract to issue the remaining ordinary shares for no consideration. Such ordinary shares generate no proceeds and have no effect on profit or loss attributable to ordinary shares outstanding. Therefore, such shares are dilutive and are added to the number of ordinary shares outstanding in the calculation of diluted earnings per share."

In view of Para 46, Dilutive number of shares in case of options/warrants is calculated as follows:

$$\frac{(Average\ market\ price\ of\ share - Exercise\ price\ of\ share) * No.\ of\ share\ options\ granted}{Average\ market\ price\ of\ share}$$

Computation of earnings per incremental share:

(a) ESOP

- Incremental earning = Nil
- Potential ordinary shares (with reference to Para 46) = 20,000 [(Rs.75-Rs.60)/Rs.75*1,00,000 shares)
- Earning per incremental share = Nil

(b) Preference shares

- Incremental earning = Rs.72,00,000 (8,00,000 * 100 *9%)
- Potential ordinary shares = 16,00,000 (8,00,000*2)
- Earning per incremental share = Rs.4.5 (72,00,000/16,00,000)

(c) Debentures

- Incremental earning = Rs.70,00,000 (1,00,00,000 * 10 *10%*70%)
- Potential ordinary shares = 20,00,000 (1,00,00,000/5)

- Earning per incremental share = Rs.3.5 (1,00,00,000/20,00,000)

Therefore, the order to include the dilutive instruments is as follows:

1. ESOP
2. Debentures
3. Preference Shares

Computation of diluted earnings per share :

Particulars	Profit attributable to ordinary equity holders	Ordinary Shares	Earnings per share
Basic EPS	1,00,00,000	20,00,000	5.00
ESOP	Nil	20,000	
	1,00,00,000	**20,20,000**	**4.95**
Debentures	70,00,000	20,00,000	
	1,70,00,000	**40,20,000**	**4.23**
Preference Shares	72,00,000	16,00,000	
	2,42,00,000	**56,20,000**	**4.31**

Diluted EPS is increased from Rs.4.23 to Rs.4.31 when taking the convertible preference shares into account, therefore convertible preference shares are antidilutive and are ignored in the calculation of diluted earnings per share. Hence, diluted earnings per share is Rs.4.23.

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Case Study 16: Written Put Options

Problem: As on 31st March 2023, the ABC Ltd has 10,00,000 outstanding ordinary shares at the face value of Rs.1 and has an outstanding 1,00,000 written put options on its own ordinary shares at the exercise price of Rs.75 per share.

ABC Ltd is facing difficulty in determining the impact of written put options on the diluted earnings per share. The average market price of the share was:

Scenario 1: Rs.85 per share

Scenario 2: Rs.60 per share.

Would you answer be different if the ABC Ltd is in the position of put holder?

Solution: Para 5 of Ind AS 33 defines **put options** as follows: *"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."*

In the given case, ABC Ltd is a put writer on its own ordinary shares, it means ABC Ltd is in the obligation to purchase if the put holders exercise their rights. Generally, put holder exercises his right only when exercise price is higher than the market price.

As per **Para 63 of Ind AS 33**, *"Contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive. If these contracts are 'in the money' during the period (ie the exercise or settlement price is above the average market price for that period), the potential dilutive effect on earnings per share shall be calculated as follows:*

(a) it shall be assumed that at the beginning of the period sufficient ordinary shares will be issued (at the average market price during the period) to raise proceeds to satisfy the contract;

(b) it shall be assumed that the proceeds from the issue are used to satisfy the contract (i.e. to buy back ordinary shares); and

(c) the incremental ordinary shares (the difference between the number of ordinary shares assumed issued and the number of ordinary shares received from satisfying the contract) shall be included in the calculation of diluted earnings per share."

Scenario-1: Market price of a share is Rs.85

In the given scenario, since the exercise price (Rs.75) is less than the market price (Rs.85) of the share, the put holder will not exercise the option of right to sell. Therefore, this instrument did not have an effect of dilutive, hence it shall not be considered in computing dilutive earnings per share.

Scenario-2: Market price of a share is Rs.60

In the given scenario, since the exercise price (Rs.75) is higher than the market price (Rs.60) of the share, put holder's position is "in the money" and will exercise the option of right to sell. Therefore, this instrument have a dilutive effect, hence it shall be considered in computing dilutive earnings per share.

In view of Para 63(c), the calculation of potential ordinary shares on the written put options is as follows:

- No. of written put options outstanding: 1,00,000
- Amount required to purchase the 1,00,000 shares to settle the put at exercise price = Rs.75,00,000 (1,00,000*75)
- Entity shall issue ordinary shares at the market price to raise proceeds to settle the put contract.
- No. of shares to be issued = 1,25,000 (Rs.75,00,000 / Rs.60)

Therefore, Incremental potential ordinary shares to be issued :

= No. of shares to be issued – No. of shares to be bought under put contract

= 1,25,000 shares – 1,00,000 shares

= 25,000 shares

It will be added to the denominator while calculating diluted earnings per share.

Disclosure requirement:

As per **Para 69 of Ind AS 33,** *An entity shall present basic and diluted earnings per share, even if the amounts are negative (i.e. a loss per share).*

If ABC Ltd is in the position of put holder, then the following is applicable:

As per **Para 62 of Ind AS 33**, *"Contracts such as purchased put options and purchased call options (ie options held by the entity on its own ordinary shares) are not included in the calculation of diluted earnings per share because including them would be antidilutive. The put option would be exercised only if the exercise price were higher than the market price and the call option would be exercised only if the exercise price were lower than the market price."*

In the derivative contracts (call/put), derivative holder has the right to buy/sell and the derivative writer has the obligation to sell/buy if the holder exercises his option. So, if ABC Ltd is a put holder, then ABC Ltd in the position of determining whether to execute & settle the contract or not and irrespective of market price, there will never be antidilutive effect for ABC Ltd. Therefore, it shall not be considered in the calculation of dilutive earnings per share.

IND AS-37 “Provisions, Contingent Liabilities and Contingents Assets”

Case Study 17: Liability and Contingent Assets

Problem: Choco Life Ltd. has entered into a sale contract (on 1st January 2023) of Rs.4,00,00,000 with Yummy Chocolates Ltd. for the supply of chocolates. 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, Choco Life Ltd. has to pay a compensation of Rs.40,00,000 to Yummy Chocolates Ltd.

During the transit (February 2023), the vehicle carrying the chocolates met accident and Choco Life 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. 3,00,00,000.

Before the financial year end, Choco Life 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.

What provision or disclosure would Choco Life Ltd. need to make at 31st March 2023?

Solution: Para 10 of Ind AS 37 define as follows:

*A **provision** is a liability of uncertain timing or amount.*

*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.*

*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.

As per **Para 14 of Ind AS 37**, *"A provision shall be recognised when:*

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

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

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised."

In the given case, Choco Life Ltd has a present obligation to pay Rs.40,00,000 as compensation to Yummy Chocolates Ltd as a result of non-fulfilment of contract. However, the timing of outflow is not certain.

Therefore, Choco Life Ltd shall recognise the provision for compensation of Rs.40,00,000 as follows:

Particulars	Debit (Rs.)	Credit (Rs.)
Profit or Loss Dr.	40,00,000	
To Provision for compensation A/c		40,00,000
(Being provision for compensation recognized)		

Further, as per **Para 85 of Ind AS 37**, *"An entity shall 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 shall disclose the major assumptions made concerning future events, as addressed in paragraph 48;and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement."

Therefore, in view of Para 85 of Ind AS 37, Choco Life Ltd shall disclose the nature of obligation and expected timing of outflow.

As per **Para 10 of Ind AS 37**, *"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."*

Further, as per **Para 31 of Ind AS 37**, *"An entity shall not recognise a contingent asset."*

As per **Para 32 of Ind AS 37**, **"***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…."*

In the given case, consignment of goods was lost in accident, however the goods were covered by the insurance policy. Therefore, Choco Life Ltd. will receive compensation from insurance company.

As per **Para 33 of Ind AS 37**, *"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."*

Further, as per **Para 34 of Ind AS 37**, *"A contingent asset is disclosed, as required by paragraph 89, where an inflow of economic benefits is probable."*

Para 89 of Ind AS 37 states as follows: *"Where an inflow of economic benefits is probable, an entity shall disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36–52."*

However, the virtual certainty of receipt will be there when informed through formal communication or the amount will be received.

Accordingly, Choco Life Ltd. would need to disclose the contingent asset of Rs.2,55,00,000 (Rs.3,00,00,000 x 85%) on 31st March 2023. However, It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising as per para 90 of Ind AS 37.

Further as per **Para 35 of Ind AS 37**, "*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. If an inflow of economic benefits has become probable, an entity discloses the contingent asset (see paragraph 89)."*

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Case Study 18: Estimate of a provision

Problem: Manufacturer XYZ gives warranties at the time of sale to purchasers of its product P.

Under the terms of the contract for sale, the manufacturer XYZ undertakes to remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. As this is the first year that the warranty has been available, there is no data from the firm to indicate whether there will be claim under the warranties. However, industry research suggests that 3% of total products sold is likely to be defective.

Should the manufacturer recognize a provision in accordance with the requirements of Ind AS 37.

Solution: Para 10 of Ind AS 37 defines liability and provision as follows:

*A **provision** is a liability of uncertain timing or amount.*

*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.*

*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.*

As per **Para 14 of Ind AS 37**, *"A provision shall be recognised when:*

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

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

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised."

Further, **Para 13 of Ind AS 37** states the difference between provision and contingent liability as follows:

"This standard distinguishes between:

(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 recognized 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 this Standard (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)."*

In the given case, the manufacturer XYZ has a present obligation to repair or replace manufacturing defects that become apparent within three years of sale due to the warranty contract entered at the time of sale.

Further, as per **Para 24 of Ind AS 37,** *"Where there are a number of similar obligations (eg product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met)."*

In the given case, as per Para 24 of Ind AS 37, probable outflow of future economic benefits will be required to settle the class of obligations as a whole.

Further, a reliable estimate of amount needs to be made, then the provision can be recognised.

Past data can provide reliable measures, even if the data is not firm specific but rather industry based. In the given case, industry based data is available and as per the industry data, 3% of the products sold will be defective.

Here, the manufacturer XYZ Ltd should recognize a provision based on the industry estimate on the amount of sales to settle the present obligation as at the reporting date.

Further, as per **Para 85 of Ind AS 37**, "*An entity shall 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 shall disclose the major assumptions made concerning future events, as addressed in paragraph 48; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement."

IND AS- 40 "Investment Property"

Case Study 19: Subsequent measurement of Investment Property

Problem: DEF Ltd, is into FMCG business, entity has purchased a building costing Rs.10,00,000 on 31st December, 2020 for the purpose of renting. The entity recorded the transaction in the books at its purchase cost. On 1st of March, 2021 the entity gave this on operating lease basis. On 31st March, 2021, the entity recognized the building by following revaluation model as per Ind AS 16 & presented under the head PPE.

During the audit, it was discovered that the treatment adopted was incorrect, the correct treatment would be?

Solution: As defined in **Para 5 of Ind AS 40**, there are two types of properties:

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

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

   (b) Sale in the ordinary course of business.

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

In accordance with the definition of investment property, in the stated case, the entity should classify the building as an "Investment property."

As per Para 20 of Ind AS 40, *an owned investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.*

The entity recognized the building on the date of purchase i.e. on 31st December, 2020 at its cost. So, no financial effect is there but as per Para 54 of Ind AS 1, it should be classified as investment property rather than PPE.

Subsequent Measurement:

As per Para 30 of Ind AS 40, *an entity shall adopt as its accounting policy the cost model prescribed in paragraph 56 to all of its investment property for Subsequent measurement.*

Para 56 of Ind AS 40 states, *"After initial recognition, an entity shall measure investment property: ….."(c) in accordance with the requirements in Ind AS 16 for cost model in all other cases."*

Considering above, the treatment done by the entity is wrong as the company has the only option of cost model. So, in accordance to this it should recognise on 31st March 2021 the building at Rs.10,00,000 less any accumulated depreciation and any accumulated impairment losses.

Further, as per **Para 32 of Ind AS 40**, *the entity is required to measure the fair value of investment property, for the purpose of disclosure even though they are required to follow the cost model. An entity is encouraged, but not required, to measure the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.*

In accordance to **Para 32 of Ind AS 40**, the company is required to measure the fair value of the investment property i.e. building only for disclosure purpose. In exceptional cases, where company was unable to estimate the fair value reliably, the disclosures required under Para 79(e) of Ind AS 40 to be provided as stated below.

As per **para 79 (e) of Ind AS 40**, *in the exceptional cases described in paragraph 53, when an entity cannot measure the fair value of the investment property reliably, it shall disclose:*

(i) a description of the investment property;

(ii) an explanation of why fair value cannot be measured reliably; and

(iii) if possible, the range of estimates within which fair value is highly likely to lie.

Paragraph 53 of Ind AS 40 *states,"….. This arises when, and only when, the market for comparable properties is inactive (e.g. there are few recent transactions, price quotations are not current or observed transaction prices indicate that the seller was forced to sell) and alternative reliable measurements of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably measurable but expects the fair value of the property to be reliably measurable when construction is complete, it shall measure the fair value of that investment property either when its fair value becomes reliably measurable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably measurable on a continuing basis, the entity shall make the disclosures required by paragraphs 79(e)(i), (ii) and (iii).*

IND AS- 41 "Agriculture"

Case Study 20: Agricultural Produce

Problem: XYZ Ltd is into dairy farming business, which encompasses the breeding, raising, and utilization of dairy animals, primarily cows, for the production & supplying of milk and the various dairy products processed from it to retail distributors. During the year, the company has purchased 100 cows at Rs.50,000 each. The milk being a perishable item, the company sold the milk within 1-2 days, the last 2 days production & sales data with Fair Value less Cost to Sell is given below. On 31st March 2023, XYZ Ltd had 1,000 liters of milk in cold storage which are not sold yet. The company has recognized the value of cows as per Ind AS 41 and did not record the value of milk produced since it was opined that company had not incurred any material cost for the production of milk.

During the audit, it was discovered that the treatment adopted for initial recognition and subsequent measurement of agricultural produce was incorrect, the correct treatment would be?

Additional Information:

Date	Units of Production	Sold Units	Balance	Fair Value Less CTS
30-03-2023	1200	700	500	45
31-03-2023	800	300	1000	48

Solution: As per **Para 2 of Ind AS 2**, "*this standard applies to all inventories, **except**: … (c) biological assets (i.e., living animals or plants) related to agricultural activity and agricultural produce at the point of harvest".*

From the above, it can be concluded that for agricultural produce, at the time of harvest, Ind AS 41 "Agriculture" is applicable. Thereafter, Ind AS 2 "Inventories" will be applied.

As per **Para 1 of Ind AS 41**, "*this standard shall be applied to account for the following when they relate to agricultural activity:*

(a) biological assets;

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

(c) government grants covered by paragraphs 34 and 35".

As per **Para 5 of Ind AS 41**, following are defined:

*"A **biological asset** is a living animal or plant"*.

***"Agricultural produce** is the harvested product of the entity's biological asset".*

In the stated case, Cow is classified as biological asset and Milk is classified as agricultural produce.

Initial Recognition (as per Ind AS 41):

As per **Para 10 of Ind AS 41**, "*an entity shall recognize a biological asset or agricultural produce when, and only when:*

(a) the entity controls the asset as a result of past events;

(b) it is probable that future economic benefits associated with the asset will flow to the entity; and

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

As per **Para 13 of Ind AS 41**, "*agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Ind AS 2 Inventories or another applicable standard."*

Assuming the entity satisfies all of the conditions stated in Para 10 of Ind AS 41, the entity should recognize the agricultural produce (Milk) as per Para 13 of Ind AS 41 as follows:

Valuation at the time of initial recognition (Point of Harvest) is as follows:

Particulars	**On 30th March 2023**	**On 31st March 2023**
A. Units of Production	1,200 liters	800 liters
B. Fair value less cost to sell per liter	Rs.45	Rs.48
Valuation (A*B)	Rs.54,000	Rs.38,400

As per **Para 28 of Ind AS 41**, "*a gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in profit or loss for the period in which it arises".*

Accordingly, the entity should recognize the gain of Rs.92,400 (54,000+38,400) in the Statement of Profit & Loss during the year 2022-2023.

Para 40 of Ind AS 41 states "*An entity shall disclose the aggregate gain or loss arising*

during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets."

Therefore, entity should disclose in notes to accounts the aggregate gain of Rs.92,400 arising on initial recognition of agricultural produce.

Measurement of Inventories after the point of harvest (As per Ind AS 2):

As per **Para 20 of Ind AS 2**, "*inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this standard".*

In accordance with the above, opting FIFO method of valuation, Cost of Inventories will be Rs.47,400 (Rs.45* 200 liters + Rs.48* 800 liters).

Measurement of inventories as per Para 9 of Ind AS 2 requires Inventories shall be measured at the lower of cost and net realizable value.

In the given case, the inventory of milk as on 31.03.2023 will be Rs.47,400 or Net Realizable Value whichever is lower.

IND AS- 102 "Share-based Payment"

Case Study 21: Cancellation and Settlement of Employee Stock Option Plan

Problem: ABC Ltd is a newly established company in the electronics industry. To retain its employees, on 1st April 2020, entity issued 100 share options to each of its 500 employees subject to a service condition of 4 years. The fair value of a share on 1st April 2020 is Rs.125. Details of employees left the organization as follows:

Year	Estimated	Actual
1	50	40
2	35	25
3	20	15
4	10	5

In January 2023, market price of the share significantly falls due to the change in management. Consequently, On 20th March 2023, the entity decided to cancel the option plan immediately and agreed to pay Rs.75 per option to each of the remaining 420 employees. Fair value of share as on 20th March 2023 is Rs.70.

The entity is facing difficulty in determining the accounting treatment at the time of cancellation of option plan.

Solution: As per **Para 10 of Ind AS 102**, "*For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.*"

As per **Para 15 of Ind AS 102**, *"If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:*

(a) if an employee is granted share options conditional upon completing three years'

service, then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period…."

In the given case, ABC Ltd has offered 100 share options to each of its 500 employees. The given option plan is subject to 4 years of service in the organization. Therefore, in view of Para 15, the entity shall recognize it over the vesting period of 4 years.

Employee benefit expenses to be recognized each year =

$$\frac{No. of\ emplyees\ estimated\ as\ on\ vesting\ date * No. of\ share\ options\ granted * Fair\ value\ of\ share\ on\ grant\ date * Vesting\ period\ completed}{Total\ vesting\ period}$$

As per **Para 20 of Ind AS 102**, *"To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21."*

Employee benefit expenses for the year 2020-2021 is as follows:

- No. of employees estimated at end of vesting period = 395 [500 – 40(actual) – 35(estimate) – 20(estimate) – 10(estimate)]
- Employee benefit expenses for the year = Rs.12,34,375 (395*100*125*1/4)

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expenses A/c Dr.	12,34,375	
To Share Based Payment Reserve A/c		12,34,375
(Being employee benefit expenses recognized)		

Employee benefit expenses for the year 2021-2022 is as follows:

- No. of employees estimated at end of vesting period = 405 [500 – 40(actual) – 25(actual) – 20(estimate) – 10(estimate)]
- Total employee benefit expenses for 2 years = Rs.25,31,250 (405*100*125*2/4)
- Employee benefit expenses for the year = Rs.12,96,875 (25,31,250 – 12,34,375)

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expenses A/c Dr.	12,96,875	
To Share Based Payment Reserve A/c		12,96,875
(Being employee benefit expenses recognized)		

Employee benefit expenses for the year 2022-2023

In the given case, entity cancelled the option plan in March 2023 and agreed to pay Rs.75 per option to the remaining employees.

As per **Para 28 of Ind AS 102**, "If a grant of equity instruments is cancelled or settled during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) the entity shall account for the cancellation or settlement as an acceleration of vesting and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

(b) any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest, i.e. as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense…"

Recognition of Employee Benefit Expense on cancellation of option plan:

In view of Para 28(a), ABC Ltd shall recognize the amount that would otherwise have been recognized for services received over the remainder of the vesting period.

- No. of employees estimated at end of vesting period = 410 [500 – 40(actual) – 25(actual) – 15(actual) – 10(estimate)] (Assumed that all of the 15 employees have left the entity till 20th March 2023)
- Total employee benefit expenses = Rs.51,25,000 (410*100*125)
- Employee benefit expenses to be recognized = Rs.25,93,750 (51,25,000 – 25,31,250)

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expenses A/c Dr.	25,93,750	
To Share Based Payment Reserve A/c		25,93,750
(Being remaining employee benefit expenses recognized on cancellation of plan)		

Recognition of cancellation compensation:

In view of Para 28(b), payment made to employees on cancellation of option plan shall be accounted for as repurchase of an equity instrument i.e. deduction from the equity (Share Based Payment Reserve) to the extent of fair value of share options granted, measured at the repurchase date. i.e. 20th March 2023 and excess amount paid over fair value shall be recognized in profit or loss.

- No. of employees on the cancellation date = 420
- Compensation per option = Rs.75
- Total compensation to be paid = Rs.31,50,000 (420*100*75)
- Fair value of share as on 20th March 2023 is Rs.70.
- Amount to be deducted from Share Based Payment Reserve (Equity) = Rs.29,40,000 (420*100*70)
- Balance amount to be recognized from Profit or Loss = Rs.2,10,000 (31,50,000 – 29,40,000)

Particulars		Debit (Rs.)	Credit (Rs.)
Share Based Payment Reserve A/c	Dr.	29,40,000	
Profit or Loss A/c	Dr.	2,10,000	
To Bank A/c			31,50,000
(Being cancellation compensation paid)			

***

Case Study 22: Share based payment transactions with cash alternatives

Problem: At 1st April 2020, ABC Ltd issued share based option to its 100 employees which can be exercised in cash or equity (at the option of employees) and it has following features:

Service condition: 2 years

Option I: Cash equivalent to 800 shares to each employee

Option II: 1000 equity shares to each employee of face value of Rs.100

Fair value of share are as follows:

- On 1st April 2020: Rs.120

- On 31st March 2021: Rs.140
- On 31st March 2022: Rs.145

At the end of vesting period, employees exercised the option of receiving cash.

Entity is facing difficulty in recognizing the accounting of the options given to employees and subsequent payment of cash to employees.

Solution: As per **Para 35 of Ind AS 102**, *"If an entity has granted the counterparty the right to choose whether a share based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (i.e. the counterparty's right to demand payment in cash) and an equity component (i.e. the counterparty's right to demand settlement in equity instruments rather than in cash)…."*

In the given case, ABC Ltd have issued share based option wherein entity has granted the employees the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, therefore ABC Ltd has granted a compound financial instrument.

Para 36 of Ind AS 102 states that *"For other transactions, including transactions with employees, the entity shall measure the fair value of the compound financial instrument at the measurement date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted."*

Further, as per **Para 37 of Ind AS 102**, *"To apply paragraph 36, the entity shall first measure the fair value of the debt component, and then measure the fair value of the equity component— taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument. The fair value of the compound financial instrument is the sum of the fair values of the two components…"*

On the grant date of option i.e. 1st April 2020

- Fair value of option (if employee exercise share option at the end of vesting period) is as follows :

$$= No.of\ share\ option\ granted\ \times No.of\ employees \\ *\ Fair\ value\ of\ option\ on\ grant\ date$$

= Rs.1,20,00,000 (1,000 *100*120)

- Fair value of option (if employee exercise cash option at the end of vesting period) is as follows :

= Rs.96,00,000 (800*100*120)

- Hence, Debt Component is Rs.96,00,000
- Equity Component = Rs.24,00,000 (1,20,00,000 – 96,00,000)

Employee Benefit Expenses on 31st March 2021:

- Debt Component =

$$\frac{No.of\ emplyees * No.of\ share\ options\ granted * Fair\ value\ of\ share\ on\ measurement\ date * Vesting\ period\ completed}{Total\ vesting\ period}$$

= Rs.56,00,000 (100*800*140*1/2)

- Equity Component = Rs.12,00,000 (24,00,000*1/2)

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expenses A/c Dr.	68,00,000	
To Share Based Payment Liability A/c		56,00,000
To Share Based Payment Reserve A/c		12,00,000
(Being employee benefit expenses recognized		

Employee Benefit Expenses on 31st March 2022:

- Debt Component as on date = Rs.1,16,00,000 (100*800*145*2/2)
- Debt component to be recognized = Rs.60,00,000 (1,16,00,000 – 56,00,000)
- Equity Component as on date = Rs.24,00,000 (24,00,000*2/2)
- Equity component to be recognized = Rs.12,00,000 (24,00,000 – 12,00,000)

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expenses A/c Dr.	72,00,000	
To Share Based Payment Liability A/c		60,00,000
To Share Based Payment Reserve A/c		12,00,000
(Being employee benefit expenses recognized)		

Settlement in cash on 31st March 2022:

As per **Para 40 of Ind AS 102**, *"If the entity pays in cash on settlement rather than issuing equity instruments, that payment shall be applied to settle the liability in full. Any equity component previously recognised shall remain within equity. By electing to receive cash on settlement, the counterparty forfeited the right to receive equity*

instruments. However, this requirement does not preclude the entity from recognising a transfer within equity, i.e. a transfer from one component of equity to another."

Cash paid on settlement of option = Rs.1,16,00,000 (100 employees*800 shares* Rs.145 per share)

Particulars	Debit (Rs.)	Credit (Rs.)
Share Based Payment Liability A/c Dr. To Bank A/c (Being Cash paid to employees in lieu of share options)	1,16,00,000	1,16,00,000
Share Based Payment Reserve A/c Dr. To Retained Earnings A/c (Being share based payment reserve transferred to retained earnings)	24,00,000	24,00,000

IND AS- 105 "Non-current Assets Held for Sale and Discontinued Operations"

Case Study 23: Changes to a plan of sale

Problem: A Ltd has purchased a machine of Rs.2,00,000 on 1st April 2018. The estimated useful life of the machine is 10 years, and the entity follows SLM method of depreciation. On 31st March 2020, management has decided to sell it in its present condition and the sale is highly probable, hence management has classified it as held for sale as per Ind AS 105. Fair value of machine on 31st March 2020 is Rs.1,20,000.

Case A: If on 31st March 2021, management has changed the plan to sell due to sudden fall in the market price of machine, and now sale is not highly probable. It has decided to use the machine in the normal course of business instead of selling. Recoverable amount of the machine on 31st March 2021 is Rs.1,10,000.

Entity is facing difficulty in determining the impact of change in plan to sell in the year 2020-2021.

Case B: If during the period 2020-2021, the market conditions that existed at the date the asset was classified as held for sale deteriorate and as a result, asset is not sold till 31st March 2021. During that period, A Ltd actively solicited but did not receive any reasonable offers for the machine and in response, A Ltd have reduced the price. Management is still committed to sell the machine. How would it be presented in the financial statements?

Solution: As per **Para 15 of Ind AS 105**, *"An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell."*

As per **Para 18 of Ind AS 105**, *"Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind ASs."*

In the given case, recognition and measurement of machine is governed by the Ind AS 16, so carrying amount of machine as on 31st March 2020 (immediately before the classification as held for sale) is measured as per Ind AS 16.

Further, as per **Para 20 of Ind AS 105**, *"An entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell, to the extent that it has not been recognised in accordance with paragraph 19."*

Computation of impairment loss on 31st March 2020:

Particulars	Amount (Rs.)
Cost of machine on 1st April 2018	2,00,000
Less: Depreciation for the year 2018-2019 (2,00,000/10 years)	(20,000)
Carrying value as on 31st March 2019	1,80,000
Less: Depreciation for the year 2019-2020 (2,00,000/10 years)	(20,000)
Carrying value as on 31st March 2020	1,60,000
Fair value less cost to sell on 31st March 2020	1,20,000
Machine shall be measured at lower of carrying amount and fair value less cost to sell	**1,20,000**
Impairment Loss (Carrying value – Fair value Less Cost to sell)	40,000

Therefore, impairment loss of Rs.40,000 shall be recognised in profit or loss on 31st March 2020.

Depreciation for the year 2020-2021:

As per **Para 25 of Ind AS 105**, *"An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale…."*

Therefore, entity shall not depreciate the machine after the 31st March 2020 since it is classified as held for sale.

Case A: Changes to a plan of sale:

As per **Para 26 of Ind AS 105**, "*If an entity has classified an asset (or disposal group) as held for sale or as held for distribution to owners, but the criteria in paragraphs 7-9 (for held for sale) or in paragraph 12A (for held for distribution to owners) are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale or held for distribution to owners (respectively). In such cases an entity shall follow the guidance in paragraphs 27-29 to account for this change except when paragraph 26A applies."*

Further, as per **Para 7 of Ind AS 105**, *"For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and*

its sale must be highly probable. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future."

In the given case, due to fall in market price, it is estimated that sale is not highly probable. Subsequently, management has decided to use the machine in its normal course of business instead of sale. Therefore, A Ltd shall cease to classify the asset as held for sale on 31st March 2021.

As per **Para 27 of Ind AS 105**, *"The entity shall measure a non-current asset (or disposal group) that ceases to be classified as held for sale or as held for distribution to owners (or ceases to be included in a disposal group classified as held for sale or as held for distribution to owners) at the lower of:*

(a) its carrying amount before the asset (or disposal group) was classified as held for sale or as held for distribution to owners, adjusted for any depreciation, amortisation or revaluations, that would have been recognised had the asset (or disposal group) not been classified as held for sale or as held for distribution to owners, and

(b) its recoverable amount at the date of the subsequent decision not to sell or distribute."

Measurement of machine as on 31st March 2021:

S.No.	Particulars	Amount (Rs.)
a.	Carrying value of machine on 31st March 2020 before classification as held for sale	1,60,000
b.	Depreciation for the year 2020-2021 that would have been recognised had the asset not been classified as held for sale (2,00,000/10 years)	(20,000)
c.	Carrying value of machine that would have been on 31st March 2021 had it not been classified as held for sale (a-b)	1,40,000
d.	Recoverable amount of machine on 31st March 2021	1,10,000
e.	**Machine shall be remeasured on 31st March 2021 at the lower of (c) or (d)**	**1,10,000**
f.	Actual carrying value of machine on 31st March 2020	1,20,000
g.	Loss to be recognised on change in classification (f-e)	10,000

Therefore, A Ltd shall measure the machine at Rs.1,10,000 on 31st March 2021.

As per **Para 28 of Ind AS 105**, *"The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale or as held for distribution to owners in profit or loss from continuing operations in the period in which the criteria in paragraphs 7-9 or 12A respectively, are no longer met."*

Accordingly, A Ltd should recognise the loss of Rs.10,000 in profit or loss for the year 2020-2021.

Disclosure Requirement:

As per **Para 42 of Ind AS 105**, *"If either paragraph 26 or paragraph 29 applies, an entity shall disclose, in the period of the decision to change the plan to sell the non-current asset (or disposal group), a description of the facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented."*

Accordingly, A Ltd should disclose the description of facts and circumstances leading to change in plan and its effects on results of operations for the year 2020-2021 and 2019-2020 as well.

Case B: Committed to a plan to sell

As per **Para 9 of Ind AS 105**, "*Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). This will be the case when the criteria in Appendix B are met."*

Further, **Para B1 of Appendix B of Ind AS 105** states that "…. *An exception to the one-year requirement in paragraph 8 shall therefore apply in the following situations in which such events or circumstances arise:*

(c) during the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:

(i) during the initial one-year period the entity took action necessary to respond to the change in circumstances,

(ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and

(iii) the criteria in paragraphs 7 and 8 are met."

In the given case, during the initial one period of 2020-2021, market conditions get deteriorated which were previously considered unlikely and as a result, machine couldn't be sold till 31st March 2021. However, during that period:

i. A Ltd took necessary action to respond to the changes in circumstances i.e., by reducing the prices

ii. Machine is actively marketed at the reasonable price

iii. Criteria in Para 7 and 8 are met i.e., Machine is available for immediate sale in its present condition and its sale is highly probable.

Therefore, A Ltd have complied all the requirements of above-mentioned paragraph of Appendix B. Consequently, A Ltd shall take extension to complete the sale and continue to classify it as held for sale.

As per **Para 30 of Ind AS 105**, "*An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).*"

In view of Para 30 of Ind AS 105, A Ltd should disclose the events and circumstances that has extended the period to complete the sale so that users of financial statements can evaluate its financial effects.

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Case Study 24: Discontinued Operations

Problem: AK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June 2022. During the 3 months ended 30th June 2022, following events occurred:

On 1st April 2022, the Company has decided to sell one of its divisions as a going concern. On 1st April 2022, the carrying amount of the assets and liabilities of the division were as follows:

- Purchased Goodwill – Rs.60,000
- Plant & Machinery (remaining useful life two years) – Rs.20,00,000
- Land – Rs.15,00,000
- Inventories – Rs.10,00,000
- Creditors – Rs.6,00,000

From 1st April 2022, the Company has started to actively market the division and has received number of serious enquiries. On 1st April 2022, the directors estimated that they would receive Rs.32,00,000 from the sale of the division. Since 1st April 2022, market condition has improved and as on 1st August 2022, the Company received and accepted a firm offer to purchase the division for Rs.33,00,000.

The sale is expected to be completed on 30th September 2022 and Rs.32,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June 2022.

The Company has approached you to suggest how the proposed sale will be reported in the interim financial statements for the quarter ended 30th June 2022. Company follows cost model of accounting as per Ind AS 16 and 38.

Solution: As per **Para 6 of Ind AS 105**, "*An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.*"

Further, as per **Para 7 of Ind AS 105**, "*For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future.*"

In the given case, the decision to offer the division for sale on 1st April 2022 means that from that date the division has been classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price and the sale is expected to be completed within one year. The division will be regarded as discontinued operation for the quarter ended 30th June 2022.

As per **Para 15 of Ind AS 105**, *"An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell."*

The consequence of this classification is that the assets and liabilities of the discontinued division will be measured at the lower of their existing carrying amounts and their fair value less cost to sell.

Carrying amount of division = Rs.39,60,000 (60,000 + 20,00,000 + 15,00,000 + 10,00,000 – 6,00,000)

Fair value less cost to sell of division = Rs.32,00,000

Therefore, the discontinued division shall be measured at Rs.32,00,000.

Further, as per **Para 20 of Ind AS 105**, *"An entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell, to the extent that it has not been recognised in accordance with paragraph 19."*

Accordingly, impairment loss of Rs.7,60,000 (39,60,000 – 32,00,000) shall be recognised.

Recognition of Impairment Loss:

As per **Para 23 of Ind AS 105**, *"The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this Ind AS, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of Ind AS 36."*

Further, as per **Para 104 of Ind AS 36**, "*An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:*

(a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and

(b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).

These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognised in accordance with paragraph 60."

In the given case, impairment loss shall be allocated as follows:

Particulars	Amount (Rs.)
Impairment Loss	7,60,000
Less: Adjusted against goodwill	(60,000)
Remaining impairment loss	7,00,000
Loss to be distributed to non-current assets in the ratio of carrying amount:	

Plant & Machinery	4,00,000
Land	3,00,000
(Carrying amount's ratio is 4:3)	

Further, as per **Para 60 of Ind AS 36**, "*An impairment loss shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in Ind AS 16). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard.*"

Accordingly, impairment loss will be recognised in profit or loss since the entity follows cost model of accounting for the measurement of PPE and Intangible Assets.

As per **Para 33 of Ind AS 105**, *"An entity shall disclose:*

(a) a single amount in the statement of profit and loss comprising the total of:

(i) the post-tax profit or loss of discontinued operations and

(ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

(b) an analysis of the single amount in (a) into:

(i) the revenue, expenses and pre-tax profit or loss of discontinued operations;

(ii) the related income tax expense as required by paragraph 81(h) of Ind AS 12.

(iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation: and

(iv) the related income tax expense as required by paragraph 81(h) of Ind AS 12.

The analysis may be presented in the notes or in the statement of profit and loss. If it is presented in the statement of profit and loss it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(d) the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of profit and loss."

As per **Para 38 of Ind AS 105**, *"An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the balance sheet or in the notes, except as permitted by paragraph 39. ….."*

Further, as per Ind AS 33, EPS will also be disclosed separately for the discontinued operation.

IND AS- 32 "Financial Instruments Presentation"

Case Study 25: Financial Instrument Presentation

Problem: X Ltd borrowed Rs.15 lakhs from Y Ltd on 1st April 2022. As per the terms of borrowing arrangement, X Ltd will deliver machinery worth Rs.25 lakhs to Y Ltd on 31st March 2027 in settlement of borrowing. During the intervening period of 5 years, X Ltd is not required to make any payment to Y Ltd. In financial statements for the year ended on 31st March 2023, X Ltd presented the borrowing as financial liability.

During the audit, it was discovered that X Ltd has adopted incorrect presentation for the above mentioned borrowing, the correct presentation would be?

Solution: Para 11 of Ind AS 32, defines the term financial liability and financial asset as follows:

Financial Liability: *Any liability that is:*

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

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

Financial Asset: *Any asset that is:*

(a) Cash

(b) An equity instrument of another entity

(c) A contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

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

In the given case, X Ltd borrows money and will deliver machinery in settlement of borrowing.

Classification of Borrowing in the books of X Ltd:

Ind AS 32 classifies liability as financial liability if the entity has contractual obligation to deliver financial asset or exchange financial asset under condition that are unfavorable to the entity. In the given case, since machinery is not a financial asset, the stated borrowing arrangement does not meet any of the criteria of financial liability. Hence, **the borrowing will be classified as non-financial liability.**

The borrowings will be shown under other non- current liabilities & in the notes to accounts the terms of agreement will be disclosed (including settlement terms).

IND AS- 109 “Financial Instruments”

Case Study 26: Interest accrual pertaining to borrowings classified as NPA

Problem: A Ltd has taken a loan of Rs.100 crores from a bank in the year 2018-2019. In the year 2023-2024, bank has classified the loan as NPAs and discontinued the recognition of interest income on the same. Consequently, A Ltd has discontinued the recognition of accrual of interest expense while calculating amortized cost of borrowing as per Ind AS 109.

Is the accounting treatment adopted by A Ltd is correct?

Solution: As per **Para 3.3.1 of Ind AS 109**, *An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished—i.e., when the obligation specified in the contract is discharged or cancelled or expires.*

Further, **Para B3.3.1 of Ind AS 109** states that *a financial liability (or part of it) is extinguished when the debtor either:*

(a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods, or services; or

(b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (if the debtor has given a guarantee this condition may still be met)

It may be noted that banks do discontinue, in their accounts, the recognition of interest income on the assets classified as NPAs based on prudential norms issued by the RBI.

However, **Para 3.4 of Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances,** dated April 1,2023 issued by RBI states as follows: *On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.*

These guidelines clearly reflect that the bank has not legally released the borrowers from their contractual liability to pay interest on borrowings. Furthermore, even if the bank write off loans for accounting purposes, borrower is not legally released from the contractual obligation.

In the given case, bank had not released A Ltd from the liability of borrowing as well as the interest.

In view of the above, **discontinuation of recognition of accrual of interest was in violation of Effective Interest Method principle resulting in under-statement of the expenses for the period**.

***

Case Study 27: Reclassification of financial asset

Problem: A Ltd has investment of Rs.10,00,000 in 6% bonds purchased on 1st October 2022 which are redeemable on 31st September 2027 at face value. The company holds the bonds to collect its contractual cash flows. Also, the company can sell, if required. Company has recognized the bonds at fair value under FVOCI model. During March 2023, A Ltd acquires B Ltd that manages portfolio of debentures and has a business model that holds the investment to collect the contractual cash flows. The portfolio of bonds of A Ltd is no longer for sale and now managed with the acquired debentures and all are held to collect the contractual cash flows only. Further details are as follows:

- Fair value of bond as on 1st April 2023: Rs.9,85,000
- Carrying amount of bond as on 31st March 2023: Rs.9,80,000
- OCI Reserve balance as on 31st March 2023: Rs.20,000 (Debit balance)

The company has reclassified the bond from FVOCI model to amortization model at the carrying amount of Rs.9,80,000 and has transferred the balance of OCI reserve to Statement of Profit and Loss. Is the accounting treatment adopted for reclassification, correct? Also, on such reclassification, do entity A Ltd. required to make any disclosures?

Solution: In Ind AS 109, classification of financial assets is based on the business model that determines how cash flows of the financial assets are collected and the contractual cash flows characteristics.

Financial asset shall be measured at **FVOCI** if it is held with business model whose objective is achieved both by collecting contractual cash flows and selling financial asset.

Financial asset shall be measured at **Amortised Cost** if it is held with business model whose objective is to hold financial assets in order to collect contractual cash flows.

As per **Para 4.4.1 of Ind AS 109**, "*When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets …*".

In the given case, initially at time of investment, objective of A Ltd was to collect contractual cash flows and to sell the bonds. Hence, A Ltd have correctly measured it at FVOCI. However, in March 2023, management has changed the objective to collect contractual cash flows by holding bonds till maturity after acquisition of B ltd. Therefore, now Bonds need to be measured by following amortization cost model.

In the given case, business model of A Ltd has changed, so A Ltd has to reclassify the bonds as per Ind AS.

As per **Para 5.6.1 of Ind AS 109**, *"If an entity reclassifies financial assets in accordance with paragraph 4.4.1, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest."*

Further, as per **Para 5.6.5 of Ind AS 109**, "*If an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset at the reclassification date. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortised cost. This adjustment affects other comprehensive income but does not affect profit or loss and therefore is not a reclassification adjustment (see Ind AS 1 Presentation of Financial Statements). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph B5.6.1.)*".

Appendix A defines Reclassification date as follows: "The first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets."

In the given case, A Ltd has reclassified the bond at carrying amount and transfers the balance of OCI reserve to Statement of Profit and Loss. **The accounting treatment adopted by A Ltd is in violation of Para 5.6.5 of Ind AS 109.**

In view of Para 5.6.5, journal entry in books of A Ltd should be as follows:

Particulars		Amount	
Bonds at FVOCI	Dr.	5,000	
To OCI Reserve			5,000
(Being bonds are remeasured at fair value at reclassification date) (9,85,000- 9,80,000)			
Bonds at Amortised Cost	Dr.	9,85,000	
To Bonds at FVOCI			9,85,000
(Being bonds are reclassified at reclassification date)			
Bonds at Amortised Cost	Dr.	15,000	
To OCI Reserve			15,000
(Being balance of OCI Reserve reversed to fair value of bond)			

Carrying amount of Bonds on reclassification date i.e. 1st April, 2023 = Rs.10,00,000 (9,85,000 + 15,000)

Further, after the reclassification, Effective interest rate needs to be calculated considering the bond value of Rs.10,00,000 and interest will be accrued using the EIR calculated.

Further, as per **Para 12B of Ind AS 107**, the entity A Ltd. need to make following disclosures on reclassification from FVOCI to Amortised Cost Business Model:

Para 12B of Ind AS 107 states, *"An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 4.4.1 of Ind AS 109. For each such event, an entity shall disclose:*

(a) the date of reclassification.

(b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.

(c) the amount reclassified into and out of each category.

***

Case Study 28: Loan at concessional rate

Problem: ABC Ltd has a policy to provide loans to its employees at 5% p.a. rate of interest. The loan amount is to be repaid in five equal installments annually. The market

rate of interest (not a Level 1 input) is 10% p.a. for comparable loans. An employee has taken a loan of Rs.10,00,000 from ABC Ltd on 1st April 2022 (Yearly EMI is Rs.2,30,975). On 1st April 2022, ABC Ltd recognized the financial asset at Rs.10,00,000, it accrued interest thereon @ 5% p.a. for the year and received a payment of EMI.

Auditor raised the question over the accounting treatment adopted by the ABC Ltd for recognizing the financial liability. Provide the correct accounting treatment as per Ind AS 109.

Solution: As per **Para 5.1.1 of Ind AS 109 "***Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability."*

However ***as per Para 5.1.1A of Ind AS 109****, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2A.*

As per **Para B5.1.2A of Ind AS 109**, "*The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also Ind AS113). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:*

(a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

In the given case, ABC Ltd has provided loan at 5% p.a. whereas market rate of interest is 10% p.a. This represents that the loan is provided at off-market terms. Hence, the loan will be recognized at a fair value.

Transaction price of providing a loan is Rs.10,00,000. However, the fair value of loan is Rs.8,75,395 as shown below in table :

Year	Cash Flow (Rs.)	PV factor @ 10%	Present Value (Rs.)
2022-23	2,30,975	0.909	2,09,956
2023-24	2,30,975	0.827	1,91,016
2024-25	2,30,975	0.751	1,73,462
2025-26	2,30,975	0.683	1,57,756
2026-27	2,30,975	0.620	1,43,205
Total	**11,54,875**		**8,75,395**

The difference between transaction price and fair value is Rs.1,24,605 (Rs.10,00,000-8,75,395)

Since the market rate of interest is not a Level 1 observable input, the difference between the transaction price and the fair value will be recognized as an asset or liability. In the stated case, A Ltd has provided a loan of Rs.10,00,000 having fair value of Rs.8,75,395, it reflects that employee is in benefit position and A Ltd has to pay Rs.1,24,605 excess amount which will be amortized over the period of loan.

In view of **Para B5.1.2A of Ind AS 109,** accounting treatment should be as follows:

Initial Recognition:

- Financial Asset at fair value of Rs.8,74,395
- Prepaid Staff Expenses at Rs.1,24,605

Subsequent Recognition:

- Interest @10% p.a. will be accrued on the outstanding balance of financial asset
- Prepaid staff expense to be amortized in Statement of Profit and Loss over the tenure of the loan in accordance to the judgement of the management.

IND AS- 115 “Revenue from Contracts with Customers”

Case Study 29: Identify the Performance Obligations

Problem: Company ABC is a diversified manufacturing company that produces and sells a range of products, including machinery and spare parts. Such machinery and spare parts are not interrelated or interdependent on each other. Company ABC enters into a contract with a customer for supply of machinery with spare parts at a single price. For revenue recognition, company needs to assess whether its products supplied should be considered as separate performance obligations or if they need to be combined.

Solution: Under the five-step model of Ind AS 115, the second step in accounting for a contract with a customer is identifying the performance obligations. Identifying performance obligations is a crucial process in the five-step model. Performance obligations are considered as unit of account for the purposes of applying the revenue standard. Identification of performance obligations requires high degree of judgment in cases where multiple goods or services are promised in a contract. Also, it needs to be determined whether those performance obligations should be accounted for separately or as in combination with other promised goods or services in the contract.

As per **Para 22 of Ind AS 115** *at contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:*

(a) A good or service (or a bundle of goods or services) that is distinct; or

(b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).

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

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

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

In the given case, there is a single contract in which two supplies are being made by the seller, one is machinery and other is spare parts.

As per Para 27, Each Performance obligation is distinct if:

(a) The customer of ABC can benefit from the good or service either on its own or together with other resources that are readily available to the customer

As per Para 28 "A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits….."

The Machinery and Spare parts of ABC can generate economic benefits on their own.

(b) The ABC promise to transfer the good or service to the customer is separately identifiable from other promises in the contract

As per para 29, Some factors that indicate that an entity's promise to transfer a good or service to a customer is not separately identifiable include, but are not limited to, the following:

"(c) the good or service is highly dependent on, or highly interrelated with, other goods or services promised in the contract."

The machinery & spare parts are not highly dependent, or highly interrelated with each other

Considering above, ABC have two separate performance obligation one is machinery and the other is spare parts.

Once Company ABC determines which goods and services are distinct performance obligations, they should allocate the transaction price to each obligation based on their standalone selling prices. If standalone selling prices are not directly observable, they can estimate them using observable market data or other suitable methods. Revenue should then be recognized when control of each distinct performance obligation is transferred to the customer.

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Case Study 30- Significant financing component

Problem: ABC Ltd. is a manufacturing company that recently entered into a contract with XYZ Corp. to supply specialized machinery for their production facility. The contract specifies a selling price of INR 1 cr., payable in three equal instalments over the next two years. The first instalment will be made upfront and the next 2 instalments will be paid at end of year 1 & year 2. XYZ Corp. has the option to pay the entire amount upfront and receive a 5% discount on the selling price. ABC Ltd. wants to determine if

there is a significant financing component in the contract as per IND AS 115. How should ABC Ltd. assess the existence of a significant financing component?

Solution: As per **Para 60 of IND AS 115**, "*In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract."*

Para 61 of Ind AS 115 states "…. *An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:*

(a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and

(b) the combined effect of both of the following:

(i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and

(ii) the prevailing interest rates in the relevant market."

Further **Para 62 of Ind AS 115** states, "*Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:*

(a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

(b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales- based royalty).

(c) the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference…."

In the given case, in view of Para 61 of Ind AS 115, following facts and circumstances exist:

- XYZ Ltd has an option to pay the entire upfront amount and receive a 5% cash discount. It reflects that there is difference between promised consideration and the cash selling price.
- XYZ Ltd is required to pay the selling price in 3 instalments over the two years. It shows that there is an expected length of time of 2 years between when ABC Ltd transfers the promised goods or services to XYZ Ltd and when XYZ Ltd pays for those goods or services.

Further, XYZ Ltd is not fulfilling any of the criteria mentioned in Para 62, therefore it is concluded that significant finance component exists in the contract between ABC Ltd and XYZ Ltd.

Accordingly, in view of Para 60 of Ind AS 115, XYZ Ltd shall adjust the promised consideration to take effects of time value of money in determining the transaction price.

Accordingly, the transaction price will be Rs.95,00,000 (1cr. less 5%).

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Case Study 31: Revenue Recognition

Problem: The entity ABC is a Public Limited Company domiciled in India. The Government of India holds 52% in the paid-up equity capital of the Company as on 31st March, 2023.The entity is into production of LPG, transmission of natural gas and LPG through pipelines. The transmission of Natural Gas during the year was 115.68 MMSCMD & Liquefied Petroleum Gas (LPG) was 5.162 MMTPA. The entity is facing difficulty in determining the timing of satisfaction of performance obligation to recognize revenue in its books.

Solution: As per **paragraph 31 of Ind AS 115**, *an entity shall recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An entity 'transfers' a good or service to a customer when (or as) the customer obtains control of that asset.*

As per **para 32 of Ind AS 115**, *For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with*

paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

Further, **paragraph 35 of Ind AS 115**, states that, "*an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:*

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37)".

Revenue is recognised at a point in time if it does not meet the above criteria.

As mentioned above, paragraph 35 gives three criteria for recognition of revenue over a period of time. In the given fact pattern, revenue recognition has been evaluated considering the criteria under paragraph 35(a).

Paragraph 35(a)

Customer simultaneously receives and consumes the benefits of the Entity XYZ performance of supplying Natural gas/ LPG through Pipelines.

Consequently, the criteria mentioned in paragraph 35(a) is met, and entity ABC has two performance obligations that it satisfies over time. To recognise revenue for these two performance obligations satisfied over time, entity ABC should measure its progress toward complete satisfaction of its performance obligation in accordance with paragraphs 39-45 and paragraph B14-B19.

Appropriate methods of measuring progress include output methods and input methods.

As per **para B15 of Ind AS 115**, ***Output methods*** *recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. E.g. milestones reached, units produced or units delivered etc.*

As per **para B18 of Ind AS 115**, ***Input methods*** *recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation.*

In determining the appropriate method, entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

IND AS- 116 "Leases"

Case Study 32: Short Term Lease

Problem: Entity X (lessee) enters into a lease with Entity Y (lessor) for two assets namely, Asset A and Asset B, with 10 months non-cancellable term with an option to extend the lease for 5 months. The lease does not have a purchase option. At the lease commencement date, for Asset A, Entity X is reasonably certain to exercise the extension option and for Asset B, Entity X is not reasonably certain to exercise the extension option. Entity X classifies both the leases as short term lease and availed the recognition exemptions provided in Ind AS 116.

During the audit, it was discovered that recognition of leases is not as per the Ind AS 116, what would be the correct recognition?

Solution: Firstly, the auditor verified whether the entity X (lessee) on commencement date is reasonably certain to exercise an option to extend a lease or not considering all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease as described in paragraphs B37– B40. After assessment, the auditor concluded that the lessee is reasonably certain to exercise the extension option in case of Asset A and not to exercise in case of Asset B.

In **Appendix A of Ind AS 116**, following are defined:

Short-term lease: *A lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short term lease.*

Lease term: *The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:*

(a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

(b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

So, to determine whether the lease is short term lease or not, firstly lease term needs to be calculated. In the stated case, considering the above definition, following is the lease terms:

Lease term of Asset A: 10 months + 5 months = 15 months

Lease term of Asset B: 10 months (since not reasonably certain to exercise the extension option)

Now, as per the definition, a lease is to be classified as short term lease if the lease term is of 12 months or less. Therefore, Asset A cannot be classified under short term lease and Asset B is classified under short term lease. **Entity X was incorrect in classifying Asset A under short term lease**.

As per **Para 22 of Ind AS 116**, "*at the commencement date, a lessee shall recognize a right-of-use asset and a lease liability"*.

However, as per **Para 5 of Ind AS 116**, "*a lessee may elect not to apply the requirements in Para 22 to 49 (Recognition, Measurement and Presentation by Lessee) to:*

(a) short-term leases;

(b) leases for which the underlying asset is of low value".

In the stated case, following Para 5, assuming both assets are not low value assets as no information given in this regard. Entity X may avail recognition exemption for Asset B only and cannot avail exemption for Asset A since it does not meet the criteria of classifying lease as short term lease. Therefore, **Entity X was incorrect in availing exemption with respect to Asset A**.

As per **Para 6 of Ind AS 116**, *"If a lessee elects not to apply the requirements in paragraphs 22-49 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognize the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis if that basis is more representative of the pattern of the lessee's benefit."*

In the given case, Entity X can avails recognition exemption for Asset B, therefore lease payments for the same shall be recognized as an expense either on SLM basis or another systematic basis. **For Asset A, Entity X should recognize the right-of-use asset and a lease liability** as per Para 22.

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Case Study 33: Allocation of consideration among lease component and non-lease component

Problem: ABC Ltd (lessee) entered into a contract with XYZ Ltd (lessor) to take machine on rent for 10 years. It is mentioned in the contract that the lessor will perform periodical maintenance service of the rented machinery and receive consideration for the maintenance services. Consideration is specified in the contract as follows:

- Rent of machine: Rs.70,000
- Maintenance service: Rs.20,000
- Total: Rs.90,000

Following are the stand-alone prices which can be readily observed in the market:

- Rent of machine: Rs.85,000
- Maintenance service: Rs.15,000
- Total: Rs.1,00,000

While preparing financial statement, ABC Ltd (lessee) recognized the right-of-use asset considering the monthly lease payment of Rs.70,000 over the lease term.

During the audit, it was discovered that measurement of lease component in the contract was incorrect, what would be the correct treatment?

Solution: As per **Para 12 of Ind AS 116**, "*for a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 15. Paragraphs B32–B33 set out guidance on separating components of a contract".*

Further, Para 13 states "*for a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components."*

Para 14 states "*the relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information."*

In view of above, total consideration should be allocated by ABC Ltd (lessee) as follows:

Particulars	Stand-alone price	Ratio of stand-alone price	Allocation of consideration
Lease component (renting)	Rs.85,000	85%	Rs.76,500
Non-lease component (maintenance service)	Rs.15,000	15%	Rs.13,500
Total	**Rs.1,00,000**	**100%**	**Rs.90,000**

Therefore, lessee was incorrect in the measurement of ROU asset. **Lessee should consider the lease payment of Rs.76,500 instead of Rs.70,000.**

Further, as per **Para 15 of Ind AS 116**, "*as a **practical expedient**, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 4.3.3 of Ind AS 109, Financial Instruments*".

In the stated case, alternatively, ABC Ltd may opt not to separate non-lease component as a practical expedient under Para 15. In that case, the company will recognize the Right of use asset considering the lease payments of Rs.90,000 over the lease term.

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Case Study 34: Inception date vs Commencement date

Problem: X Ltd (lessee) entered into a lease agreement with Y Ltd (lessor) for premises located at Lajpat Nagar to open a showroom for a period of 5 years. The agreement is dated April 1,2023. As per the contract, X Ltd is required to make lease payments beginning from July 1, 2023 when the store is expected to open. Before the store opening, X Ltd has to make some leasehold improvements to structure the store as per its requirements for which Y ltd provides the premises from May 1, 2023. When will X Ltd recognize the right-of-use asset and the lease liability relating to the lease?

Solution: *As per* **Para 9 of Ind AS 116**, "*At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration".*

Appendix A of Ind AS 116 defines the term **'inception date'** as "*The earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.*"

In the given case, **inception date is the date of the agreement, i.e., April 1, 2023**. On this date, X Ltd has to determine whether or not the arrangement is, or contains, a lease.

Considering para 9, the given agreement is a lease agreement as the identified asset (premises) is taken on lease by X ltd for consideration for a term period of 5 years.

Further, **Para 22 of Ind AS 116** states, "*At the commencement date, a lessee shall recognise a right-of-use asset and a lease liability*".

Appendix A of Ind AS 116 defines the terms **'commencement date'** as "*The date on which a lessor makes an underlying asset available for use by a lessee.*"

In the given case, to make certain leasehold improvements, the lessee has taken possession of the underlying asset before it begins operations or making lease payments under the terms of the lease.

As per the definition stated above, commencement date is the date on which a lessor makes an underlying asset available for use by a lessee. The timing when the lease payments start does not affect the determination of commencement date of the lease.

Accordingly, in the given case, since Y Ltd has made the premises available to X Ltd on May 1, 2023 for carrying out leasehold improvements, **the lease commencement date is May 1, 2023** and accordingly, X Ltd is required to recognise the right of use asset and lease liability as on that date.

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Case Study 35: Fixed or Variable Lease Payment

Problem: A Ltd (lessee) is in the business of supplying bottled water to various restaurants in Delhi. For bottle filling process, it takes a machine on lease from Company B for 10 years. A Ltd has right to control with respect to when to use, how to use and how much to use. As per the agreement terms, A Ltd is required to pay Rs.2 per bottle filled by using the leased machinery or a minimum payment of Rs.1,00,000 each year, whichever is higher to B Ltd.

What payments are to be considered for purpose of calculating lease liability?

Solution: As per **Para 27 of Ind AS 116**, "*at the commencement date, the lease payments included in the measurement of the lease liability comprise the following*

payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

(a) fixed payments (including in-substance fixed payments as described in Para B42), less any lease incentives receivable;

(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 28);

(c) amounts expected to be payable by the lessee under residual value guarantees;

(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs B37–B40); and

(e) *payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease".*

Para B42 of Ind AS 116 states that, *"Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable…".*

In the given case, A Ltd is required to make a minimum payment of Rs.1,00,000 each year to B Ltd which is unavoidable. In view of Para B42, the annual payment of Rs.1,00,000 are in-substance fixed lease payments and will be considered in measuring the right-of-use asset and lease liability at commencement date.

Para 28 of Ind AS 116 states, "*Variable lease payments that depend on an index or a rate described in Para 27(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates".*

In the given case, payment of Rs.2 per bottle packed is variable is nature because the no. of bottle packed will vary. However, these variable payments are not dependent on an index or rate. Hence, they are excluded from calculation of right-of-use asset and lease liability as at commencement date.

To conclude, annual payment of Rs.1,00,000 will be considered in measuring lease liability and any payment over and above Rs.1,00,000 will not be considered in measuring the lease liability.

Any payment over and above Rs.1,00,000 will be recognized in profit or loss as and when they are incurred. The variable rentals will be charged to profit and loss account as and when incurred.