FR - CA Final May 21 Revision

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IND AS – 40
INVESTMENT PROPERTY

(1) **Definition**
(2) **Recognition**
(3) **Initial Measurement**
(4) **Subsequent Expenditure**
(5) **Subsequent Measurement**
(6) **Transfer**
(7) **Disposal**

(1) DEFINITION :

Investment property - Land or building, or part of a building, or both, held by the owner or the lessee under a finance lease to earn rentals and/or for capital appreciation, rather than for:

- use in production or supply of goods and services or
- use in administrative purposes or
- sale in the ordinary course of business.

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

The following are examples of investment property

- Land held for long-term capital appreciation rather than for short term sale in the ordinary course of business
- Land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)

- A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.
- A building that is vacant but is held to be leased out under one or more operating leases.
- Property that is being constructed or developed for future use as investment property.
- Property intended for sale in the ordinary course of business or in the process of construction or development for such sale (Ind AS - 2, Inventories), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.
- owner-occupied property (Ind AS - 16), including (among other things)property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.
- Property that is leased to another entity under a finance lease.
- Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.
- In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.
- In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.
- In some cases, an entity owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, from the

perspective of the entity that owns it, the property is investment property if it meets the definition of investment property. Therefore, the lessor treats the property as investment property in its individual financial statements.

(2) RECOGNITION

Investment property shall be recognized as an asset when and only when:

- It is probable that future economic benefits will flow to the entity; and
- The cost of the investment property can be measured reliably.

(3) INITIAL MEASUREMENT

Owned Investment Property that qualifies for recognition as an asset should be measured at its COST. An investment property held by a lessee as a right-of-use asset shall be measured initially at its COST as per Ind AS 116.

Initial acquisition/construction

↓

Asset is acquired by

Payment of Cash/for credit	Self construction	Exchange of Non-monetary assets

(A) INVESTMENT PROPERTY BY CASH / CREDIT

Cost of asset includes the following:—

Particulars	Amount Rs.
Purchase price (Basic price)	XXX
(+) Non refundable taxes, Property transfer taxes	XXX
(+) Professional fees (e.g. fees of legal services, architects and engineers)	XXX
(+) Brokerage & commission (transaction costs)	XXX
(+) Borrowing cost (If permitted by Ind AS 23)	XXX
(+) Present value of Decommissioning, restoration costs	XXX
(+) Any directly attributable cost to bring the asset to the location & condition necessary to operatefor its intended purpose	XXX
Cost of Investment Property to be capitalized	**XXX**

Deferred credit period

Deferred credit period means excess credit period over and above normal credit period. If the entity acquired Investment property on deferred credit basis, it should be recognised at **CASH PRICE equivalent on the date of recognition** (Present value). The **difference** between the cash price **and** the total payment should be recognised as interest expense over the period of credit.

(B) SELF CONSTRUCTED INVESTMENT PROPERTY :

The following costs should be capitalised when the assets are constructed by the entity-

Particulars	Amounts Rs.
All the costs which are capitalised under Cash/Credit	XXX
Any other costs of construction that directly relate to the specific asset	XXX
Any other costs that can be attributable/allocable to the construction activity	XXX
Borrowing costs (if the Investment Property is a qualifying asset as per Ind AS 23)	XXX
Cost of self constructed Investment Property	**XXXX**

Note:

(a) The entity should NOT include internal profits on any items used from its stores (one cannot sell to own). Only cost of the items should be capitalised.

Abnormal loss of material, labour or any other resources used should not be part of self constructed asset.

(C) ACQUIRED BY EXCHANGE

When investment property is acquired in exchange or part exchange for another asset, the asset received is> usually recorded at

Determination of cost of assets to be recorded is based on the following TWO conditions:—

1. Does the transaction has commercial substance (explained below)? &

2. Can fair value of the asset given or taken is measured reliably?

Yes

Recognise at
- Fair value of the asset given up; (1st preference) or
- Fair value of the asset received; Whichever is **clearly evident**

No

It should be measured at COST i.e. Carrying amount of asset given up is the Cost of asset received.

(4) SUBSEQUENT EXPENDITURE :

Does subsequent expenditure increase the future economic benefits

i.e. satisfies the recognition criteria ?

Yes
Capitalise

No
Charge to P&L Statement

Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'repairs and maintenance' of the property and hence these expenses should be charged to P&L immediately in the period in which it is incurred.

(5) SUBSEQUENT MEASUREMENT

An entity should measure the investment property using COST MODEL as explained in Ind AS 16. The Standard **PROHIBITS** recognising the investment property using **fair value model.**

As per Ind AS 16 - COST MODEL	
Cost	xxx
Less: Accumulated depreciation	xx
Less: Accumulated impaired loss	xx
Net carrying amount	**xxx**

As per Ind AS 16, the entity should select an appropriate method of depreciate which reflects the pattern of consumption of future economic benefits. It should review residual value and useful life at every year end.

Note:

This Standard requires all entities to **measure the fair value** of investment property, only **for the purpose of disclosure** even though they are required to follow the cost model.

(6) TRANSFERS / RECLASSIFICATION

Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

- commencement of owner-occupation, for a transfer from investment property to owner-occupied Property;
- commencement of development with a view to sale, for a transfer from investment property to inventories;
- end of owner-occupation, for a transfer from owner-occupied property to investment property;
- Commencement of an operating lease to another party, for a transfer from inventories to investment property.

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

Investment property to Inventory:

An entity to transfer a property from investment property to inventories only when, there is a change in use, evidenced by commencement of development with a view to sale.

When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognised (eliminated from the balance sheet) and does not reclassify it as inventory.

Investment property to Owner occupied property:

Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

(7) DISPOSAL

An investment property shall be derecognised (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal..'

Gains or losses arising (difference between net sale proceeds and carrying amount) from the retirement or disposal of investment property shall be recognised in the statement of profit or loss in the period of disposal. If it is a sale and leaseback it should be dealt as per Ind AS 116;

QUESTIONS

Q.1. Shaurya Limited owns Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.

Following information is relevant for Building A for the year ending 31st March, 2020:

Building A was purchased 5 years ago at the cost of ₹ 10 crore and building life is estimated to be 20 years. The company follows straight line method for depreciation.

During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 2019 at the cost of ₹ 2 crore. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

Further, during the year 2019-2020, the company earned / incurred following direct operating expenditure relating to Building A and Building B:

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

The company does not have any restrictions and contractual obligations against buildings - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of ₹ 50 - ₹ 60. It is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at ₹ 10.50 crore on 31st March, 2020.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet. **(Nov. 20)**

IND AS – 16
PROPERTY, PLANT AND EQUIPMENT

(1) Scope
(2) Definition
(3) Recognition criteria
(4) Modes of Acquisition
(5) Subsequent Expenditure
(6) Replacement of PPE
(7) Inspection
(8) Subsequent Measurement Models
(9) Depreciation
(10) Component Accounting
(11) Question

(1) SCOPE

This standard does NOT deal with the following:- (Reasons are given in brackets)

(a) PPE classified as held for sale as per Ind AS 105;

(b) Biological assets (a living animal or living plant like group of animals) related to agricultural activity other than **bearer plants** (See below for bearer plant definition). This Standard applies to bearer plants but it does not apply to the produce on bearer plants (Refer Ind AS 41 for biological assets);

(c) Recognition and Measurement of exploration and evaluation assets (Refer Ind AS 106);

(d) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources; and (NO Ind AS exists, Industry rules and regulations are followed)

(e) If a PPE's recognition & measurement is covered by any other Ind AS (like Ind AS 116 - finance lease) to that extent one should follow the respective standard.

Bearer plant is a plant that:

(a) is used in the production/supply of agricultural produce;

(b) is expected to bear produce for more than a period of twelve months (in a way the life of the plant is more than 12 months); and

(c) has a remote likelihood of being sold as an agricultural produce, except for incidental scrap sales.

(2) DEFINITIONS

PPE are

↓

Tangible items

↓

Held for use in

Producing goods | Providing services | Rental to other | For administrative purpose

and expected to be used during more than a period.

3. RECOGNITION CRITERIA

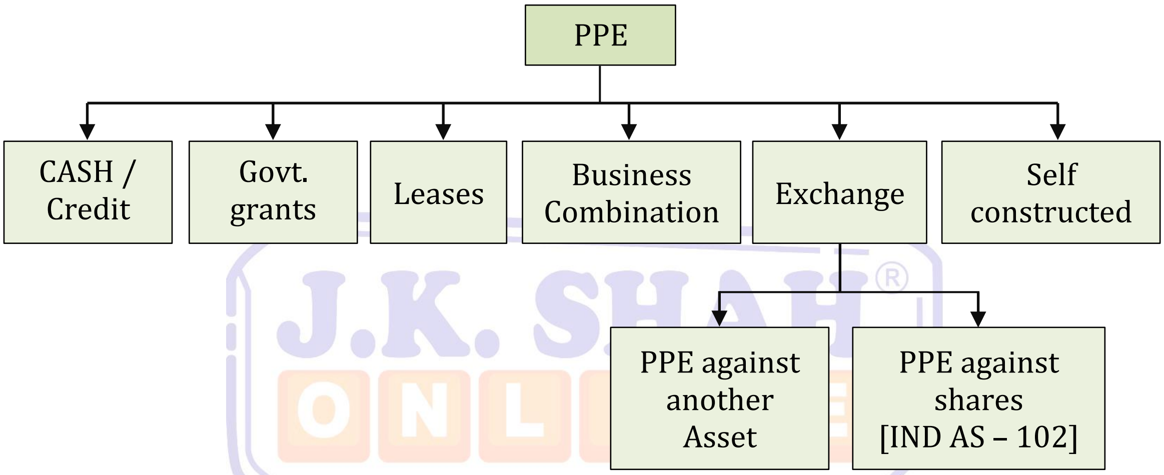
The cost of an item of PPE should be recognized as an asset if and only if:

- it is probable that future economic benefits associated with the asset will flow to the entity and,
- The cost of the item can be measured reliably.

Safety and environmental equipment

- The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an entity to obtain the future economic benefits from its other assets.
- Such items of PPE qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

4. MODES OF ACQUISITION



5. SUBSEQUENT EXPENDITURE

- The issue is whether subsequent expenditure is capital expenditure (i.e., to the Balance Sheet) or revenue expenditure (i.e., profit or loss statement).
- An entity does not recognize in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognized in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.
- To qualify for capitalization, cost must be associated with incremental benefit for example, modification to the asset made to extend its useful life or to increase its capacity would be capitalised. Similarly if the expenditure results in an improve quality of output or results in saving the cost it will qualify for capitalization.

6. REPLACEMENT OF PPE

- Some items (e.g. aircraft, ships, gas, turbine etc) are series of linked ' parts which require regular replacement at different intervals and so z have different useful lives.
- The carrying amount of an item of PPE recognizes the cost of replacing a part when that cost is incurred, if the recognition criteria are met.
- The carrying amount of replaced parts is derecognized (ie., treated as a disposal).

7. MAJOR INSPECTION

- Performing regular major inspections for faults, regardless of whether parts of the item are replaced, may be a condition of continuing to operate an item of PPE (e.g. an aircraft).
- The cost of each major inspection performed is recognized in the carrying amount, as a replacement, if the recognition criteria are satisfied.
- Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized.

8. SUBSEQUENT MEASUREMENT

Accounting Models

COST MODEL		REVALUATION MODEL	
If this model is chosen –PPE should be measured every year at		This model should be chosen to the PPE, where FAIR VALUE can be measured reliably.	
Cost	XXX	↓	
Less : Accumulated Depreciation	XX	PPE should be measured at	
		Fair Value of PPE	XXX
Less : Accumulated Impaired Loss	XX	Less : SUBSEQUENT accumulated	
Net carrying amount	**XXX**	depreciation	XX
		Less : SUBSEQUENT acc. impairment loss	XX
		Net carrying amount	XXX

Treatment of revaluation surplus

The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognized. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

Deferred taxation

- When an asset is revalued the amount of the revaluation is adjusted to reflect the impact of deferred tax on the revaluation.
- In most cases the tax base of an asset will not change when a company revalues its assets. Revaluation therefore creates a taxable temporary difference (assuming an increase in value)
- The credit recognized within other comprehensive income will be net of taxation and any subsequent transfer from revaluation reserve to retained earnings will also be net of taxation.

9. DEPRECIATION

Depreciation is the **systematic allocation** of the **depreciable** amount of an asset over its **useful life.**

Depreciable amount

Historical cost OR revalued amount (as determined above)	XXX
Less: Estimated residual value (Refer below)	(XX)
Depreciable amount	**XXX**

Example: **(Rs. in lakhs)**

Cost	**1000**
Accumulated depreciation	(250)
Carrying amount	750

Determine the accounting entries required to restate the carrying amount if revalued at Rs.1100 lakhs by elimination method.

(Rs. in lakhs)

Cost	**1100**
Accumulated depreciation	-
Carrying amount	1100

(Rs. in lakhs)

Cost (1100-1000)	Dr.	100	
Accumulated depreciation	Dr.	250	
To revaluation surplus (1100-750)			350

Example: **(Rs. in lakhs)**

Cost	1000
Accumulated depreciation	(250)
Carrying amount	750

Determine the accounting entries required to restate the carrying amount if revalued at Rs.1100 lakhs by using proportionately restatement method.

(Rs. in lakhs)

Cost (1000 × 1100/750)	1467
Accumulated depreciation 9250 × 1100/750)	(367)
Carrying amount	1100

(Rs. in lakhs)

Cost (1467-1000)	Dr.	467	
To Accumulated depreciation (367-250)			117
To Revaluation surplus (1100-750)			350

10 COMPONENT ACCOUNTING

An asset may consist of several different and significant physical components. If an item of property, plant and equipment comprises two or more significant components, with substantially different useful lives, usage or flow of economic benefits then each component should be recognised and depreciated separately over its individual useful life.

When a significant component is replaced or restored, the old component is derecognised (removed from the books of account i.e. ensuring the carrying amount of that will be NIL) and the cost of new component is capitalised, if the cost is recoverable (asset). This accounting leads to fair presentation of financial statements.

QUESTIONS

Q.1 Company X performed a revaluation of all of its plant and machinery at the beginning of 2018-2019. The following information relates to one of the machinery:

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

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

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? **(May – 19, May - 20)**

Q.2 Entity X has a warehouse which is closer to factory of Entity Y and vice versa. The factories are located in the same vicinity. Entity X and Entity Y agree to exchange their warehouses. The carrying value of warehouse of Entity X is ₹ 1,00,000 and its fair value is ₹ 1,25,000. It exchanges its warehouse with that of Entity Y, the fair value of which is ₹ 1,20,000. It also receives cash amounting to ₹ 5,000. How should Entity X account for the exchange of warehouses? **(Nov. 20)**

IND AS – 21

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

(1) Scope

(2) Definition

(3) Accounting of Foreign Currency transactions in functional currency

(4) Translation to the presentation currency from the functional currency

(5) Translation of a foreign operation

(6) Different reporting dates of foreign operation and reporting entity

(7) Disposal of foreign entity

(8) Foreign currency transactions and advance consideration (Appendix B)

(1) SCOPE :

This Standard shall be applied:

- **Reporting foreign currency transactions in the functional currency-** I
- **Translation in foreign operations-**
- **Translation to the presentation currency-**

This Standard does not apply:

- To the presentation in a statement of cash flows of the cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (Ind AS-7, Statement of Cash Flows).
- To long-term foreign currency monetary items for which an entity has opted for the exemption given in Ind AS-101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.

(2) DEFINITION:

Presentation currency is the currency in which the financial statements are presented; Indian companies must present the financial statements in Rupees - hence Indian Rupee is the presentation currency;

FUNCTIONAL CURRENCY - the currency of the PRIMARY ECONOMIC ENVIRONMENT in which the entity operates.

What is primary economic environment?

It is the economic environment in which an entity **primarily generates and expends cash.**

Indicators to decide Functional Currency

Primary Indicators	Secondary Indicators
Functional currency is ▸ the currency which Influence the selling price of goods/services (Mostly sales are denominated and settled in this currency); ▸ the currency of the country based on whose market forces and regulations - selling price of goods/services are determined; **(The above points are related to revenue)** ▸ The currency which influence the labour, material and other costs of providing goods or services (normally such costs are denominated and settled in that currency) **(This point related to costs) In simple words, functional currency is currency which influence the revenue and expenses.**	Management should consider the following: ▸ It is the currency in which financing activities are taking place i.e. issuing debt or equity instruments in that currency; ▸ It is the currency in which receipts from operating activities are retained i.e. savings are retained in this currency;

What is foreign currency?

A currency **other than functional currency** of the entity;

Say, A Ltd. is an Indian company, whose functional currency is US dollars (as its revenue and expenses are fully in USD). All other currencies other than USD are foreign currencies for the preparation of financial statements. In this case, Indian rupees also foreign currency, as it is other than functional currency.

Closing rate - Spot rate on the balance sheet date;

Monetary items are units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.

Non-monetary items are those which are not monetary items.

Self test for you

Particulars	Monetary/Non-monetary ?
Fixed assets:	
Tangible fixed assets	
Intangible assets	
Right-of-use Asset (Ind AS 116)	
Investments:	
Investment in equity shares	
Investment in debentures	
Investment in Govt, bonds	
Current Assets, Loans and advances:	
Cash in hand & at bank	
Trade receivable (debtors)	
Bills receivable	
Inventory	
Prepaid expenses	
Advance paid to suppliers for goods	
Loan given	
Other receivables	

Secured loans & Unsecured loans:	
Debentures	
Convertible debentures	
Bank loans	
Public deposits	
Current liabilities:	
Trade payables (creditors)	
Dividend payable	
Bills payable	
Advance received from customers	
Lease liabilities	
Provisions:	
Provisions for income tax	
Provision for gratuity	
Provision for warranty	

(3) ACCOUNTING OR FOREIGN CURRENCY TRANSACTIONS IN FUNCTIONAL CURRENCY:

Initial recognition

Foreign currency transactions should be recorded initially at the spot rate of exchange at the date of the transaction. An approximate rate can be used. For example, in general, an average rate for a particular period can be used, but if exchange rates are fluctuating wildly, an average rate cannot be used.

Reporting at the ends of subsequent reporting periods

Subsequently, at each balance sheet date:

- Foreign currency monetary amounts should be reported using the closing rate.
- Non-monetary items measured at historical cost should be reported using the exchange rate at the date of the transaction.
- Non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined.

Foreign exchange rate difference

The foreign exchange difference arises in the following cases:-

(1) Transaction is initially recorded at one rate and it is settled at another rate during the same period. (Settlement means payment or receipt of consideration)

(2) Transaction is initially recorded at one rate and it is subsequently measured using another rate. (Since it is not settled till the balance sheet date)

(3) Transaction is measured on BS date using one rate and subsequently settled at another rate.

All the above foreign exchange differences should be recognised in the Profit and Loss a/c as exchange gain or loss in the year in which it occurs.

Exception

When a gain or loss on a non-monetary item is recognised in other comprehensive income (COI), any fluctuation gain or loss arising from such item shall be recognised in OCI. 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.

Say an Indian entity has a building in US and cost is $ 100,000, initially recognised at ₹ 50,00,000 (when 1$ = ₹ 50). The entity is valuing the PPE using **revaluation model**. The fair value at the year end is $ 102,000 and 1$ = ₹ 52 on that date. The revaluation gain is transferred to revaluation surplus and presented in OCI as per Ind AS 16. At the same time, as per this standard, if the non-monetary asset valued at fair value, it should be restated using the rate on valuation date. In this case, the fluctuation difference **and** revaluation gain of ₹3,04,000 should be taken to OCI (but not to P&L).

(4) TRANSLATION TO PRESENTATION CURRENCY FROM THE FUNCTIONAL CURRENCY:

An entity can present its financial statements in any currency. If the presentation currency differs from the functional currency, the financial statements are retranslated into the presentation currency.

Translation approach - Translation from functional currency to presentation currency

Functional Currency	Presentation Currency
Assets / Liabilities	
♦ Current Period	Closing rate (current Balance Sheet date)
♦ Comparative period	Closing rate (Comparative Balance Sheet date)

Equity items	
♦ Current Period	Actual rates(or appropriate average for current period)
♦ Comparative period	Actual rates(or comparative average for comparative period)
Income/expenses (including those recognized directly in equity)	
♦ Current Period	Actual rates(or appropriate average for current period)
♦ Comparative period	Actual rates(or comparative average for comparative period)
Exchange differences	**Separate component of equity**

(5) TRANSLATION OF A FOREIGN OPERATION:

What is a foreign operation?

It is Foreign → Subsidiary / Associate / Joint / Branch — Whose activities are Based OR Conducted → In a Country / OR Currency — Other than those of the reporting entity

Important - read carefully

When the entity has a foreign operation (FO), one should **determine the functional currency of FO.**

If the FO is an integral part OR an extension of the reporting entity - functional currency of FO should be same functional currency as the reporting entity; (If functional currency of reporting entity and FO are same, there is no need to convert any balances ofFO)

Where the FO is set up as a special purpose entity (SPE) in a country other than the reporting entity s country, its activities are clearly being conducted on behalf of the parent entity (e.g. it may be set up for tax reasons to effect a lease or research and development activities) and the SPE is an extension of the reporting entity, it would be expected to have the same functional currency as that of the reporting entity.

Translation of a foreign operation:

The financial statements should be translated into the presentation currency as under:

- assets and liabilities for each balance sheet presented (ie., including comparatives) shall be translated at the closing rate at the date of that balance sheet;
- income and expenses for each statement of profit and loss presented (ie., including comparatives) shall be translated at exchange rates at the dates of the transactions;

The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary. However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations.

Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference is recognised in profit or loss or, if it arises from the exchange difference arising on a monetary item that forms part of reporting entity net investment in a foreign operation, it is recognised in other comprehensive income and accumulated in a separate component of equity until the disposal of the foreign operation.

Exchange differences on intra group items are recognized in profit or loss unless the difference arises on the retranslation of an entity's net investment in a foreign operation when it is classified as equity.

Dividends paid in a foreign currency by a subsidiary to its parent company may lead to exchange differences in the parent's financial statements and will not be eliminated on consolidation but recognized in profit or loss.

(6) DIFFERENT REPORTING DATES:

Different reporting dates (Balance sheet dates) of Foreign Operation & Reporting entity

- In this case foreign operation has one reporting date (say Balance sheet date say 31st Dec) whereas the reporting entity i.e. holding company has another reporting date (Say Balance date say 31st March).
- Normally in case of different reporting dates, FO often prepares its financial statements as at the same date as the reporting entity only for consolidation purpose (i.e. FO also prepares financial statements as at 31st March for consolidation purpose).

- ✍ If it is impracticable to prepare financial statements as at the same date as reporting entity, Ind AS 110 allows the use of financial statements prepared at a different reporting date (maximum allowed gap is three months between the reporting date of FO and reporting entity).
- ✍ In this case FO should be adjusted by giving effects of all significant transactions and events occurred between the different reporting dates.
- ✍ In such a case, the assets and liabilities of the FO are translated at the exchange rate at the balance sheet date of the FO and adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprises in accordance with Ind AS 110.
- ✍ The same approach is used in applying the equity method to associates and joint ventures in accordance with Ind AS 28.

(7) DISPOSAL OF FOREIGN ENTITY:

- ✍ Disposal means - entity is reducing its interest in the foreign operation. It can dispose of fully or partially through a sale, liquidation, repayment of share capital, abandonment of all or part of it.
- ✍ Writing down the carrying amount of interest in foreign operation because of impairment loss or huge losses incurred by FO does not constitute partial disposal and it need not follow the following accounting.
- ✍ On **complete sale** of foreign operation (branch, subsidiary, etc.), the accumulated balance in FCTR should be reclassified from equity to P&L statement (as a reclassification adjustment) as gain or loss on disposal; FCTR related to non controlling interest should NOT be reclassified to profit or loss but it should be derecognised.

(8) FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION (APPENDIX-B)

Example: On 1-2-2018 Sun Ltd enters into a contract to supply machinery for USD. 10000. The terms of the contract stipulated that an advance payment of 40% should be paid on 1-3-2018 and balance on 30-4-2018. The machinery will be delivered on 1 -4-2018. On 1 -3-2018 Sun Ltd receives USD 4,000 and recognises a non-machinery liability by converting the advance receipt at the spot exchange rate on 1-3-2018 which was 1USD = INR 60. Entry passed:

Bank A/c	Dr. ₹ 2,40,000
To Contract Liability	₹ 2,40,000

On 1-4-2018 Sun Ltd will pass the following entry (Exchange rate on this date was 1 USD = INR 62):

Contract Liability A/c	Dr. ₹ 2,40,000
Receivables A/c	Dr. 3,72,000
To Revenue (USD 10000)	₹ 6,12,000

On 30-4-2018 payment against receivable was received at exchange rate1 USD = INR 63

Bank A/c	Dr. ₹ 3,78,000
To Receivables	₹3,72,000
To Foreign Exchange Gain	₹ 6,000

(9) FIRST TIME ADOPTION OF IND AS

Long Term Foreign Currency Monetary Items (LTFCMI) (Carve out)

A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items RECOGNISED in the financial statements for the period ending immediately before the beginning of the First Ind AS financial reporting period as per the previous GAAP.

If any LTFCMI is created after First Ind AS financial period -for those LTFCMI, this option is not available. It means foreign exchange difference arising from those should be charged to P&L i.e. complying with Ind AS 21.

It means, if they had chosen the option as per MCA notification in AS 11 - it can be continued in Ind AS at the entity's option.

QUESTIONS

Q.1. Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are 72 per USD and 75 per USD respectively.

(May - 19)

Q.2. On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = 2.50.
- 31st March, 20X2 – FCY 1 = 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2?

Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. (May - 20)

Q.3. Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1.

The exchange rates as at 30th September, 20X1 was 82 / EURO and at 31st March, 20X2 was 84 / EURO.

What is the value at which the goodwill has to be recognised i n the financial statements of Global Limited as on 31st March, 20X2?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was 83 / EURO and on 31st March, 20X2 was 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements.

(Nov. 19)

Q.4. An Indian entity, whose functional currency is rupees, purchases USD dominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = 40 and USD 1 = 45, respectively. The weighted average exchange rate for the year is 1 USD = 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees)

(Nov. 20)

IND AS – 32, 109, 107
Financial Instruments

QUESTIONS

IND AS - 109

Q.1. KK Ltd. has granted an interest free loan of ₹ 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:

(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.

(ii) The said Loan is interest free and will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. Considering the same, the fair value of the loan at initial recognition is ₹ 8,10,150.

(iii) The said loan is interest free and will be repaid as and when the YK Ltd. has funds to repay the Loan amount.

Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year for the above loan.

Further the Company is also planning to grant interest free loan from YK Ltd. to KK Ltd. in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS? **(May - 19)**

Q.2. An entity purchases a debt instrument with a fair value of ₹ 1,000 on 15th March, 20X1 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5% over the contractual term of 10 years, and has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset.

On 31st March 20X1 (the reporting date), the fair value of the debt instrument has decreased to ₹ 950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that ECL should be measured at an amount equal to 12 month ECL, which amounts to ₹ 30.

On 1st April 20X1, the entity decides to sell the debt instrument for ₹ 950, which is its fair value at that date.

Pass journal entries for recognition, impairment and sale of debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided. **(Nov. - 19)**

IND AS 32

Q.3. XYZ issued ₹ 4,80,000 4% redeemable preference shares on 1st April 20X5 at par. Interest is paid annually in arrears, the first payment of interest amounting 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by accountant. The preference shares are redeemable for a cash amount of ₹ 7,20,000 on 31st March 20X8. The effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity by accountant as this reflects the legal nature of the shares. Board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

Mukesh, Accounts manager of XYZ has been told to review the accounting of aforesaid issue. CFO has asked from Mukesh the closing balance of preference shares at the year end. If you were Mukesh, then how much balance you would have shown to CFO on analysis of the stated issue. Prepare necessary adjusting journal entry in the books of account, if required. **(May – 20)**

Q.4. On 1st January, 20X0, entity A issued a 10% convertible debenture with the face value of ₹1000 maturing on 31st December, 20X9.The debenture is convertible into ordinary shares of entity A @ a conversion price of ₹ 25 Per share. Interest is payable half yearly in cash. At the date of issue, entity A could have issued non-convertible debt with a 10 year term bearing a coupon interest rate of 11%. On 1st January, 20X5, the convertible debentures have a fair value of ₹ 1600 entity A makes a tender offer to the holder of the debentures to repurchase the debentures for ₹ 1600, which the holder accepts. At the date of repurchase, entity A could have issued non-convertible debt with a 5 year term bearing a coupon interest rate of 8%.

Q.5. A Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of A Limited, took a loan from the Company on the following items :

- Principal amount is ₹ 10,00,000.
- Interest rate is 4% for the first ₹ 4,00,000 and 7% for the next ₹ 6,00,000.
- Start date is 1st January 2019.
- Tenure is 5 years.
- Pre – Payment option: Full or partial pre – payment at the option of he employee.
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal.
- The accrued interest shall be paid on an annual basis.
- Mr. X must remain in service till the term of the loan ends.

The market rate of a comparable loan available to Mr. X, is 12% per annum. Following table shows the contractually expected cash flows from the loan given to Mr. X.

(Amount in Rs.)

Date	Inflows				
	Outflows	Principal	Interest income @ 7%	Interest income @4%	Principal outstanding
1st January, 2019	(10,00,000)				10,00,000
31st December, 2019		2,00,000	42,000	16,000	8,00,000
31st December, 2020		2,00,000	28,000	16,000	6,00,000
31st December, 2021		2,00,000	14,000	16,000	4,00,000
31st December, 2022		2,00,000	-	16,000	2,00,000
31st December, 2023		2,00,000	-	8,000	-

Mr. X pre – pays ₹ 2,00,000 on 31st December 2020, reducing the outstanding principal as at that date to ₹ 4,00,000.

Following table shows the actual cash flows from the loan given to Mr. X, considering the pre – payment event on 31st December 2020:

Date	Inflows				
	Outflows	Principal	Interest income @ 7%	Interest income @4%	Principal outstanding
1st January, 2019	(10,00,000)				10,00,000
31st December, 2019		2,00,000	42,000	16,000	8,00,000
31st December, 2020		4,00,000	28,000	16,000	4,00,000
31st December, 2021		2,00,000	-	16,000	2,00,000
31st December, 2022		2,00,000	-	8,000	2,00,000
31st December, 2023		-	-	-	-

Record journal entries in the books of A Limited applying the requirements of Ind As 109.

Q.6. A Limited issues INR 1 crore convertible bonds on 1st July 20X1. The bonds have a life of eight years and a face value of INR 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited at any time in the next eight years. Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8 per cent per annum.

Required:

(a) Provide the appropriate accounting entries for initial recognition.

(b) Calculate the stream of interest expenses across the eight years of the life of the bonds.

(c) Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year.

Q.7. Vedika Ltd. issued 80,000 8% convertible debentures of ₹ 100 each on 1st April, 2015. The debentures are due for redemption on 31st March, 2019 at a premium of 20%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion right was 12%. The conversion to equity qualifies as fixed for fixed.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Vedika Ltd.'s books at initial recognition only. The following present values of Rupee 1 at 8% and 12% are provided for a period of 5 years.

Interest rate	Year 1	Year 2	Year 3	Year 4	Years 5
8%	0.923	0.853	0.789	0.731	0.677
12%	0.887	0.788	0.701	0.625	0.557

Q.8. **Make necessary journal entries** for accounting of the security deposit made by Admire Ltd., whose details are described below. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1st April, 2014
Date of Security Deposit (Finishing Date)	31st March, 2019
Description	Lease
Total Lease Period	5 years
Discount rate	12%
Security deposit (A)	20,00,000
Present value factor at the 5th year	0.567427

(OR)

Calculate EPS, when

	20X0	20X1	20X2
Profit attributable to ordinary equity holders of the parent entity	₹ 1,100	₹ 1,500	₹ 1,800

Shares outstanding before rights issue	500 shares
Rights issue	One new share for each five outstanding shares
Exercise price	₹ 5.00
Date of rights issue	1st January 20X1
Last date to exercise rights	1st March 20X1
Market price of one ordinary share immediately before exercise on 1st March 20X1:	₹ 11.00
Reporting date	31st December

IND AS – 34
INTERIM FINANCIAL REPORTING

(1) Terms

(2) Period of Reporting to be presented

(3) Recognition and Measurement

(4) Measurement of Tax Expense for IFR

(5) Interim Financial Reporting and Impairment

(1) TERMS:

Interim financial report means a financial report containing either a **complete set** of financial statements (as per Ind-AS 1) or a **condensed set** of financial statements (as described in this Standard) for an interim period. (Complete or condensed set is an option to the entity)

Interim period is a financial reporting period shorter than a full financial year.

Interim Financial Report

An entity has an option to prepare either

Complete set of financial statements

Normally this includes:

(a) balance Sheet;

(b) statement of profit and loss;

(c) Statement of changes in equity;

(d) cash flow statement;

Condensed set of financial statements

This should include:

(a) condensed balance sheet;

(b) condensed statement of profit and loss;

(c) condensed statement of changes in equity;

(d) condensed cash flow statement;

(e) notes to accounts - significant accounting policies & explanatory information;	(e) **selected explanatory notes.**
(f) comparative information for PY;	
(g) Opening Balance sheet of PY (3 balance sheets) Only when: (i) Change in accounting policies; (ii) Retrospective restatement of financial statements; and (iii) Reclassification of items in FS.	

(2) PERIOD OF REPORTING TO BE PRESENTED:

Interim reports should include interim financial statements (condensed or complete) for periods as follows: (The following examples are based on the Assumption that financial year ends on 31st March)

	Current period	Comparative period
Balance Sheet	BS as at the end of current Interim period; E.g. 30th September, 2015	As at the end of immediate previous financial year; E.g. 31st March, 2015
Profit and Loss statement	(i) P&L for the current interim period; (ii) P&L cumulatively for the current financial year to date; and (iii) P & L for 12 months period (Only if the entity is engaged in highly seasonal business)	Comparable interim periods for all the three situations. For the period in PY, P&L cumulatively for the PY financial year to date and P&L for 12 months period.
Example 1	Assume Interim report period has been assumed to be September, 2015 (2nd Quarter ending)	
	(i) 3 months ending Sep 2015 (P&L period is July to Sep 2015) and	**(i) 3 months ending Sep.2014** (P & L period is July to Sep.2014) and

	(ii) 6 months ending Sep 2015 (P&L period is Apr to Sep 2015) - (P&L cumulatively)	**(ii) 6 months ending Sep 2014** (P&L period is Apr to Sep 2014)
Example 2	If the entity is Engaged in **highly Seasonal business** :	
	(i) 3 months ending Sep 2015 (P&L period is July to Sep 2015)	**(i) 3 months ending Sep 2014** (P&L period is July to Sep 2014)
	(ii) 6 months ending Sep 2015 (P&L period is Apr to Sep 2015) - (P&L cumulatively) and	**(ii) 6 months ending Sep 2014** (P&L period is Apr to Sep 2014) - (P&L cumulatively) and
	(iii) 12 months ending Sep 2015 (P&L for the period Oct 2014 to Sep 2015)	**(iii) 12 months ending Sep 2014** (P&L for the period Oct 2013 to Sep 2014)
Statement of changes in equity	Statement of changes in equity for the current financial year to date; E.g. Statement period is Apr to Sep 2015	Comparable year to date period of immediately preceding financial year; E.g. Statement period is Apr to March 2015
Cash flow statement (CFS)	**6 months ending Sep 2015** (CFS period is Apr to Sep 2015)	**6 months ending Sep 2014** (CFS period is Apr to Sep 2014)
	If the entity is Engaged in **highly Seasonal business:**	
	12 months ending Sep 2015 (CFS for the period Oct 2014 to Sep 2015)	**12 months ending Sep 2014** (CFS for the period Oct 2013 to Sep 2014)

(3) RECOGNITION AND MEASUREMENT:

Same accounting policies as ANNUAL

In preparation of interim financial statements, an entity should use the same accounting policies which were applied in its annual financial statements. In case of any change in accounting policies, it should use the new policies.

The principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements. Let us understand the same in detail (Please read once again the chapter "framework for preparation of financial statements" before going through the below lines). Read this carefully, as these items will not be recognised in interim financial statements when it does not satisfy the below discussed conditions:-

- **Asset:** An asset should be recognised (recorded in books of account) when it satisfies the two conditions i.e. 1. Future economic benefits inflow should be probable and 2. Costs or value should be measured reliably. The same conditions should be satisfied even on interim date like annual accounts. If it doesn't satisfy the conditions it cannot be recognised.
- **Liability:** It should be recognised only when the obligation is present (exist) as on interim date.
- **Income:** Recognise when there is an increase in future economic benefits either by way of increase in an asset or decrease of a liability and it should be measured reliably.
- **Expense:** Recognise when there is a decrease in future economic benefits either by way of decrease in an asset or an increase of a liability and it should be measured reliably.
- In case of annual accounts, they measure the above items on year to date basis i.e. cumulatively by considering the information from the beginning of the accounting year till the balance sheet date.

Costs incurred unevenly during the financial Year

Generally costs that are incurred unevenly during an entity's financial year should be recognised whenever they are incurred. Deferring or anticipated costs are permitted only when deferring or anticipating that type of costs is appropriate at the end of the financial year.

(4) MEASUREMENT OF TAX EXPENSE :

What is estimated annual effecting tax rate?

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

Measuring interim income tax expense

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

Example 1: An entity reporting quarterly expects to earn ₹10,000 pre-tax each quarter and operates in a jurisdiction with a tax rate of 20% on the first ₹20,000 of annual earnings and 30% on all additional earnings. Actual earnings match expectations. The following table shows the amount of income-tax expense that is reported in each quarter:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expense (₹)	2,500	2,500	2,500	2,500	10,000

Total income for the full year = 10000 × 4 = ₹ 40,000

Total tax payable for the full year: 20% on ₹ 20,000 = ₹ 4,000 and 30% on ₹ 20,000 = ₹6,000;

Total tax ₹ 10,000; Annual effective tax rate = 10,000/40,000 × 100 = 25%

Therefore, tax for each quarter = ₹ 10,000 × 25% – ₹ 2,500 per quarter

Example 2: An entity reports quarterly, earns ₹ 15,000 pre-tax profit in the 1st quarter but expects to incur losses of ₹ 5,000 in each of the 3 remaining quarters (thus having zero income for the year), and operates in a jurisdiction in which its estimated average annual income-tax rate is expected to be 20% . The following table shows the amount of income-tax expense that is reported in each quarter:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expenses (₹)	3,000	(1,000)	(1,000)	(1,000)	0

Effective tax rate in this case will be 20% only and will be applied to each quarter.

Ex for practice:-

An enterprise reports quarterly, estimates an annual income of ₹10 lakh. Assume tax rates on 1st ₹5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹75,000, ₹2,50,000, ₹3,75,000 and ₹3,00,000. Calculate the tax expense to be recognized in each quarter.

(5) INTERIM FINANCIAL REPORTING AND IMPAIRMENT:

Interim Financial Reporting and Impairment

I An entity is required to assess goodwill for impairment at the end of each reporting period, to assess investments in equity instruments and in financial assets carried at cost for impairment at the end of each reporting period and, if required, to recognize an impairment loss at that date in accordance with Ind AS-36 and Ind AS-109. However, at the end of a subsequent reporting period, conditions may have so changed that the impairment loss would have been reduced or avoided had the impairment assessment been made only at that date. Appendix to Ind AS-34 provides guidance on whether such impairment losses should ever be reversed.

An entity shall not reverse an impairment loss recognized in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

An entity shall not extend this accounting principle by analogy to other areas of potential conflict between Ind AS-34 and other Indian Accounting Standards.

Example: AK Ltd. with a 31st December year end prepared interim financial statements for the 1st half of the year. At 31st December 2018, it has goodwill with a carrying amount of ₹1,000. At 30th June 2019, the cash generating units (CGU) to which the goodwill had been allocated at the date of the acquisition became loss-making and AK Ltd. reviewed the assets of the CGU for impairment. This resulted in the goodwill being written down to ₹ 200, with the impairment of ₹ 800 recognized in the income statement. During the 2nd half of the year, the CGUs became profitable once again and, had no impairment been recognized, would have supported a goodwill carrying amount of ₹1,000. Despite this, AK Ltd. is not permitted to reverse the impairment and the goodwill will have a carrying amount of ₹ 200 in its annual financial statements for the year ended 31st December 2019.

QUESTIONS

Q.1. An entity reports quarterly, earns ₹ 1,50,000 pre-tax profit in the first quarter but expects to incur losses of ₹ 50,000 in each of the three remaining quarters. The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct. If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

(Nov. 19)

Q.2. An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at ₹ 10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

How the related tax charge would be calculated for the year 2019 and its quarters.

(Nov. 20)

IND AS – 36
IMPAIRMENT OF ASSETS

(1) Scope
(2) Definitions
(3) Impairment Testing
(4) Recognition and Measurement
(5) Cash Generating Unit
(6) Goodwill
(7) Corporate Assets
(8) Reversal of Impairment Loss
(9) NCI measured initially as a proportionate share of the Net Identifiable Assets
(10) Question

(1) SCOPE

This Standard is applicable for the impairment of all assets - except the following:—

(a) Inventories (as it is valued at the lower of cost or NRV as per Ind-AS 2);

(b) contract assets and assets arising from costs to obtain or fulfill a contract that are recognised in accordance with Ind-AS 115, Revenue from contracts with customers;

(c) Deferred tax assets (as covered by Ind-AS 12);

(d) assets arising from employee benefits (see Ind-AS 19 - Employee Benefits); (As per Ind-AS 19, Plan assets are measured a fair value)

(e) Financial assets which are covered by Ind-AS 109 - Impairment of these assets are given in the same Ind-AS;

(f) biological assets related to agricultural activity within the scope of Ind-AS 41 (Agriculture that are measured at fair value less costs to sell - NRV);

(g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of Ind-AS 104, Insurance Contracts; and

(h) non-current assets (or disposal groups) classified as held for sale in accordance with Ind-AS 105 - (As per the standard, non-current assets are valued at Book value or NRV whichever is lower)

(2) DEFINITIONS

(a) Impairment Loss

It is the amount by which the carrying amount of an asset exceeds its recoverable amount (**Carrying amount > Recoverable amount**). Impairment loss = Carrying amount - recoverable amount;

Fair value less costs of disposal

Recoverable amount → is higher of → OR

Value in use

(b) Value in use

It is the **present value of estimated** future cash flows

↓

Arising from

(a) Continuing usage of the asset during its useful life;

+

(b) Sale of asset at the end of its useful life

(c) Fair value

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

(d) Costs of disposal

These are incremental (additional) costs directly attributable to the disposal of an asset, excluding finance costs and income-tax expense.

Examples are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct costs to bring an asset into condition for its sale. However, termination benefits to employees (as per Ind-AS 19) and costs associated with reorganising a business following the disposal of an asset are **not direct incremental** costs to dispose of the asset.

(e) Carrying amount (Book value)

Cost of the asset		xxx
Less:	Accumulated depreciation/amortisation	xx
Less:	Accumulated impairment losses (which were recognised in previous years)	xx
Carrying amount (This should be compared with recoverable amount)		xxx

(3) IMPAIRMENT TESTING

Indicator and Impairment

External Source of Information	Internal Source of Information
(a) Asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; (because of this fair value less costs of disposal will be reduced)	(a) Obsolescence or Physical damage of an asset;
(b) Significant adverse effects on the technological, market, economic or legal environment in which the entity is operating; e.g. recession, technology obsolescence, ban of products by the government, restrictions because of change in laws, etc.;	(b) The asset becoming idle or Any restructuring activity i.e., as part of the plans to discontinue or restructure an asset may be disposed off before the previously expected date or the asset may not be used in the manner in which it was used - it may affect the cash flows; (But remember once the asset meets the criteria to be classified as held for sale - it will be scoped out of this Ind-AS and governed by Ind-AS 105)

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;	(c) Reassessing the useful life of an asset as finite rather than indefinite; (that leads to decrease in cash flows during the limited life and have an impact on value in use and its market value as well)
(d) the carrying amount of the net assets of the reporting entity is more than its market capitalization	(d) The economic performance of an asset is worse than expected;
	(e) Actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted; and
	(f) Cash flows for acquiring the asset, or subsequent cash requirements for operating or maintaining it, that are significantly higher than those originally budgeted.

EXCEPTION TO IMPAIRMENT TESTING :

It means the entity should **test for impairment every year irrespective of any indication.** It is with respect to the following items:

(a) Intangible asset with an indefinite useful life;

(b) Intangible asset not yet available for use (Intangible asset under development);

With respect to (a) & (b) -

- This impairment test may be performed at any time during an annual period, but it should be performed at the same time every year.
- Different intangible assets may be tested for impairment at different times.
- If such an intangible asset [(a) & (b)] was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

(c) Goodwill acquired in a business combination for impairment annually.

(4) RECOGNITION AND MEASUREMENT

Recognition of an impairment loss for an individual asset

If recoverable amount of an asset is less than carrying amount, the impairment loss equal to excess of carrying amount over recoverable amounts is recognized as impairment loss in profit or loss and carrying amount of an asset is reduced to its recoverable amount. The amount of impairment loss to be recognized in profit or loss will differ if asset is carried at historical cost and if carried at revalued price.

If asset is carried at historical cost

Impairment losses will be recognized only when recoverable amount of an asset is less than the carrying amount (historical cost less depreciation)

Amount of impairment loss, which is equal to carrying amount of asset minus recoverable amount, this amount of loss, will be debited to Profit or Loss as an expense.

If asset is carried at revalued amount

If asset is carried at revalued amount the amount of impairment loss is calculated in the same way i.e.:

Carrying amount of Assets minusrecoverable amount

(Which is revalued price less depreciation)

However the recognition of impairment loss shall be as under:

- Impairment loss upto revaluation reserve (surplus) is recognized in other comprehensive income and reduces the revaluation surplus.
- Impairment loss in excess of revaluation surplus balance shall be recognized as an expense in statement of profit and loss.

(5) CASH GENERATING UNIT

Impairment loss for cash generating unit (CGU)

What is cash generating unit - Till this time we have discussed how the impairment loss for an individual asset is determined and recognized. However generally, it becomes difficult to calculate the recoverable amount for an individual asset because cash flows to be derived from individual asset cannot be calculated separately, as this individual asset in itself without the help of other assets cannot generate the cash flows. Therefore for the purpose of identifying cash flows, asset can be grouped into a smallest unit and such a grouping of assets to facilitate the identification of cash flows gives a new concept of cash generating unit (CGU).

Recoverable amount of CGU

A CGU includes the carrying amount of only those assets which are attributed directly or allocated on a reasonable and consistent basis to it. When assets are grouped for recoverability assessments, it is important to include in the CGU all assets that generate or are used to generate the relevant stream of cash inflows. This might include goodwill or corporate assets at head office.

However a liability is not included in CGU unless the recoverable amount of the CGU cannot be determined without consideration of this liability. This may occur if the disposal of a CGU would require the buyer to assume the liability. Example is decommissioning and restoration liability attached to Property, Plant and Equipment.

In allocating impairment loss as explained above, the carrying amount of an asset should **not be reduced below the highest of:**

(a) its fair value less costs of disposal (if determinable);

(b) its value in use (if determinable); and

(c) zero.

If any particular asset carrying amount becomes zero after impairment, the remaining impairment loss should be allocated to other assets on pro-rata basis as if that asset does not exist.

(6) GOODWILL :

Only acquired goodwill should be recognised in financial statements. Goodwill does not generate cash flows independently, therefore recoverable amount of goodwill as an individual asset cannot be determined.

ONLY for impairment testing, Goodwill acquired in a business combination should be allocated from the date of acquisition to each of the **acquirer's CGUs or group of CGUs, that EXPECT TO GET BENEFIT from the synergies of the combination** irrespective of whether other assets or liabilities of the acquiree are assigned to those units or group of units. (Read again carefully)

One should remember that, this process is only for impairment testing. The entity should decide which CGU or group of CGU is getting the synergy benefit from the business combination. This involves significant professional judgement at the time of the acquisition (i.e. the acquisition date). It can be allocated to the existing CGUs of the entity before acquisition OR to the new CGUs OR in some proportion.

Purchased goodwill may be related to a single or a group of CGUs.

Each unit or group of units to which the goodwill is so allocated shall:

(a) represent the lowest level within the entity at which the goodwill is **monitored for internal management purposes;** and

(b) **not be larger than an operating segment** as defined by Ind-AS 108, Operating Segments, before aggregation.

If the above two conditions are not satisfied, goodwill should not be allocated such CGU or group of CGU. (remember this - useful at the time of testing for impairment); it means there will be CGUs, for which goodwill is related but the same is not allocated due to the above conditions.

A **'non-arbitrary'** basis for the allocation of goodwill to CGUs (or groups of CGUs) is a matter of judgement depending on facts and circumstances. An example that would be considered 'arbitrary' is allocating goodwill to four individual CGUs on the basis of 25% to each CGU, simply because there are four CGUs. One of the approaches for goodwill allocation is a **relative fair value approach (In the proportion of fair values on the date of acquisition).**

The initial allocation of goodwill should normally take place in the financial year in which acquired. If the **initial allocation** of goodwill acquired in a business combination **cannot be completed before the end of the annual period** in which the business combination is effected, that initial allocation shall be completed before the **end of the first annual period beginning after the acquisition date.**

In accordance with Ind-AS 103 - 'Business Combinations', if the initial accounting for a business combination is determined **only provisionally by the end of the period** in which the combination is effected, the acquirer:

(a) accounts for the combination **using those provisional values**; and

(b) **recognise any adjustments** to those provisional values as a result of completing the initial accounting within the measurement period, which will not exceed **twelve months from the acquisition date.** In this case, the entity should disclose the reason for not allocating.

Testing CGU with goodwill for impairment

The following table explains on when to test the goodwill for impairment L0

Situation	When to test?
When goodwill is **related** to the CGU but **NOT ALLOCATED**	Only when there is an **indication** that it may be impaired;
When goodwill is **ALLOCATED** to the CGU	Test impairment **Annually;** and • Whenever there is an indication that CGU is impaired; **Some important points** • Impairment test can be performed anytime during the year; but it should be at the same time every year; • Different CGUs can be tested at different timings; • If a CGU to which goodwill is allocated, is acquired during the current annual period, it shall be tested for impairment before the end of current annual period;

(7) CORPORATE ASSETS

As defined by the Ind-AS - Corporate assets are assets **other than goodwill** that contribute to the future cash flows of both the CGU under review and other CGUs. Corporate assets include group or divisional assets such as the headquarters building, EDP equipment or a research centre.

Corporate assets do not generate cash inflows independently and their carrying amount **cannot be** fully **attributed to the CGU under review.**

Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. As a consequence to the management decision, if there is an indication that a corporate asset may be impaired, recoverable amount is determined for the CGU to which the corporate asset belongs (after allocation of corporate assets to the CGU), compared to the carrying amount of this CGU and any impairment loss is recognised on pro rata basis of corporate assets and other assets of CGU.

Can corporate assets be allocated to CGU on reasonable and consistent basis?

YES

↓

- Compare the total carrying amount of CGU along with corporate assets with the recoverable amount;
- If there is any impairment loss –
  If any goodwill allocated to that CGU - Apply the impairment loss first on Goodwill and the remaining loss should be on the assets of CGU (including corporate assets) on prorate basis of its carrying amount;

NO

↓

- Compare the carrying amount of CGU (excluding Corporate assets) with its recoverable amount - if any impairment loss - Allocate as usual; goodwill first & remaining on prorate basis;
- Identify smallest group of CGUs - to which corporate assets can be allocated on reasonable and consistent basis; and
- Compare the carrying amount of CGUs (including corporate assets) with recoverable amount of the group of units. - if any impairment loss Allocate as discussed above;

(8) REVERSAL OF IMPAIRMENT LOSS

An entity should assess on each balance sheet date if impairment loss recognized in prior years for an asset other than goodwill may no longer exist or impairment loss charged earlier has decreased. If there are any indications to this effect the entity should estimate the recoverable amount of that asset, indications may be from:

- External sources
- Internal sources

Topic 1: Reversal of impairment loss in case of INDIVIDUAL ASSET

Was it revalued earlier?

NO

↓

(a) Reverse the impairment loss by recording below JE;

Asset a/c Dr.

To Impairment loss (P&L)

(b) Due to reversal of impairment loss - the carrying amount should **NOT exceed what it would have been without impairment loss;** (it means, maximum previously recognised loss can be reversed)

(c) Such reversal profit should be transferred to P&L;

YES

↓

(a) Reverse the impairment loss by recording the below JE;

Asset a/c Dr.

To Revaluation surplus a/c (b/f)

To impairment loss (P&L)

(b) Point (b) remains same;

(c) Credit the P&L to the extent it was debited at the time of impairment loss and the remaining reversal should be credited to revaluation surplus.

(d) Increase in revaluation is presented in OCI;

After a reversal of an impairment loss—

Depreciation (amortisation) charge for the asset should be computed **prospectively** i.e. the revised carrying amount after deducting residual value, should be depreciated over the remaining useful life of the asset.

Topic 2: Reversal of impairment loss in case of CGU

A reversal of an impairment loss for a CGU should be allocated to ALL assets in CGU **(other than goodwill) on a pro-rata basis** of the carrying amount;

These increase in carrying amounts should be treated as reversals of impairment losses for individual assets as discussed in above **Topic 1.**

In allocating a reversal of an impairment loss for a CGU, the carrying amount of an asset should not be increased above the **LOWER of:**

(a) its recoverable amount (if determinable); and

(b) normal level of carrying amount as if impairment loss had not been recognised previously;

The amount of the reversal of the impairment loss should be allocated to each asset on a pro rata basis.

Topic 3: Reversal of impairment loss in case of Goodwill

An impairment loss recognised for goodwill **SHALL NOT be reversed** in a subsequent period.

As per Ind-AS 38 - 'Intangible Assets' **prohibits the recognition of internally generated** goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.

(9) NON-CONTROLLING INTEREST MEASURED INITIALLY AS A PROPORTIONATE SHARE OF THE NET IDENTIFIABLE ASSETS

As discussed earlier, goodwill acquired in a business combination to be allocated to each of the acquirer's CGU, or groups of CGUs, expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, or groups of units.

If an entity measures non-controlling interests as **its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date,** (rather than at fair value), goodwill attributable to non-controlling interests is included in the recoverable amount of the related CGU but is not recognised in the parent's consolidated financial statements.

As a consequence, **an entity shall gross up the carrying amount of goodwill allocated to the unit** to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the CGU is impaired.

If a subsidiary, or part of a subsidiary, with a non-controlling interest is itself a CGU, the impairment loss is allocated between the parent and the non-controlling interest in the same proportion of profit or loss allocation.

Example

Parent acquires an 80% ownership interest in Subsidiary for ₹ 2,100 on 1st April, 2018. At that date, Subsidiary's net identifiable assets have a **fair value** of ₹ 1,500 (100% of the entity). Parent chooses to measure the non-controlling interests as the **proportionate interest of Subsidiary's net identifiable assets** of ₹ 300 (20% of ₹ 1,500). Goodwill of ₹ 900 is the difference between the aggregate of the consideration transferred and the amount of the non-controlling interests (₹ 2,100 (paid for 80%) + ₹ 300 (20% worth)) and the net identifiable assets (₹ 1,500).

In the given case, subsidiary as a whole is considered as a CGU. Based on the synergy benefits available, ₹ 400 is allocated to this subsidiary and ₹ 500 is allocated to other CGUs of the parent. As you know, goodwill allocated to the CGU, it should be tested for impairment every year.

At the end of the financial year, parent determines the recoverable amount of the Subsidiary CGU is ₹ 1,000 (100% entity) and carrying amount of the net assets except goodwill are ₹ 1,350.

Parent company recognised only ₹ 400 goodwill which is related only to its proportion and not related to non-controlling interest portion. Hence, as per the standard, carrying amount of subsidiary is grossed up to include goodwill attributable to the non-controlling interests, before being compared with there coverable amount of₹ 1,000. Goodwill attributable to parent i.e. 80% of share = ₹ 400; So goodwill related to non-controlling interest = ₹ 100; Testing impairment loss of subsidiary as follows:-

	Goodwill of subsidiary	Non-identifiable assets	Total
Carrying amount	400	1,350	1,750
Unrecognised Non-controlling interest	100	-	100
Adjusted carrying amount	500	1,350	1,850
Recoverable amount			1,000
Impairment loss			**850**

Therefore, ₹ 500 of the ₹ 850 impairment loss for the unit is allocated to the goodwill.

In accordance with **paragraph C6 of Appendix C of Ind-AS 36, if the partially-owned subsidiary is itself a CGU, the goodwill impairment loss is allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated.** In this example, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e. ₹ 400).

The remaining impairment loss of₹ 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets in the following manner.

	Goodwill of subsidiary	Non-identifiable assets	Total
Carrying amount	400	1,350	1,750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	1,000	1,000

QUESTIONS

Q.1. Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India.

There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to 2 Lakh and Goodwill amounting to 1.50 Lakhs is included in such CGU.

Machinery A was purchased on 1st April 2013 for 10 Lakhs and residual value is 50 thousands. Machinery B was purchased on 1st April, 2015 for 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

Year	Cash Flows from Machinery A
1	1,50,000
2	1,00,000
3	1,00,000
4	1,50,000
5	1,00,000 (excluding Residual Value)
Total	**6,00,000**

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is ₹ 7 lakhs. The valuation fee was ₹ 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.50 lakhs. Specialised packaging cost would be ₹ 25 thousand and legal fees would be ₹ 75 thousand.

The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 Lakhs ie on 31st March, 2019. The Recoverable value of Machine A is ₹ 4,50,000 and combined Machine A and B is ₹ 7,60,000 as on 31st March, 2019.

Required:

(a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.

(b) Compute the prospective depreciation for the year 2018-2019 on the above assets.

(c) Compute the carrying value of CGU as at 31st March, 2019. **(May - 2019)**

Q.2. PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	₹ 000
Year ended 31st March 20X7	276
Year ended 31st March 20X8	192
Year ended 31st March 20X9	120
Year ended 31st March 20Y0	114

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for 6,00,000 and related selling expenses in this regard could have been 96,000. The machine had been re valued previously, and at 31st March 20X6 an amount of 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was 660,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for? **(May - 20)**

Q.3 One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1st June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of ₹ 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of ₹ 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company ₹ 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be ₹ 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue? **(Nov. - 19)**

Q.4. East Ltd. (East) owns a machine used in the manufacture of steering wheels, which are sold directly to major car manufacturers.

- The machine was purchased on 1st April, 20X1 at a cost of ₹ 500 000 through a vendor financing arrangement on which interest is being charged at the rate of 10 per cent per annum.
- During the year ended 31st March, 20X3, East sold 10 000 steering wheels at a selling price of ₹ 190 per wheel.
- The most recent financial budget approved by East's management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for ₹ 200 during 20X3-X4, the price rising in later years in line with a forecast inflation of 3 per cent per annum.
- During the year ended 31st March, 20X4, East expects to sell 10 000 steering wheels. The number is forecast to increase by 5 per cent each year until 31st March, 20X8.
- East estimates that each steering wheel costs ₹ 160 to manufacture, which includes ₹ 110 variable costs, ₹ 30 share of fixed overheads and 20 transport costs.

- Costs are expected to rise by 1 per cent during 20X4-X5, and then by 2 per cent per annum until 31st March, 20X8.
- During 20X5-X6, the machine will be subject to regular maintenance costing 50,000.
- In 20X3-X4, East expects to invest in new technology costing ₹ 100000. This technology will reduce the variablecosts of manufacturing each steering wheel from ₹ 110 to ₹ 100 and the share of fixed overheads from ₹ 30 to ₹ 15 (subject to the availability of technology, which is still under development).
- East is depreciating the machine using the straight line method over the machine's 10 year estimated useful life. The current estimate (based on similar assets that have reached the end of their useful lives) of the disposal proceeds from selling the machine is ₹ 80,000 net of disposal costs. East expects to dispose of the machine at the end of March, 20X8.
- East has determined a pre-tax discount rate of 8 per cent, which reflects the market's assessment of the time value of money and the risks associated with this asset.

  Assume a tax rate of 30%. What is the value in use of the machine in accordance with Ind AS 36? **(Nov. - 19)**

Q.5. The UK entity with a sterling functional currency has a property located in US, which was acquired at a cost of US$ 1.8 million when the exchange rate was £1 = US$ 1.60. The property is carried at cost. At the balance sheet date, the recoverable amount of the property (as a result of an impairment review) amounted to US$ 1.62 million, when the exchange rate £1 = US$ 1.80. Compute the amount which is to be reported in Profit & Loss of UK entity as a result of impairment, if any. Ignore depreciation. Also analyse the total impairment loss on account of change in value due to impairment component and exchange component. **(Nov. - 20)**

IND AS – 38
INTANGIBLE ASSETS

(1) Definition

(2) Recognition Criteria

(3) Modes of Acquisition

(4) Subsequent Expenditure

(5) Valuation Models

(6) Amortization

(7) Retirement and Disposal

(8) Impairment

(1) DEFINITION

Intangible asset is an identifiable non-monetary asset without physical substance.

Identifiability

The intangible asset must be separate i.e., it should be capable of being separated from the entity, and sold/transferred. For example, Import license can be separated from the entity and sold.

Controlled by an entity

Control means:

- Power to obtain future economic benefits; and
- Power to restrict the access of others to those benefits

Thus power normally stems from a legal right e.g. copyright, but the legal right is not a necessary condition, because an entity may be able to control the future economic benefit in some other way.

An entity may seek to protect the technical talent or knowledge of certain skilled staff by including a "non-compete" or 'restraint of trade' clause into their contracts of employment.

Future economic benefits

These may be seen by any one of the following ways:

- Revenue from the sale of products and services
- Cost savings
- Other benefits resulting from the use of an asset.

(2) RECOGNITION CRITERIA

Intangible asset should be recognised only if it satisfies the following:

1. Definition of Intangible asset; and
2. Asset recognition conditions i.e.
   (a) It is probable that the future economic benefits will flow into the entity; and
   (b) The cost of the asset should be measured reliably.

Probable means "more likely than not" i.e. there are more than 50% chances of inflows. The entity should assess the probability of economic benefits inflow using the reasonable and supportable assumptions i.e. it should be performed based on the evidence available at the time of initial recognition.

(3) MODES OF ACQUISITION

Intangible Asset

CASH / CREDIT(separately acquired)	Government grants IND AS 20	Leases IND AS 116	Business Combination IND AS 103	Exchange	Internally generated

(1) CASH / CREDIT :

Deferred Credit term

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

If Intangible asset is purchased by

PAYMENT OF CASH/FOR CREDIT (SEPARATE ACQUISITION)

Cost of asset includes the following:—

Particulars	Amount (Rs.)
Purchase price (Basic price)	XXX
(+) Non-refundable taxes & duties	XXX
(+) Registration charges	XXX
(+) Brokerage costs	XXX
(+) Professional fees for legal services	XXX
(+) Any directly attributable cost to	XXX
make the asset ready for its intended use	
(-) Government grant received specific to the asset as per Ind AS 20	(XXX)
(-) Trade discounts and rebates (if included above)	(XXX)
Cost of Intangible asset	**XXXX**

The cost cannot be included are:

- Costs of introducing new products or services, such as advertising
- Costs of conducting new business
- Administration costs and other general overheads cost
- Costs incurred while an asset that is ready for use is awaiting deployment
- Costs of redeployment of an asset
- Initial operating losses incurred from operation

(2) EXCHANGE :

Intangible asset is acquired by EXCHANGE OF ANOTHER ASSET

When an intangible asset is acquired in exchange or part exchange for another asset, the asset received is usually recorded at

Determination of cost of assets to be recorded is based on the following TWO conditions

1. Does the transaction has commercial substance and
2. Can fair value of the asset given or taken is measured reliably?

Yes | No

Recognise at

It should be measured at COST
i.e. Carrying amount of asset given up is the

- Fair value of the asset given up; (1st preference) Cost of asset received.

or

- Fair value of the asset received;

Whichever is **clearly evident**

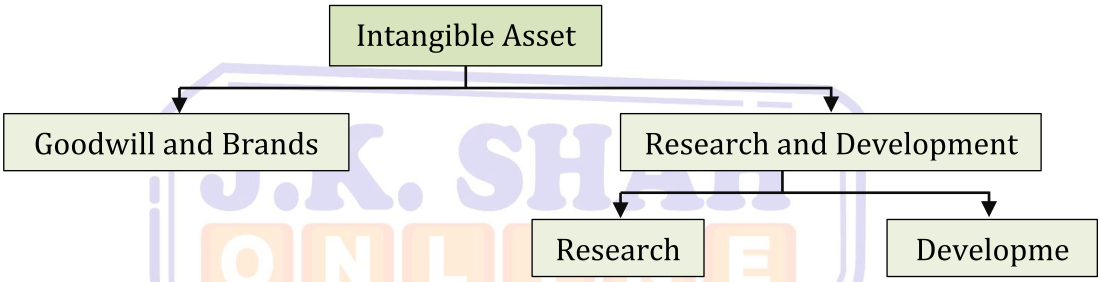
What is commercial substance?

We can say that an exchange transaction has commercial substance if:

(a) **Risk, timing and amount of the cash flows** of the asset received are **significantly different** from the cash flows of the asset transferred; or

(b) There is a **significant effect on** the present value of the **after tax cash flows** an entity expects to arise **from the continuing use of an asset and from its disposal** at the end of its useful life due to the exchange transaction.

(3) INTERNALLY GENERATED



(1) GOODWILL AND BRAND

Internally generated goodwill & brands should NOT (prohibited) be recognised as an asset because it is NOT an identifiable (separable) resource controlled by the entity and the cost of these cannot be measured reliably.

Same rule is applicable even to **internally generated** brands, publishing titles, customer lists and other similar items – These items should NOT be recognised as intangible assets as cost of assets cannot be measured reliably.

(2) RESEARCH AND DEVELOPMENT :

(A) RESEARCH

An asset is recognised only when there are probable future economic benefits inflow and when costs can be measured reliably. But during the research phase, an entity cannot demonstrate that intangible asset exists and that generates probable future economic benefits (There is NO guarantee that research will be successful). Hence ALL research expenditure should be CHARGED TO P&L as expense as and when it is incurred.

(B) DEVELOPMENT:

Development is → Application of → Research knowledge / Other knowledge → For production of new / substantially improved

- Product /Service
- Devices / Processes

PRIOR TO commencement of commercial production or use

In this phase an entity may get new/substantially improved products/services - Such products, services, etc. may generate future economic benefits to the entity, the costs incurred for development phase can be capitalised as an intangible asset ONLY when the entity can demonstrate that:

(1) There is technical feasibility to complete the intangible asset;

(2) The entity has an intention to complete;

(3) It is able to use or sell the intangible asset;

(4) Adequate technical, financial, other resources are available to complete it;

(5) The intangible asset will generate probable future economic benefits either by:

   (i) Using in its production of goods or providing services or for administration purposes;

   (ii) Renting to others;

   (iii) Selling the intangible asset; etc.

(6) The entity can reliably measure the expenditure incurred for the development activity.

If an entity cannot distinguish the research phase from the development phase of an internal project, the total expenditure incurred should be treated as research phase expenditure and it should be charged to P&L in the same year.

The cost includes:

Particulars	Amount (Rs.)
Cost of material/services consumed in generation of IA	XXX
Salaries, wages and other employment benefits paid to personnel, who is engaged in development process	XXX
All overheads (which are directly related to generation of intangible asset) allocated on reasonable and consistent basis	XXX
All costs which are directly related to generation of intangible asset like registration fees, amortisation of patents, etc.	XXX
Borrowing costs that can be capitalised as per Ind AS 23	XXX
Cost of Intangible asset to be capitalised	**XXXX**

The following costs SHOULD NOT be capitalised (i.e. these should be charged to P&L)

1. Selling overheads;
2. Administration overheads; (But if these are directly related to generate the asset - can be capitalised)
3. Abnormal loss of material, labour or any other inefficiencies;
4. Initial operating losses;
5. Training costs to operate the asset; (this expense is not to generate the asset).

(4) BUSINESS COMBINATION :

- As per Ind AS 103, Business combinations, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. Such intangible asset should satisfy the recognition criteria i.e. it is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably.
- As per this Standard and Ind AS 103, an intangible asset will be recognised in the books of acquirer even if it is NOT recognised in the books of acquiree before the business combination.

(4) SUBSEQUENT EXPENDITURE :

The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Most of the subsequent expenditures are likely to maintain the expected future economic benefits of the asset and not able to satisfy the recognition criteria. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole.

Therefore, only in rare circumstances, subsequent expenditure incurred after the initial recognition be recognised/added to the carrying amount of the intangible asset.

(5) VALUATION MODELS

An entity as a matter of choosing as an accounting policy, it should select any one of the TWO MODELS available after recognising the intangible asset and follow the same consistently. It is a matter of choice of the management.

Accounting Models

COST MODEL		REVALUTION MODEL	
↓		↓	
If this model is chosen - Intangible asset should be measured every year at		This model should be chosen to the intangible asset, where FAIR VALUE can be measured reliably.	
Cost	xxx	PPE should be measured at	
Less: Accumulated depreciation	xx	Fair Value of PPE	xxx
Less: Accumulated Impaired loss	xx	Less: SUBSEQUENT	
Net carrying amount	**xxx**	accumulated depreciation	xx
		Less: SUBSEQUENT	
		accumulated impairment loss	xx
		Net carrying amount	**xxx**

- If an entity chooses the revaluation model as accounting policy for intangible assets then all the other assets in its class shall also be ac- counted for using the same model unless there is no active market for those assets.
- Fair value must be determined by reference to an active market. This is different to the treatment of revaluation under Ind AS-16 where depreciated replacement cost can be used when there is no evidence of market value.
- Revaluation must be sufficiently regular that carrying amount is not materially different from fair value.
- The revaluation model does not allow:
  - The revaluation of intangible assets that have not previously been recognized as assets;
  - The initial recognition of intangible assets at amount other than their cost.

- If as a result of revaluation the carrying amount of intangible asset is increased, the increase shall be recognized in Other Comprehensive Income (OCI) and accumulated in equity under the heading of "Re-valuation Surplus"
- If as a result of revaluation the carrying amount of intangible asset is decreased, the decrease shall be recognized in profit and loss.
- Revaluation surplus included in equity may be transferred directly to the retained earning when the surplus is realized on the retirement or disposal of an asset.

(6) AMORTIZATION

- Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life;
- Depreciable amount = Cost/substituted amount (revalued amount) less residual value;
- Useful life is:
  - (a) the period over which an asset is expected to be available for use by an entity; or
  - (b) the number of production or similar units expected to be obtained from the asset by an entity.

Amortisation Period

- The entity should assess whether the useful life of the intangible is finite (limited life) or indefinite;

Review of Method and useful life

The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If there has been a change in the expected pattern of consumption or useful life of the asset, such changes shall be accounted for as changes in accounting estimates and will be accounted for prospectively.

Residual value

The residual value of an intangible asset should be assumed to be zero unless:

(a) There is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) There is an active market for the asset:

- (i) Residual value can be determined with reference to that market; and
- (ii) It is probable that such a market will exist at the end of the asset's useful life.

The estimations are made using prices prevailing at the date of acquisition of the asset.

The residual value should be reviewed at least at the end of every year and if there is any change in residual value, it should be considered as change in estimate and to be accounted for prospectively.

If residual value increased to an amount equal to or greater than carrying amount - the asset should not be amortised till the residual value decreases to below the carrying amount.

(7) RETIREMENT AND DISPOSAL

- An intangible asset should be derecognised from the balance sheet (derecognised) on disposal OR when no future economic benefits are expected from its use or disposal.
- The difference between the consideration and the carrying amount of the asset should be treated as gain or loss and it should be recognised as income or expense in P&L statement, (unless Ind AS 116 requires otherwise on a sale and leaseback).
- The consideration received or receivable = Transaction price as per Ind AS 115;
- If there are any subsequent changes to the estimated consideration, it will be accounted as changes in transaction price as per Ind AS 115;
- Gains shall not be classified as "Revenue from operations" i.e. it should be part of 'other income'.
- An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use as per Ind AS 105.

(8) IMPAIRMENT

To determine whether an intangible asset is impaired, an entity applies Ind AS-36. Intangible asset is said to be impaired if its recoverable amount is less than the carrying amount. Recoverable amount as per the Standard on impairment of asset means higher of the value in use and fair value less cost of disposal, value in use is the present value of future cash inflow to be derived from the asset.

Intangible assets with indefinite useful lives

An intangible asset with an indefinite useful life shall not be amortized. In accordance with Ind AS-36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

- Annually, and
- Whenever there is an indication that the intangible asset may be im- paired.

QUESTIONS

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

Q.2. ABC Pvt. Ltd., recruited a player. As per the terms of the contract, the player is rohibited from playing for any other entity for coming 5 years and have to in the employment with the company and cannot leave the entity without mutual agreement. The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches. State whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38? **(Nov - 20)**

IND AS – 102
SHARE BASED PAYMENTS

(1) Scope
(2) Definitions
(3) Recognition & Measurement
(4) Equity Settled Share Based Payments
(5) Treatment of Vesting and Non Vesting Conditions
(6) Modification, Settlement and Cancellation
(7) Cash Settled Share Based Payment Transactions
(8) Share Based Payment Transaction with Cash Alternative
(9) Share Based Payment with Entity own Equity Instruments
(10) Share Based Payment with Parents Equity Instruments
(11) Questions and Answers

(1) SCOPE

Ind AS-102 applies to all share-based payment transactions in which an entity acquires or receives goods or services. Goods include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. There are three types of share-based payments:

- Equity-settled share-based payment transactions,
- Cash-settled share-based payment transactions, and
- Share-based payment transaction with cash alternatives.

This Standard does not apply to:

- ✍ Share issued as consideration in a business combination (Ind AS-103 "Business Combination") and
- ✍ Certain contract transactions falling within Ind AS-32 "Financial Instruments: Presentation" or Ind AS-109 "Financial Instruments".

(2) DEFINITIONS

Fair value - The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

Measurement date - The date at which the fair valued the equity instruments granted is measured for the purposes of this Ind AS. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

Equity-settled share-based payment transaction: A share-based payment transaction in which the entity

(a) receives goods or services as consideration for its own equity instruments (including shares or share)options), or

(b) receives goods or services but has no obligation to settle the transaction with the supplier.

Equity instrument granted: The right (conditional or unconditional) to an equity instrument of the entity conferred by the entity on another party, under a **share-based payment arrangement.**

Equity instruments, which means a residual interest in asset & liability of the company will include:

(a) Ordinary shares

(b) Redeemable Preference shares

(c) Written call option or warrants over such ordinary shares

Share based payment arrangement: An agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:

(a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, or

(b) equity instruments (including shares or share options) of the entity or another group entity, provided I the specified vesting conditions, if any, are met.

This means that Share based payment should be formed with an agreement i.e., communication of the terms and conditions.

Note: Group does not include Associates & Joint Ventures.

(3) RECOGNITION AND MEASUREMENT

An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received.

The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction or a liability if the goods or services were acquired in a cash-settled sharebased payment transaction.

When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

Equity-settled share-based payment transactions

Measurement

The general principle in Ind AS-102 is that an entity recognises the goods or services received and the corresponding increase in equity. It should measure these at the fair value of the goods or services received Where the transaction is with parties other than employees, there is a rebuttable presumption that the fair of the goods or services received can be estimated reliably.

If the fair value of the goods or services received cannot be measured reliably, the entity should measure their value by reference of the fair value of the equity instruments granted.

Where the transaction is with a party other than an employee fair value should be measured at the date the entity obtains the goods or the counterparty renders service.

Where shares, share options or the other equity instruments are granted to employees as part of their remuneration package, it is not normally possible to measure directly the services received. For this reason, the entity should measure the fair value of the employee service received by reference to the fair value of the equity instruments granted. The fair value of those equity instruments should be measured at grant date.

(4) EQUITY SETTLED SHARE BASED PAYMENTS

With employees and others providing similar services / shares, share options and other equity instruments granted to employees as part of the remuneration package.

Fair value (at grant date) of the equity instruments granted because fair value of services received cannot be estimated reliably.

Transactions with parties other than employees: There shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase inequity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service.

Equity instruments granted vest immediately: This means, no conditions are to be satisfied for entitlement. It is assumed that services have received. On grant date, the entity shall recognise the services received in full, with a corresponding increase in equity.

(5) VESTING AND NON VESTING CONDITIONS

Vesting conditions: A condition that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.

Service condition: A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

Market condition: A performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price (or value) of the entity's equity instruments (or .the equity instruments of another entity in the same group), such as:

(a) Attaining a specified share price or a specified amount of intrinsic value of a share option; or

(b) Achieving a specified target that is based on the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group) relative to an index of market prices of equity instruments of other entities.

A market condition requires the counterparty to complete a specified period of service (i.e., a service condition); the service requirement can be explicit or implicit.

Conditions	To include in fair value of SBP (refer note-1)	To include expected equity shares which meet conditions (refer note-2)
Service condition	No	Yes
Performance condition - Market related	Yes	No
Performance condition - Non-market related	No	Yes
Non-vesting condition	Yes	No

Note 1: Share based payment (SBP) will be measured at fair value on initial recognition which will include the effect of these conditions. Equity settled share based payment will be measured at fair value on grant date with no subsequent measurement, whereas cash settled share based payment shall be re-measured at each reporting date till its settlement in full.

Note 2: These conditions will have no impact on fair valuation of share based payments. However, they will be considered while estimating the expected number of equity shares at the end of each period for recognition of the share based payment

(6) MODIFICATION, CANCELLATION AND SETTLEMENT

(a) **Increase in the fair value of the equity instrument -** When there is a modification resulting in reducing the exercise price of equity instruments which means increase in fair value of the equity instrument, the entity shall consider this amount for recognition of services for which equity z instruments are granted.

Incremental Fair Value = FV of the re-prices instrument - grant date FV (both estimated at the date of modification)

If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instrument, which Is recognised over the remaining period of the original vesting period.

If the modification occurs after vesting date, the incremental fair value granted is recognised immediately or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

(b) **Increase in the number of equity instruments granted -** The entity shall include the fair value of the additional equity instruments granted, measured at the date of the modification, in the measurement of the amount recognised for services received as consideration for the equity instruments granted, consistency with the requirements in (a) above.

(c) **Modifies the vesting conditions in a manner that is beneficial to the employees** - For example, by reducing the vesting period or by modifying or eliminating a performance condition other than a market condition, changes to which are accounted for in accordance with (<z) above, the entity shall take the modified vesting conditions into account when applying the requirements of treatment of vesting and non-vesting conditions.

If an entity or counterparty can choose whether to meet a non-vesting condition, the entity shall treat the entity's or counterparty's failure to meet the non-vesting condition during the vesting period as a cancellation. If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

(d) Modifications those are not beneficial to the employee - Furthermore, if the entity modifies the terms or conditions of the equity instruments, granted in a manner that reduces the total fair value of the share-based payment arrangement, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification has not occurred other than a cancellation of some or all the equity instruments granted, which shall be accounted for as if cancelled or settled during the vesting period. For example:

(i) if the modification reduces the fair value of the equity instruments granted, measured immediately before and after the modification, the entity shall not take into account that decrease in fair value and shall continue to measure the amount recognised for services received as consideration for the equity instruments based on the grant date fair value of the equity instruments granted.

(ii) If the modification reduces the number of equity instruments granted on an employee, that reduction shall be accounted for as a cancellation / of that portion of the grant, during the vesting period.

(iii) If the entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by increasing the vesting period or by modifying or adding a performance condition (other than a market condition changes to which are accounted for in accordance with (z) above), the entity shall not take the modified vesting conditions into, account when applying the requirements of treating vesting conditions.

CANCELLATION

(A) Recognise immediately the amount that would have been recognised for services over the remainder of the vesting period.

(B) Any payment made in this case is considered as repurchase of an equity interest i.e., deduction from equity, except payment exceeds fair value of the Equity instruments granted at the repurchase date which is recognised as expense.

Reverse i.e., if share based payment include liability components, the entity shall remeasure the FV of the liability at the date of cancellation or settlement. Payment made for this is accounted as extinguishment of liability.

(C) If new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments. The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments.

(7) CASH SETTLED SHARE BASED PAYMENT TRANSACTIONS

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall re-measure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

Examples of this type of transaction include:

- Share appreciation rights granted to employees: the employees becomes entitled to the future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time; or
- An entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares that are redeemable.

  The entity should recognise the services received and a liability to pay for those services, as the employees render service. For example, shares appreciation rights do not vest until the employees have completed specified period of service, the entity should recognise the services received and the related liability over that period.

(8) SHARE BASED PAYMENT TRANSACTIONS WITH CASH ALTERNATIVES

For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with:

- the choice of whether the entity settles the transaction in cash (or other assets) or
- by issuing equity instruments,

The entity shall account for:

- that transaction or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or
- as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred

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 fie., 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).

If the fair value of the goods or services received can be measured directly and easily, the equity element is determined by taking the fair value of the goods or services less the fair value of the debt element of this instrument. The debt element is essentially the cash payment that will occur. If the fair value of the goods or services is measured by reference to the fair value of the equity instruments given, the whole of the compound instrument should be fair valued. The equity element becomes the difference between the fair value of the equity instruments granted less the fair value of the debt component.

(9) SHARE BASED PAYMENT PLAN WITH ENTITY OWN EQUITY INSTRUMENT:

The first issue is whether the following transactions involving an entity's own equity instruments should be accounted for as equity-settled or as cash-settled in accordance with the requirements of this Standard:-

(a) An entity grants to its employees rights to equity instruments of the entity (eg: share options), and either chooses or is required to buy equity instruments (i.e., treasury shares) from another party, to satisfy its obligations to its employees; and

(b) an entity's employees are granted rights to equity instruments of the entity (eg: share options), either by the entity itself or by its shareholders, and the shareholders of the entity provide the equity instruments needed.

(10) SHARE BASED PAYMENT WITH PARENTS EQUITY INSTRUMENTS

Share-based payment transactions between two or more entities within the same group involving an equity instrument of another group entity. For example, employees of a subsidiary are granted rights to equity instruments of its parent as consideration for the services provided to the subsidiary.

Therefore, the second issue concerns the following share-based payment arrangements:

(a) a parent grants rights to its equity instruments directly to the employees of its subsidiary: the parent (not the subsidiary) has the obligation to provide the employees of the subsidiary with the equity instruments; and

(b) a subsidiary grants rights to equity instruments of its parent to its employees: the subsidiary has the obligation to provide its employees with the equity instruments.

A parent grants rights to its equity instruments to the employees of its subsidiary:

The subsidiary does not have an obligation to provide its parent's equity instruments to the subsidiary's employees. The subsidiary shall measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions, and recognise a corresponding increase in equity as a contribution from the parent.

The parent has an obligation to settle the transaction with the subsidiary's employees by providing the parent's own equity instruments. Therefore, in accordance with paragraph 42C, the parent shall measure its obligation in accordance with the requirements applicable to equity-settled share-based payment transactions.

A subsidiary grants rights to equity instruments of its parent to its employees:

Because the subsidiary does not meet either of the conditions in paragraph 43B, it shall account for the transaction with its employees as cash-settled. This requirement applies irrespective of how the subsidiary obtains the equity instruments to satisfy its obligations to its employees.

QUESTIONS

Q.1. A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is ₹ 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options.

Pass the necessary journal entries for giving effect to the above arrangement.

(May - 19)

Q.2. An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is ₹ 11; and it estimates that overall 10% of the employees will leave during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31 December 20X5	12
31 December 20X6	8
31 December 20X7	13
31 December 20X8	12

10% of employees left before the end of 20X6. On 31st December 20X7 (when the intrinsic value of each SAR was ₹ 10), six employees exercised their options; and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of ₹ 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries. **(May – 20)**

Q.3. QA Ltd. had on 1st April, 20X1 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 20X4 provided the employee remains in employment till 31st March, 20X4.

On 1st April, 20X1, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 20X4. This estimate was amended to 1,850 employees on 31st March, 20X2 and further amended to 1,840 employees on 31st March, 20X3.

On 1st April, 20X1, the fair value of an option was ₹ 1.20. The fair value increased to ₹ 1.30 as on 31st March, 20X2 but due to challenging business conditions, the fair value declined thereafter. In September, 20X2, when the fair value of an option was 0.90, the Directors repriced the option and this caused the fair value to increase to ₹ 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was ₹ 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 20X2 should be spread over the remaining vesting period from 30th September, 20X2 to 31st March, 20X4.

The Company has requested you to suggest the suitable accounting treatment for these transactions as on 31st March, 20X3. **(Nov. 19)**