saransh

Last Mile Referencer for

ACCOUNTING

The Institute of Chartered Accountants of India
(Setup by an Act of Parliament)

Board of Studies (Academic)

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Saransh - Last Mile Referencer for Accounting

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PREFACE

Board of Studies (Academic), the student wing of the Institute, does not leave any stone unturned in providing best-in-class services to its students. It imparts quality academic education through its value-added study materials, wherein concepts are explained in lucid language. Illustrations and Test Your Knowledge Questions contained therein facilitate enhanced understanding and application of concepts learnt. Booklet on MCQs & Case Scenarios contain a rich bank of MCQs and Case Scenarios to hone the analytical skills of students, by applying the concepts learnt in problem solving. Revision Test Papers contain updates and Q & A to help students update themselves with the latest developments before each examination and revise the concepts and provisions by solving questions contained therein. Suggested Answers containing the ideal manner of answering questions set at examination also helps students revise for the forthcoming examination. Mock Test Papers help students assess their level of preparedness before each examination. BoS (Academic) also conducts live virtual classes through eminent faculty for its students across the length and breadth of the country.

To reach out to its students, the BoS (Academic) has also been publishing subject-specific capsules in its monthly Students' Journal "The Chartered Accountant Student" since the year 2017 for facilitating effective revision of concepts dealt with in different topics of each subject at the Foundation, Intermediate and Final levels of the chartered accountancy course. Each issue of the journal includes a capsule relating to specific topic(s) in one subject at each of the three levels. In these capsules, the concepts and provisions are presented in attractive colours in the form of tables, diagrams and flow charts for facilitating easy retention and quick revision of topics.

The BoS (Academic) is now coming out with a comprehensive booklet 'Saransh - Last Mile Referencer for Accounting' wherein the significant concepts dealt with across topics in accounting are captured by way of diagrams, flow charts and tables. In the subject of accounting, the booklet is divided into two parts viz – Part I: Accounting Standards and Part II: Indian Accounting Standards. The booklet captures the substantial provisions contained in Accounting Standards and Indian Accounting Standards (Ind AS) forming part of the syllabi of the subject at different levels. The booklet encapsulates diagrams, flow charts, tables and illustrated journal entries. This booklet consolidates all significant topics of accounting at one place, by capturing the key points. This would help the reader appreciate the requirements contained in each such accounting standard / Ind AS at a glance. It will surely facilitate the reader to grasp the essence of the subject as a whole by serving them as a ready reckoner.

Happy Reading!

Message of Key ICAI Office Bearers

CA. (Dr.) Debashis Mitra
President, ICAI

The Board of Studies (Academic) of ICAI has always been at the forefront of providing quality education to aspiring CA students and handholding them in preparing for their exams. Saransh — Last Mile Referencer is a step in that direction. This pack of 3 booklets on Accounting, Auditing & Cost Management and Strategic Decision Making covers significant concepts of each chapter in precise form. This will not only help students for their reference for examinations but also Members can use it for their practice reference.

CA. Aniket S. Talati
Vice-President, ICAI

It has always been the endeavour of ICAI to provide updated information to its student to keep them abreast about the latest happenings in the accounting and related fields. The Board of Studies (Academic), the academic wing of ICAI, has come up with a series of booklets 'Saransh – Last Mile Referencer' with key points of different subjects. This will help facilitate effective revision of concepts in each subject.

CA. Dayaniwas Sharma
Chairman, Board of Studies (Academic)

Saransh — Last Mile Referencer is a compilation of capsules on different subjects of Foundation, Intermediate and Final levels of the chartered accountancy course. This series of booklets consolidates all significant topics of Accounting including Accounting Standards & Ind AS, Auditing with Auditing Standards and Cost Management and Strategic Decision Making at one place by capturing the key points. The concepts and provisions presented in attractive colours in the form of tables, diagrams and flow charts will facilitate quick revision of topics and easy retention.

CA. Vishal Doshi
Vice-Chairman, Board of Studies (Academic)

Among the many best-in-class services that the Board of Studies (Academic) provides to its students, Saransh — Last Mile Referencer is another initiative in that direction. These booklets on different subjects have been provided in a concise and precise form. It will facilitate understanding of the concepts better to students and grasp the essence of the subject. These capsules will enhance of level of preparedness before the examinations.

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Part I

ACCOUNTING STANDARDS

INTRODUCTION TO ACCOUNTING STANDARDS

Overview

Concepts & Benefits of Accounting Standards → Accounting Standards setting process → List of Accounting Standards → Significance of Global Standards → International Financial Reporting Standards (IFRS) → International Financial Reporting Standards as global standards → Convergence to IFRS in India → Ind AS → Concept of Carve Outs

Issuance of Accounting Standards

Accounting Standards are written policy documents issued by

- Government e.g. (MCA) for corporate entities in consultation with NFRA
- ICAI for non corporate entities

Benefits of Accounting Standards:

- Standardisation of alternative accounting treatments
- Comparability of financial statements
- Enhanced disclosures

Accounting Standards - Benefits			
Recognition of events and transactions	Measurement of transactions and events	Presentation of transactions and events	Disclosures

Accounting Standards Setting Process

Identification of area
↓
Constitution of study group
↓
Preparation of draft and its circulation
↓
Ascertainment of views of different bodies on draft
↓
Finalisation of exposure draft (E.D.)
↓
Comments received on exposure draft (E.D.)
↓
Modification of the draft
↓
Issuance of AS

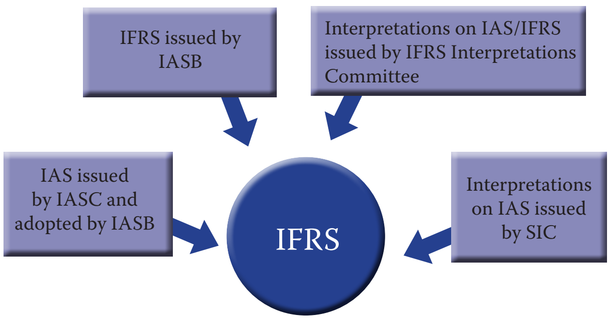
List of Accounting Standards

1	Disclosure of Accounting Policies
2	Valuation of Inventories
3	Cash Flow Statement
4	Contingencies and Events Occurring after the Balance Sheet Date
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
7	Construction Contracts
9	Revenue Recognition
10	Property, Plant and Equipment
11	The Effects of Changes in Foreign Exchange Rates
12	Accounting for Government Grants
13	Accounting for Investments
14	Accounting for Amalgamations
15	Employee Benefits
16	Borrowing Costs
17	Segment Reporting
18	Related Party Disclosures
19	Leases
20	Earnings Per Share
21	Consolidated Financial Statements
22	Accounting for Taxes on Income
23	Accounting for Investments in Associates in Consolidated Financial Statements
24	Discontinuing Operations
25	Interim Financial Reporting
26	Intangible Assets
27	Financial Reporting of Interests in Joint Ventures
28	Impairment of Assets
29	Provisions, Contingent Liabilities and Contingent Assets

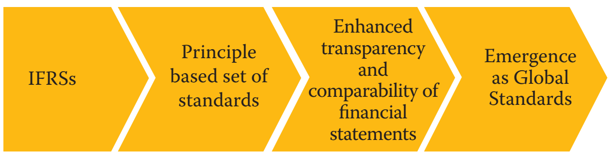
Effectively, there are now only 27 Accounting Standards.

Significance of Global Standards

International Financial Reporting Standards (IFRS)



International Financial Reporting Standards (IFRSs) as Global Standards



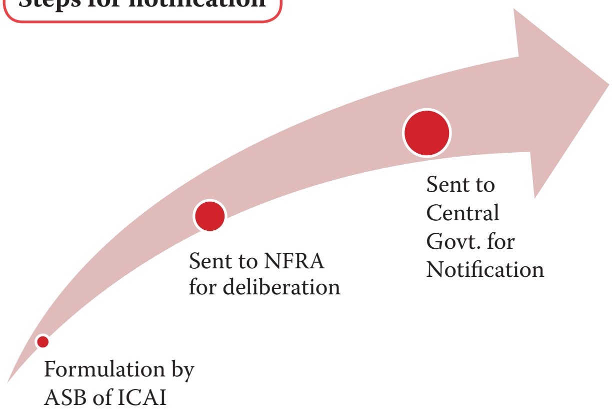
Convergence to IFRS in India

- ICAI
- Convergence to IFRS; not adoption
- Application of IFRS in India considering legal and other conditions prevailing in India
  - Deviation from corresponding IFRS, if required
  - Decision to have two sets of Accounting standards
    - Indian Accounting Standards (Ind AS)
    - Accounting Standards (AS)

Ind AS

Ind AS are IFRS converged standards issued by the Central Government with certain carve outs.

Steps for notification



Indian Accounting Standards - Benefits

Globalization and Liberalization	Transparency of financial statements	Comparability of financial statements	Enhanced Disclosure requirements

Objectives and Concepts of Carve Outs

- **Formulation of Ind AS**
  - **Departures**
    - **Resulting into carve-outs**
      - **Deviation from the accounting principles stated in IFRS**
    - **Not resulting into carve-outs**
      - **Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS**

AS 1 "DISCLOSURE OF ACCOUNTING POLICIES"

Introduction

AS 1 deals with the disclosure of significant accounting policies followed in preparation and presentation of financial statements.

AS 1 covers

- **Fundamental Accounting Assumptions**: These assumptions underlie the preparation and presentation of financial statements.
- **Accounting Policies**: Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

Fundamental Accounting Assumptions

- **Going Concern**: The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future.
  - It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.
- **Consistency**: Accounting policies are considered to be consistent from one period to another.
- **Accrual**: Revenues and costs are accrued, that is, recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

Considerations in selection of Accounting policies

- **Prudence**: In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash.
  - Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.
- **Substance over Form**: The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.
- **Materiality**: Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the users of the financial statements.

Fundamental Accounting Assumptions

- If followed → Not required to be disclosed
- If not followed → Specific disclosure required in financial statements.

Accountant has to make decisions from various permitted alternative methods for recording or disclosing various items in the books of accounts for example:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
Depreciation	Straight Line Method, Reducing Balance Method, Units of Production Method etc.

This list is not exhaustive.

Considerations in Selection of Accounting Policies

Selection of Accounting Policies must ensure

- True and fair view of the state of affairs of the enterprise as at the balance sheet date;
- Correct determination of profit or loss for the period.

Disclosure of Accounting Policies

- All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
- Disclosure should form part of the financial statements.
- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Disclosure of Changes in Accounting Policies

Change in Accounting Policy

- Having material effect in current period
  - Amount ascertained → Amount to be disclosed
  - Not ascertained → Fact to be disclosed
- Having non-material effect in current period but expected to have material effect in later periods
  - Fact of such change to be disclosed in current period.

AS 2 "VALUATION OF INVENTORIES"

Introduction

AS 2 (Revised) 'Valuation of Inventories', provides complete guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognised. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realisable value.

Scope of AS 2

Applicability of AS 2 in accounting for inventories other than

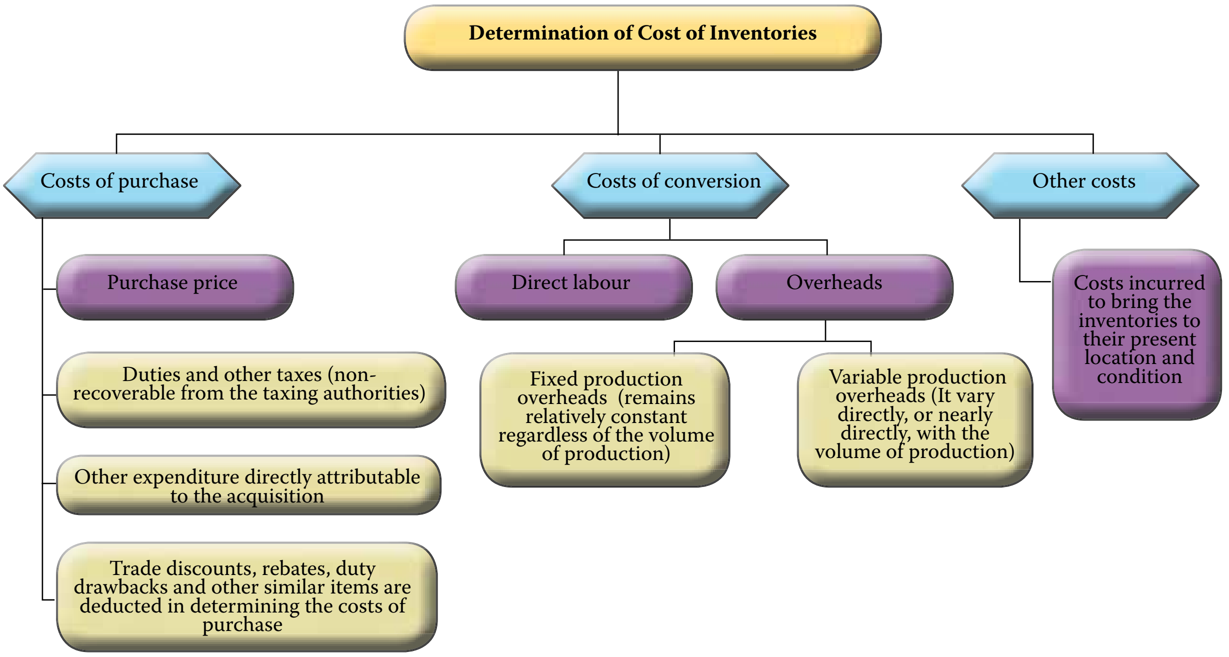
- Work in progress arising under construction contracts, including directly related service contracts;
- Work in progress arising in the ordinary course of business of service providers;
- Shares, debentures and other financial instruments held as stock-in-trade;
- Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries.

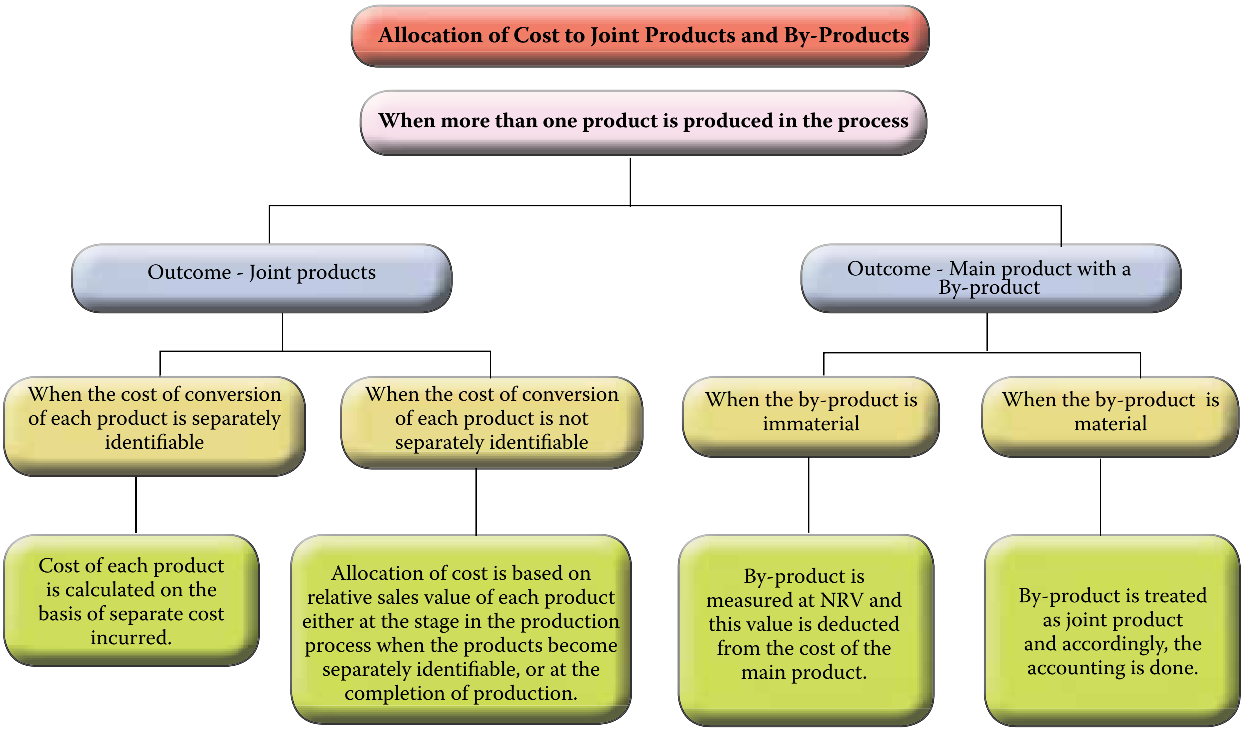
Definition of Inventories

Inventories are assets

- Held for sale in the ordinary course of business
  - It includes goods purchased and held for resale
- In the process of production for such sale
  - It includes Finished goods or work in progress, produced, or materials and supplies awaiting use in the production process
- In the form of materials* or supplies* to be consumed in
  - Production process
  - Rendering of services

** Other than machinery spares, servicing equipment and stand-by equipment meeting the definition of PPE*


Determination of Cost of Inventories
Costs of purchase
Costs of conversion
Other costs
Purchase price
Duties and other taxes (non-recoverable from the taxing authorities)
Other expenditure directly attributable to the acquisition
Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase
Direct labour
Overheads
Fixed production overheads (remains relatively constant regardless of the volume of production)
Variable production overheads (It vary directly, or nearly directly, with the volume of production)
Costs incurred to bring the inventories to their present location and condition


Allocation of Cost to Joint Products and By-Products
When more than one product is produced in the process
Outcome - Joint products
Outcome - Main product with a By-product
When the cost of conversion of each product is separately identifiable
When the cost of conversion of each product is not separately identifiable
When the by-product is immaterial
When the by-product is material
Cost of each product is calculated on the basis of separate cost incurred.
Allocation of cost is based on relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
By-product is measured at NRV and this value is deducted from the cost of the main product.
By-product is treated as joint product and accordingly, the accounting is done.

Conversion Cost

- Factory Overheads
  - Fixed
    - At Normal Capacity*
    - At Actual Production**
  - Variable
    - At Actual Production
- Direct labour
- Joint Cost
  - Main/Joint***
    - Sale value at Separation
    - Sale value at Completion
  - By Products
    - NRV is deducted from cost of main / joint products

**When actual production is almost equal or lower than normal capacity.*
*** When actual production is higher than normal capacity.*
**** Allocation at reasonable and consistent basis.*

Costs excluded from the cost of inventories and recognised as expenses

- Abnormal amounts of wasted materials, labour, or other production costs;
- Storage costs, unless the production process requires such storage;
- Administrative overheads that do not contribute to bringing the inventories to their present location and condition;
- Selling and distribution costs.

Cost Formulas

Inventory Valuation Technique

- Inventory ordinarily interchangeable
  - Historical Cost Methods
    - FIFO
    - Weighted Average
  - Non Historical Cost Methods
    - Retail Inventory / Adjusted selling price method
      - It is used when large numbers of rapidly changing items with similar margins are involved
        - Cost is determined by reducing sales value of the inventory by the appropriate percentage gross margin
    - Standard Cost Method
      - It takes into account normal levels of consumption (and are reviewed regularly)
        - Materials
        - Supplies
        - Labour efficiency
        - Capacity utilisation
- Inventory not ordinarily interchangeable
  - Specific Identification Method (applicable when individual items can be clearly identified and specific costs are attributed)

Measurement of Inventories

- **Raw Materials**
  - At cost (if finished goods are sold at or above cost), otherwise at replacement cost
- **Finished Goods and Work in progress**
  - Lower of
    - Cost
    - Net Realisable Value
      - Realisable Value *less* Selling Expenses *less* estimated cost of completion

Disclosures

Information about the carrying amounts held in different classification of inventories and the extent of changes in these assets must be disclosed in financial statements.

Common Classifications of inventories

- Stock-in-trade (in respect of goods acquired for trading),
- Finished goods,
- Stores and spares,
- Work in progress,
- Loose tools,
- Raw materials and components,
- Others.

The financial statements should disclose — Accounting policies adopted in measuring inventories, including the cost formula used. — The total carrying amount of inventories together with its classification appropriate to the enterprise.

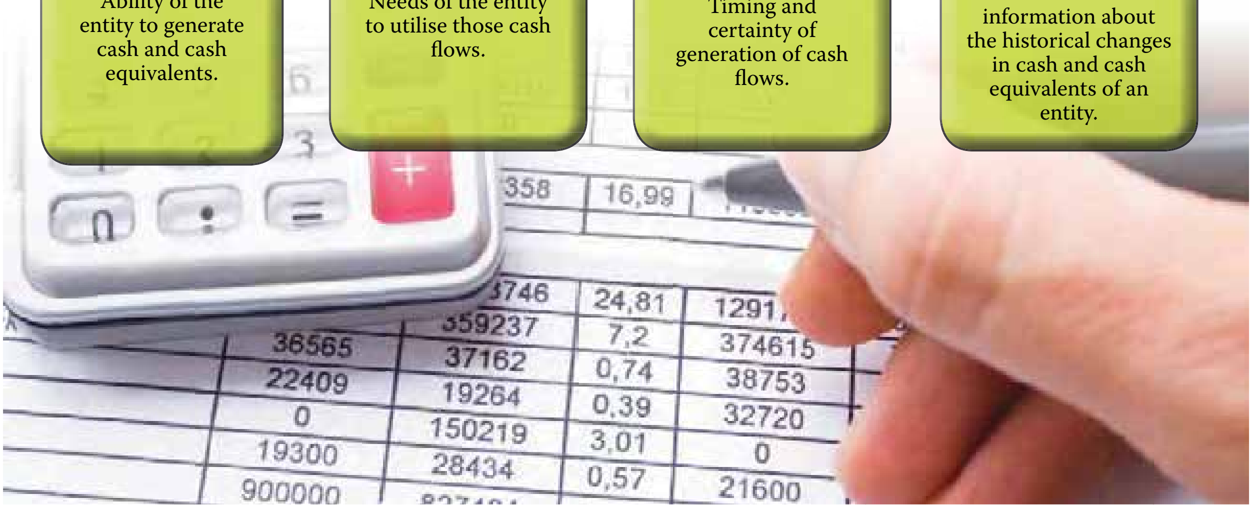
AS 3 "STATEMENT OF CASH FLOWS"

Introduction

AS 3 provides information about historical changes in cash and cash equivalents of an enterprise by mean of a cash flow statement which classifies cash flows during an accounting period into operating, investing and financing activities.

Objectives of AS 3

- **To assess**
  - Ability of the entity to generate cash and cash equivalents.
  - Needs of the entity to utilise those cash flows.
  - Timing and certainty of generation of cash flows.
- **To require**
  - Provision of information about the historical changes in cash and cash equivalents of an entity.



Presentation of a statement of cash flows

Report cash flows (inflows and outflows) during the period

Classified as

Operating activities

These are the principal revenue-producing activities of the entity other than investing or financing activities

Reporting

Under direct method

Major classes of gross cash receipts and gross cash payments are disclosed

Under indirect method

Profit or loss is adjusted for
- non-cash transactions
- any deferrals or accruals of past or future operating cash receipts or payments
- items of income or expense associated with investing or financing cash flows

Entities are encouraged to follow the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.

Investing activities

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents

Financing activities

Financing activities are activities that result in changes in the size and composition of the owner's capital and borrowings of the entity

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities

Cash and cash equivalents

Cash

It comprises cash on hand & demand deposits with banks

Cash equivalents
- are short-term, highly liquid investments
- are readily convertible to known amounts of cash
- are subject to an insignificant risk of changes in value
- are not for investment purposes
- has a short maturity of, say, 3 months or less from the date of acquisition

Exception

Investments in shares are excluded from cash equivalents

Cash flows arising from operating activities

Key indicator of the extent to which the operations of the entity have generated sufficient cash flows to
- repay loans
- maintain the operating capability of the entity
- pay dividends
- make new investments without recourse to external sources of financing

Generally, result from the transactions and other events that have role in the determination of net profit or loss

Examples

(a) Cash receipts from the sale of goods and the rendering of services
(b) Cash receipts from royalties, fees, commissions and other revenue
(c) Cash payments to suppliers for goods and services
(d) Cash payments to and on behalf of employees
(e) Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits
(f) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
(g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.
(h) Cash flows arising from the purchase and sale of dealing or trading securities
(i) Cash advances and loans made by financial institutions since they relate to their main revenue-producing activity

Cash flows arising from investing activities

Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows

Examples

(a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;
(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

Note: *When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.*

Cash flows arising from financing activities

useful in predicting claims on future cash flows by providers of funds to the entity.

Examples

(a) cash proceeds from issuing shares or other equity instruments;
(b) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
(c) cash repayments of amounts borrowed.

Reporting cash flows on a net basis

Entities other than financial institutions

Cash flows arising from operating, investing or financing activities

Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity

Examples are:
(a) The acceptance and repayment of demand deposits of a bank;
(b) Funds held for customers by an investment entity; and
(c) Rents collected on behalf of, and paid over to, the owners of properties

Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short

Examples are advances made for, and the repayment of:
(a) Principal amounts relating to credit card customers;
(b) The purchase and sale of investments; and
(c) Other short-term borrowings, for example, those which have a maturity period of three months or less.

Financial institutions

Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:
(a) Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
(b) The placement of deposits with and withdrawal of deposits from other financial institutions; and
(c) Cash advances and loans made to customers and the repayment of those advances and loans.

Foreign currency cash flows → Arising from transactions in a foreign currency → Recorded in an enterprise's reporting currency → Foreign currency amount ✖ Exchange rate between the reporting currency and the foreign currency at the date of the cash flow

- Cash flows denominated in a foreign currency are reported in a manner consistent with AS 11.
- Weighted average exchange rate for a period may be used for recording foreign currency transactions.

Important Points

1.	**Unrealised gains and losses arising from changes in foreign currency exchange rates**	are not cash flows.
2.	**The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency**	is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period.
		is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

Interest and Dividends

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

In case of financial institutions
- Interest paid; Interest and dividends received → Classified as cash flows arising from operating activities
- Dividends paid → Classified as cash flows from financing activities

In the case of other entities
- Dividends paid; Interest paid → Classified as cash flows from financing activities → They are costs of obtaining financial resources
- Interest and dividends received → Classified as cash flows from investing activities → They are returns on investments.

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

Acquisitions and Disposals of Subsidiaries and Other Business Units

Cash flows arising from
- Acquisitions of subsidiaries or other businesses
- Disposal of subsidiaries or other businesses

- Shall be classified as investing activities
- Shall be presented separately → The cash flow effects of disposals are not deducted from those of acquisions
- Shall disclose, in aggregate, during the period
  - The total purchase or disposal consideration
  - The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

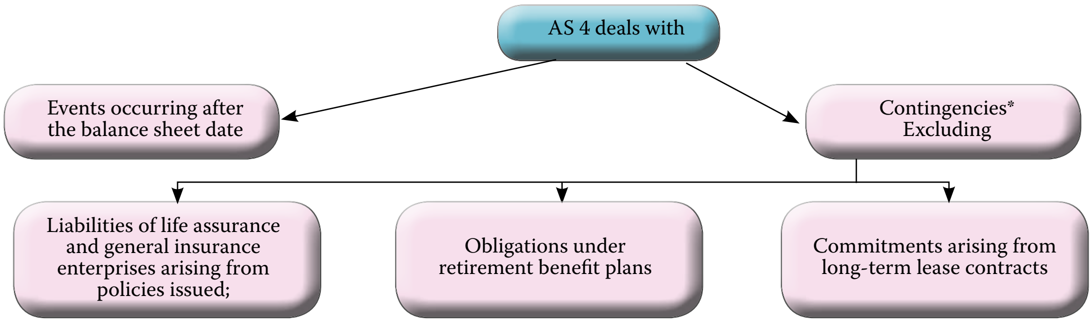
Important points/disclosures

Investing and financing transactions that do not require the use of cash or cash equivalents	shall be excluded from a statement of cash flows.
	disclosed elsewhere in the financial statements in a way that provides all relevant information.
Components of cash and cash equivalents	disclose the components of cash and cash equivalents.
	shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.
	discloses the policy which entity adopts in determining the composition of cash and cash equivalents.
Other disclosures	disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

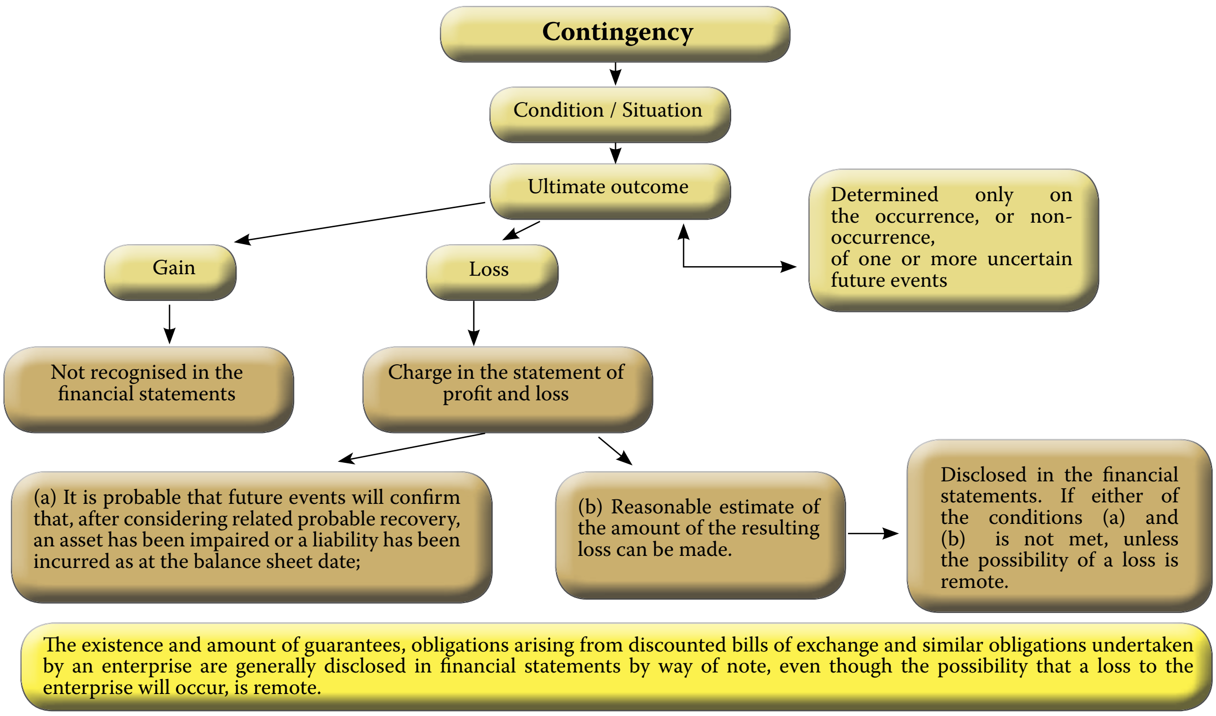
AS 4 "CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE"

Introduction

AS 4 defines contingencies and events occuring after the balance sheet date and describes the accounting treatment and disclosure requirements thereof.



** All paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government.*



Events occurring after the reporting period

Both favourable and unfavourable

That occur between the end of the reporting period and the date when the financial statements are approved

By the Board of Directors in case of a company

By the corresponding approving authority in case of any other entity

Adjusting events

Those which provide further evidence of conditions that existed at the balance sheet date

Non-adjusting events

Those which are indicative of conditions that arose after the balance sheet date.

Disclosure

Adjusting events after the reporting period

Adjust the amounts recognised in the financial statements to reflect it

Example of adjusting events:
Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern.
For example, Destruction of a major production plant by a fire after the balance sheet date may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

Non-adjusting events after the reporting period

Do not adjust the amounts recognised in the financial statements to reflect it

Example of a non-adjusting event
Decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not relate to the condition of the investments at the balance sheet date

If non-adjusting events after the reporting period are material, then **disclose**
- the nature of the event; and
- an estimate of its financial effect, or a statement that such an estimate cannot be made.

Dividend Declared after the reporting period but before approval of financial statements

Do not recognise it as a liability at the end of the reporting period.

Disclosed in the notes

No obligation exists at the end of reporting period.

AS 5 "NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES"

Introduction

The objective of AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis. This standard requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies.

This Statement does not deal with tax implications of
- Extraordinary items,
- Prior period items,
- Changes in accounting estimates, and
- Changes in accounting policies for which appropriate adjustments are made.

Net Profit or Loss for the Period

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss.

Net Profit or Loss for the Period comprises
- Ordinary Items,
- Extra Ordinary Items,
- Prior Period Items,
- Changes in Accounting Estimates and
- Changes in Accounting Polices.

Profit or Loss from Ordinary Activities

Ordinary Activities

- **Activities**
  - Which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.
- **Example**
  - Profit/ Loss on sale of merchandise.
- **Disclosure**
  - When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain performance of entity, Nature and amount of such items should be disclosed separately.
- **Special disclosure**
  - Write-down of inventories to net realisable value as well as the reversal of such write-downs
  - Restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring
  - Disposals of items of fixed assets and long-term investments
  - Legislative changes having retrospective application
  - Litigation settlements and other reversals of provisions

Extraordinary Items

Extraordinary items

- Income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly
- Disclosed in the statement of profit and loss
  - As a part of net profit or loss for the period.
  - Nature and amount of each item separately disclosed
    - in a manner that its impact on current profit or loss can be perceived.
- Examples
  - Attachment of property of the enterprise
  - An earthquake

An event or transaction may be extraordinary for one enterprise but not so for another enterprise because of the differences between their respective ordinary activities.

Prior Period Items

Are income or expenses → Which arise in the current period as a result of → Errors or omissions → In the preparation of the financial statements

- Errors or omissions: Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight
- In the preparation of the financial statements: Of one or more prior periods.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived

Changes in Accounting Estimates

An estimate may have to be revised consequent to

changes occuring in the circumstances based on which the estimate was made, or

new information, more experience or subsequent developments.

Revision of an estimate

is neither an extraordinary item

nor a prior period item.

Residual value and the useful life of PPE → should be reviewed at each financial year-end and → if expectations differ from previous estimates → change should be accounted for → as a change in an accounting estimate.

Effect of a change in an accounting estimate

- **Included in the determination of net profit or loss**
  - Period of the change
    - if the change affects the period only.
  - Period of the change and future periods
    - if the change affects both periods.
- **Classification in statement of profit and loss**
  - Using same classification as was used previously for the estimate.
- **Disclosure**
  - Nature and amount need to be disclosed
    - which has a material effect in the current period,
    - or expected to have a material effect in subsequent periods.

Accounting Policies

- Can be changed only
  - When the adoption of a different accounting policy is required by statute; or
  - For compliance with an accounting standard; or
  - When it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.
- Conditions wherein there are no changes in accounting policies
  - Adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions,
  - Adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.
- Disclosure
  - Any change in accounting period which has material effect should be disclosed
  - The impact of, and the adjustments resulting from, such change, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change.

AS 7 "CONSTRUCTION CONTRACTS"

AS 7 prescribes the principles of accounting for construction contracts in the financial statements of contractors. The focus of the standard is on allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.

What are Construction Contracts?

- Contracts specifically negotiated for the construction of an asset or combination of assets that are closely interrelated.
- Contracts for rendering of services related to construction of assets.
- Contracts for destruction or restoration of assets.

Construction contracts can be classified into two categories.

Types of construction contracts

- Fixed price contract
  - Contractor agrees to a fixed contract price or fixed rate per unit of output, which in some cases is subject to cost escalation.
- Cost plus contract
  - Contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

If the final outcome of the contract

- Can be estimated reliably
  - Revenue and costs recognized as per percantage of completion method considering the stage of completion of contract at reporting date.
- Can not be estimated reliably
  - Revenue should be recognized only to the extent of contract costs incurred, of which recovery is probable.
  - Contract costs should be recognised as an expense in the period in which they are incurred.

Note: Any expected loss (when contract cost > contract revenue) on the construction contract should be recognised as an expense immediately in both the situations.

AS 7 prescribes conditions under which the outcome of a contract can be estimated reliably.

Outcome of contracts can be estimated reliably when

- In fixed price contract
  - Total contract revenue can be measured reliably.
  - It is probable that the economic benefits associated with the contract will flow to the enterprise.
  - Both contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably.
  - Contract costs attributable to contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.
- In cost plus contract
  - It is probable that the economic benefits associated with the contract will flow to the enterprise.
  - Contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

Methods for Determination of Stage of Completion of Contracts

Determination of Stage of Completion
(Method to be chosen depending on the nature of the contract)

Proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs	Surveys of work performed	Completion of a physical proportion of the contract work

As per the standard, Contract revenue and Contract costs comprise of the following:

Contract Revenue

Contract Revenue	
Initial amount of revenue agreed in the contract.	Variations in contract work, claims and incentive payments if (i) it is probable that they will result in revenue. (ii) they are capable of being reliably measured.

Contract Costs

Contract Costs		
Costs that relate directly to the specific contract.	Costs that are attributable to contract activity in general and can be allocated to the contract.	Such other costs as are specifically chargeable to the customer under the terms of the contract.

Changes in Estimates

- Application of percentage of completion on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs.
- Effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate.
- The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.

When a contract covers a number of assets, each contract should be treated as separate contract if

- Separate proposals have been submitted for each asset.
- Each asset has been subject to separate negotiation and contractor and customers are able to accept or reject that part of the contract relating to each asset.
- Costs and revenues of each asset can be identified.

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when

- Group of contracts is negotiated as a single package.
- Contracts are performed concurrently or in a continuous sequence.
- Contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin.

A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset.

Construction of the additional asset should be treated as a separate construction contract when

- Asset differs significantly in design, technology or function from the asset or assets covered by the original contract
- Price of the asset is negotiated without regard to the original contract price.

Disclosures in Financial Statements

General	Specific for contracts in progress
Amount of contract revenue recognised as revenue in the period	Amount of advances received
Methods used to determine the stage of completion of contracts in progress	Amount of retentions

Retentions are the amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

An enterprise should present gross amount for contract work in the financial statements

- Due from customers — As an asset
- Due to customers — As a liability

AS 9 "REVENUE RECOGNITION"

AS 9 explains the timing for recognition of revenue in the financial statements and also state the circumstances under which revenue recognition should be postponed.

AS 9 deals with → Bases for recognition of revenue arising in the course of the ordinary activities → In the statement of profit and loss of an enterprise.

Revenue is the gross inflow of cash, receivables or other consideration arising from

- Sale of goods
- Rendering of services
- Use by others of enterprise resources yielding interest, royalties and dividends

AS 9 does not deal with reveue arising from

- Construction contracts
- Hire-purchase, lease agreements
- Government grants and other similar subsidies
- Insurance contracts of insurance companies

Items not included within the definition of "revenue"

- Realised gains resulting from the disposal of non-current assets
- Unrealised gains resulting from the holding of non-current assets e.g. appreciation in the value of fixed assets
- Unrealised holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products
- Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments due to translation of foreign currency financial statements
- Realised gains resulting from the discharge of an obligation at less than its carrying amount
- Unrealised gains resulting from the restatement of the carrying amount of an obligation

Sale of Goods

Revenue from sale of goods should be recognised when the requirements as to performance as set out in the standard are satisfied.

In sale of goods, performance should be regarded as being achieved when

- Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred.
- No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Rendering of Services

Revenue from service transactions is usually recognised as the service is performed.

Methods of recognition of Revenue

Proportionate completion method

(i) Recognition of revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.
(ii) Performance consists of the execution of more than one act.
(iii) Revenue is recognised proportionately by reference to the performance of each act.

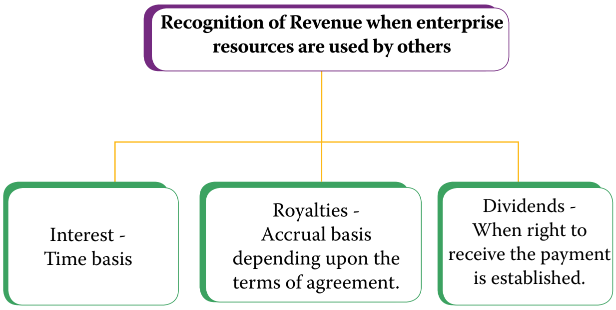
Completed service contract method

(i) Recognition of revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.
(ii) Services become chargeable.
(iii) Performance consists of the execution of a single act.

Note: Revenue from Sale of goods "for consideration" and Service transactions should be recognized only when no significant uncertainty exists regarding amount of consideration.

Use of Enterprise Resources by Other Parties

Use of enterprise resources by others may yield revenue in the form of Interest, Royalties and Dividends.



Effect of Uncertainties on Revenue Recognition

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved.

When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

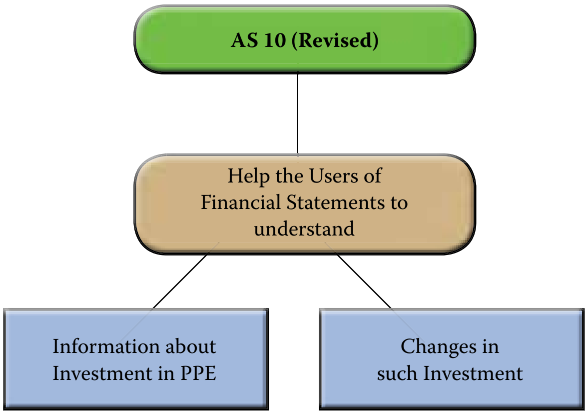
Disclosures

In addition to the disclosures required by AS 1 "Disclosure of Accounting Policies", an enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

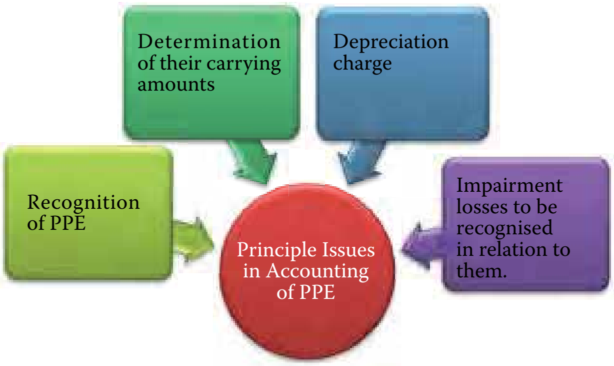
AS 10 "PROPERTY, PLANT AND EQUIPMENT"

Introduction

The objective of this Standard is to prescribe accounting treatment for Property, Plant and Equipment (PPE).

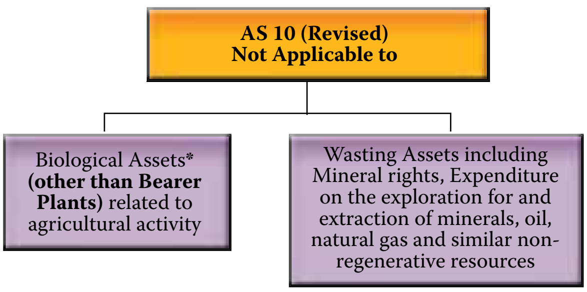


The principal issues in Accounting for PPE are:



Scope of Standard

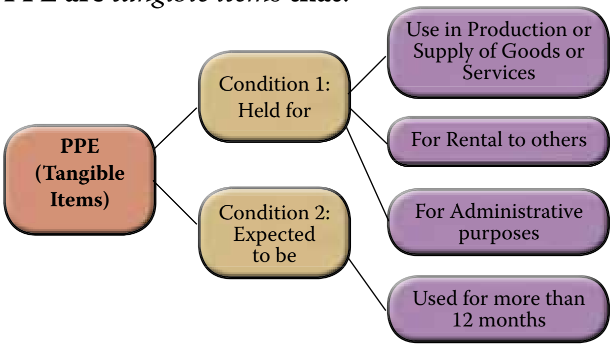
As a general principle, AS 10 (Revised) should be applied in accounting for PPE. Except when another Accounting Standard requires or permits a different accounting treatment.



***AS 10 (Revised) applies to Bearer Plants but it does not apply to the produce on Bearer Plants.**

Clarifications:
1. AS 10 (Revised) applies to PPE used to develop or maintain the assets described above.
2. Investment property (defined in AS 13 (Revised)), should be accounted for only in accordance with the Cost model prescribed in this standard.

PPE are *tangible items* that:



Intangible items are covered under AS 26.

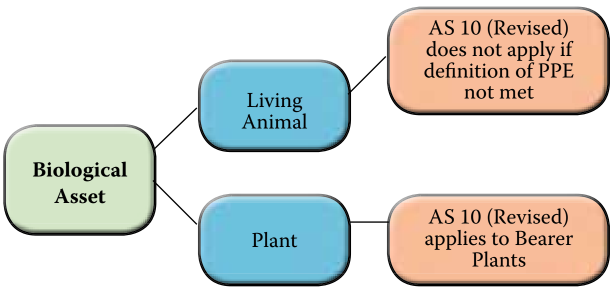
"Administrative purposes": **The term 'Administrative purposes' has been used** in wider sense **to** *include all business purposes*. Thus, PPE would include assets used for:

- Selling and distribution
- Finance and accounting
- Personnel and other functions of an Enterprise.

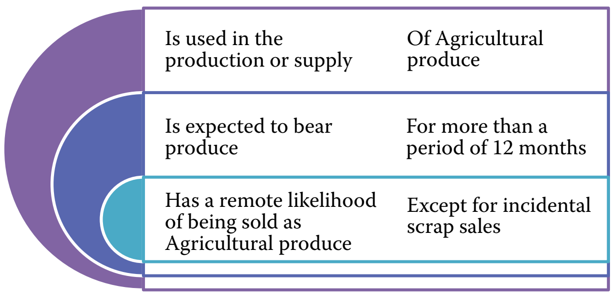
> Items of PPE may also be acquired for safety or environmental reasons.
>
> The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets.
>
> Such items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

Other definitions

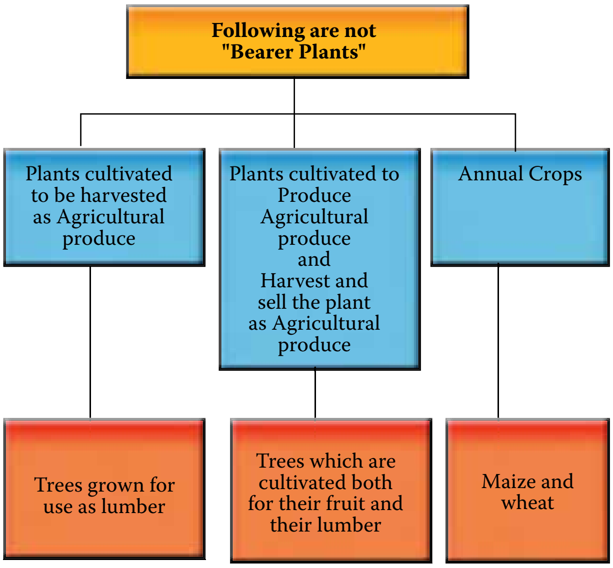
1. **Biological Asset:** Till the time, the Accounting Standard on "Agriculture" is issued, accounting for livestock meeting the definition of PPE, will be covered as per AS 10 (Revised).



2. Bearer Plant: Is a plant that (satisfies all 3 conditions):

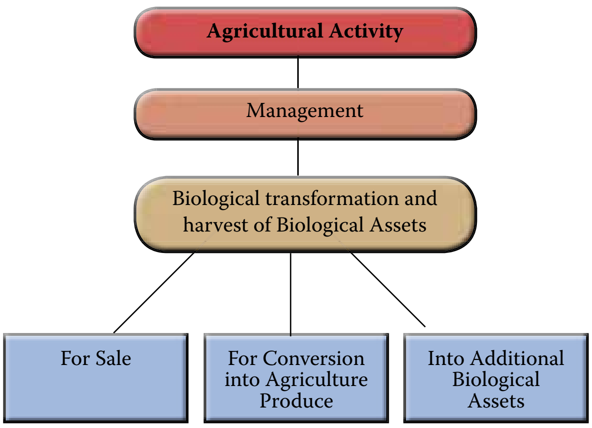


Note: When bearer plants are no longer used to bear produce they might be cut down and sold as scrap. For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.



Agricultural Produce is the harvested product **of** Biological Assets **of the enterprise.**

3. **Agricultural Activity:** is the management by an Enterprise of:
   - Biological transformation and Harvest of Biological Assets



Recognition Criteria for PPE

The *cost of an item of PPE* **should be recognised as an asset** *if, and only if:*

(a) It is probable that future economic benefits associated with the item will flow to the enterprise, and

(b) The cost of the item can be measured reliably.

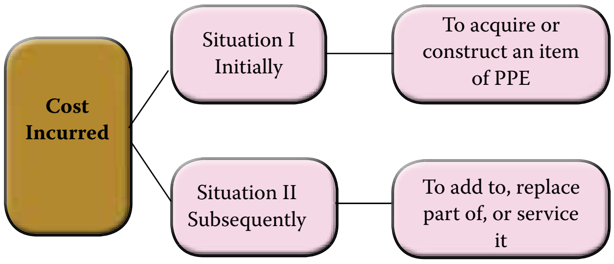
Notes:

1. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
2. An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

When to apply the above criteria for Recognition?

An enterprise evaluates under this recognition principle all its costs on PPE at the time they are incurred.

These costs include costs incurred:



Treatment of Spare Parts, Stand by Equipment and Servicing Equipment

Case I If they meet the definition of PPE as per AS 10 (Revised):

- **Recognised as PPE as per AS 10 (Revised)**

Case II If they do not meet the definition of PPE as per AS 10 (Revised):

- **Such items are classified as Inventory as per AS 2 (Revised)**

Treatment of Subsequent Costs

Cost of day-to-day servicing

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 item of PPE.

An enterprise does not recognise in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the Statement of Profit and Loss as incurred.

Replacement of Parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

An enterprise recognises in the carrying amount of an item of PPE the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met.

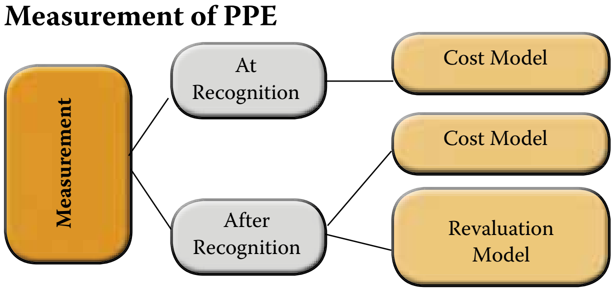
Notes: The carrying amount of those parts that are replaced is derecognised in accordance with the de-recognition provisions of this Standard.

Regular Major Inspections - Accounting Treatment

When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE 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 derecognised.

Measurement of PPE

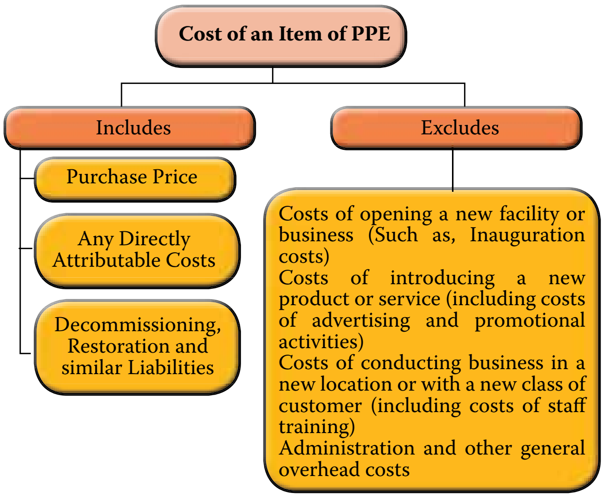


Measurement at Recognition

An item of PPE that qualifies for recognition as an asset should be measured at its cost.

What are the elements of Cost?

Cost of an item of PPE comprises:



Recognition of costs in the carrying amount of an item of PPE ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The following costs are not included in the carrying amount of an item of PPE:

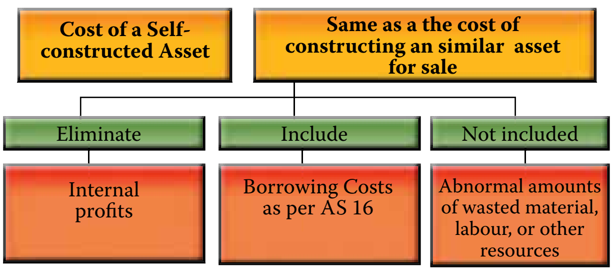
1. Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
2. Initial operating losses, such as those incurred while demand for the output of an item builds up. And
3. Costs of relocating or reorganising part or all of the operations of an enterprise.

Note: Some operations occur in connection with the construction or development of an item of PPE, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities.

Decommissioning, Restoration and similar Liabilities:

The cost of an item of PPE comprises initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

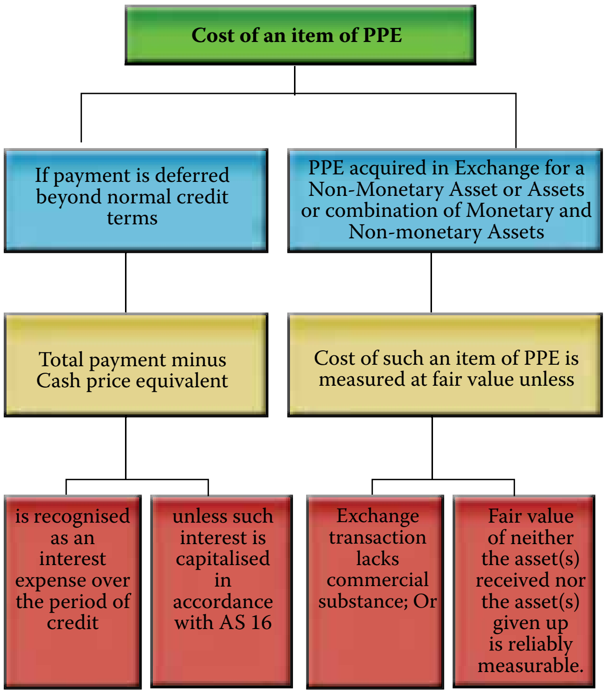
Exception: *An enterprise applies AS 2 (Revised) "Valuation of Inventories", to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.*



Bearer plants are accounted for in the same way as self-constructed items of PPE before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement of Cost

Cost of an item of PPE is the cash price equivalent **at the recognition date.**



Note:

1. The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up.
2. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.
3. An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
   (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
   (b) the enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;
   (c) and the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

PPE purchased for a Consolidated Price

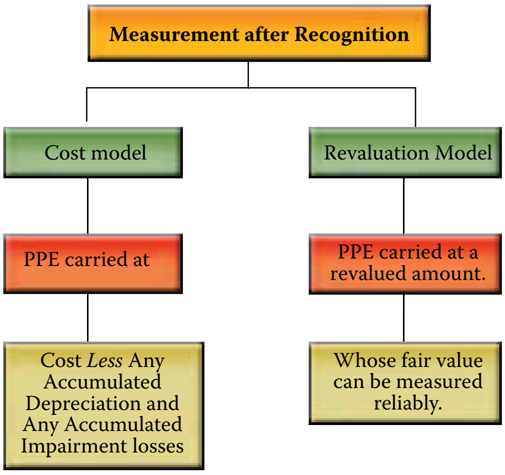
Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

PPE held by a lessee under a Finance Lease

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

Government Grant related to PPE

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).



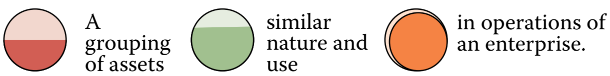
Revaluation for entire class of PPE

If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

Reason:

The items within a class of PPE are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the Financial Statements that are a mixture of costs and values as at different dates.

Class of PPE is

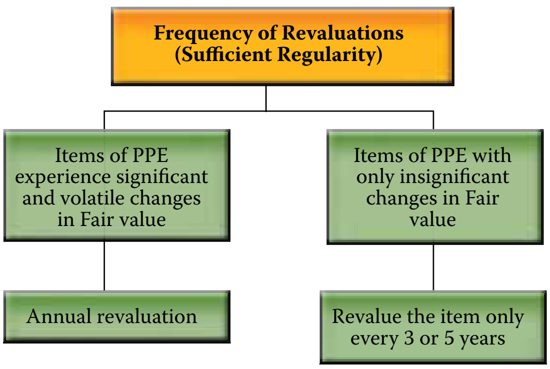


Frequency of Revaluations

Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using Fair value at the Balance Sheet date.

The frequency of revaluations depends upon the changes in fair values of the items of PPE being revalued.

When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.



Determination of Fair Value

Fair value of items of PPE is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

If there is no market-based evidence of fair value because of the specialised nature of the item of PPE and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach or a depreciated replacement cost approach.

Accounting Treatment of Revaluations

When an item of PPE is revalued, the carrying amount of that asset is adjusted to the revalued amount.

At the date of the revaluation, the asset is treated in one of the following ways:

Technique 1: Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

Gross carrying amount

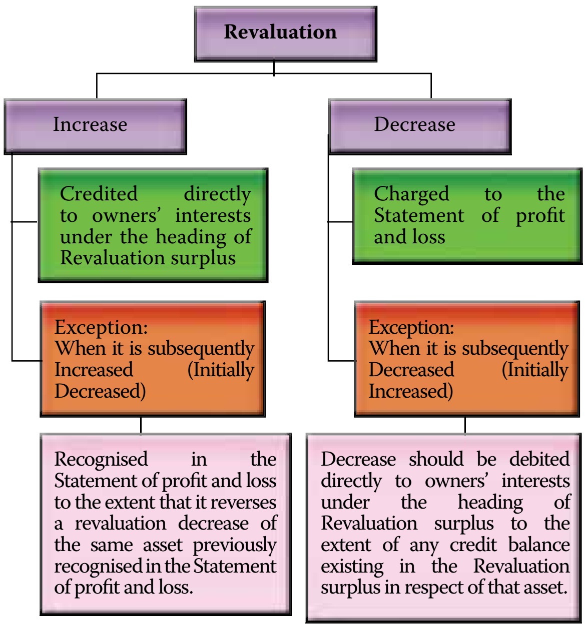
- May be restated by reference to observable market data, or
- May be restated proportionately to the change in the carrying amount.

Accumulated depreciation at the date of the revaluation is

- Adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses

Technique 2: Accumulated depreciation is eliminated against the Gross Carrying amount of the asset

Revaluation - Increase or Decrease



Treatment of Revaluation Surplus

The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred to the Revenue Reserves when the asset is derecognised.

Case I : When whole surplus is transferred:

If the asset is:

- Retired; Or
- Disposed of.

Case II : Some of the surplus may be transferred as the asset is used by an enterprise:

In such a case, the amount of the surplus transferred would be:

Depreciation (based on Revalued Carrying amount) – Depreciation (based on Original Cost)

Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss.

Depreciation

Component Method of Depreciation

Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

A significant part of an item of PPE may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Depreciable Amount and Depreciation Period

Depreciable amount is:

Cost of an asset (or other amount substituted for cost i.e. revalued amount) -Residual value

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Review of Residual Value and Useful Life of an Asset

Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

Commencement of period for charging Depreciation

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

Cessation of Depreciation

I. **Depreciation ceases to be charged when asset's residual value exceeds its carrying amount**

The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

II. **Depreciation of an asset ceases at the earlier of:**

- The date that the asset is retired from active use and is held for disposal, and
- The date that the asset is derecognised.

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.

Land and Buildings

Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

A. **Land:** Land has an unlimited useful life and therefore is not depreciated.

Exceptions: Quarries and sites used for landfill.

Depreciation on Land:

I. **If land itself has a limited useful life:**

It is depreciated in a manner that reflects the benefits to be derived from it.

II. **If the cost of land includes the costs of site dismantlement, removal and restoration:**

That portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.

B. **Buildings:**

Buildings have a limited useful life and therefore are depreciable assets.

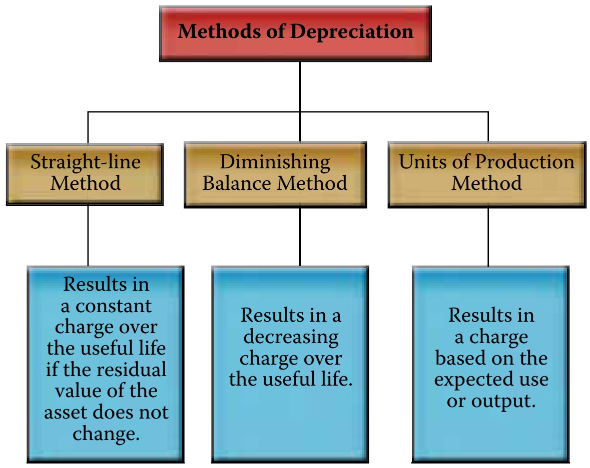
An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

Depreciation Method

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

The method selected is applied consistently from period to period unless:

- There is a change in the expected pattern of consumption of those future economic benefits; Or
- That the method is changed in accordance with the statute to best reflect the way the asset is consumed.



Review of Depreciation Method

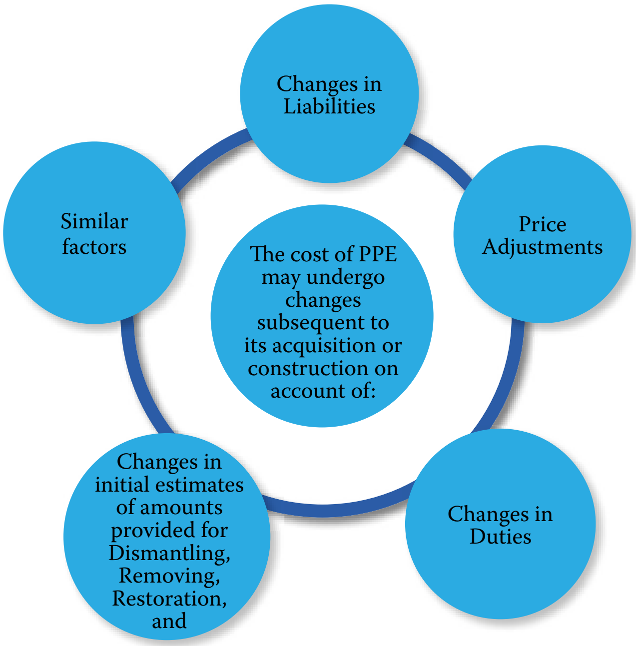
The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern.

Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

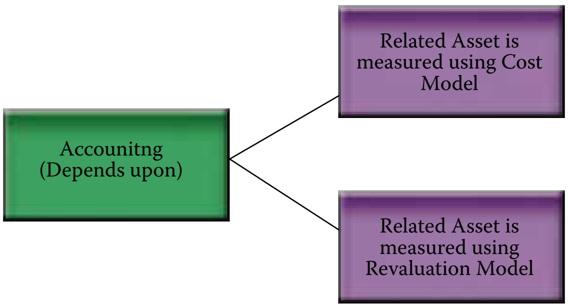
Depreciation Method based on Revenue:

A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate.

Changes in Existing Decommissioning, Restoration and Other Liabilities



Accounting for the above changes:



If the related asset is measured using the Cost model

Changes in the Liability should be added to, or deducted from, the cost of the related asset in the current period

Note: Amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the Statement of Profit and Loss.

If the adjustment results in an addition to the cost of an asset

- Enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable.

Note: If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with applicable Accounting standards.

If the related asset is measured using the Revaluation model

Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:

(i) **Decrease in the liability credited directly to revaluation surplus in the owners' interest**

Exception:

- It should be recognised in the Statement of Profit and Loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the Statement of Profit and Loss.

Note: In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the Statement of Profit and Loss.

(ii) **Increase in the liability should be recognised in the Statement of Profit and Loss**

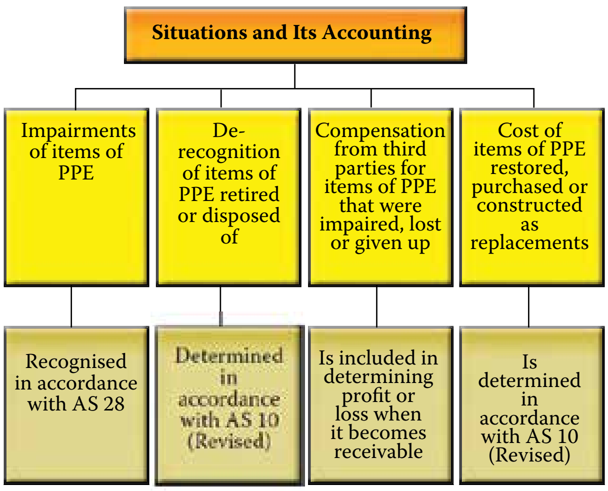
Exception:

- It should be debited directly to Revaluation surplus in the owners' interest to the extent of any credit balance existing in the Revaluation surplus in respect of that asset

Caution:
A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

What happens if the related asset has reached the end of its useful life?

All subsequent changes in the liability should be recognised in the Statement of Profit and Loss as they occur. This applies under both the cost model and the revaluation model.



Retirements

Items of PPE retired from active use and held for disposal should be stated at the lower of:

- Carrying Amount, and
- Net Realisable Value

Note: Any write-down in this regard should be recognised immediately in the Statement of Profit and Loss.

De-Recognition

Derecognition of Carrying amount PPE:

- On disposal
  - By sale
  - By entering into a finance lease, or
  - By donation.
- When no future economic benefits are expected from its use or disposal
- Accounting Treatment
  - Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss when the item is derecognised unless AS 19 on Leases, requires otherwise on a sale and leaseback (AS 19 on Leases, applies to disposal by a sale and leaseback.)
  - Gain or loss arising from de-recognition of an item of PPE

    = Net disposal proceeds (if any) - Carrying Amount of the item

Note: Gains should not be classified as revenue, as defined in AS 9 'Revenue Recognition'.

Exception:

An enterprise that in the course of its ordinary activities, routinely sells items of PPE that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale.

The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9 on Revenue Recognition.

Determining the date of disposal of an item:

An enterprise applies the criteria in AS 9 for recognising revenue from the sale of goods.

Disclosure

Disclosures

- General
- Additional
- Disclosures related to Revalued Assets

General Disclosures:

(a) The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;

(b) The depreciation methods used;

(c) The useful lives or the depreciation rates used.

In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

- The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- A reconciliation of the carrying amount at the beginning and end of the period showing:
  - (i) additions
  - (ii) assets retired from active use and held for disposal
  - (iii) acquisitions through business combinations
  - (iv) increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus
  - (v) impairment losses recognised in the statement of profit and loss
  - (vi) impairment losses reversed in the statement of profit and loss
  - (vii) depreciation
  - (viii) net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11
  - (ix) other changes.

Additional Disclosures:

The financial statements should also disclose:

- The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- The amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
- The amount of assets retired from active use and held for disposal;
- The amount of contractual commitments for the acquisition of property, plant and equipment;
- If amount of contractual commitments is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss.

Disclosures related to Revalued Assets:

If items of property, plant and equipment are stated at revalued amounts, the following should also be disclosed:

- The effective date of the revaluation;
- Whether an independent valuer was involved;
- The methods and significant assumptions applied in estimating fair values of the items;
- The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
- The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Transitional Provisions

Previously Recognised Revenue Expenditure

Where an entity has in past recognised an expenditure in the Statement of Profit and Loss which is eligible to be included as a part of the cost of a project for construction of PPE in accordance with the requirements of this standard:

- It may do so retrospectively for such a project.

> ***Note:*** The effect of such retrospective application, should be recognised net-of-tax in Revenue reserves.

PPE acquired in Exchange of Assets

The requirements of AS 10 (Revised) regarding the initial measurement of an item of PPE acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.

Spare parts

On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS 2 (Revised), and are now required to be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts.

> ***Note:*** The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.

Revaluations

The requirements of AS 10 (Revised) regarding the revaluation model should be applied prospectively.

In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of items of PPE reflects any previous revaluation it should adjust the amount outstanding in the Revaluation reserve against the carrying amount of that item.

> ***Note:*** The carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as Revaluation reserve over the carrying amount of that item should be adjusted in Revenue reserves.

AS 11 "THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES"

Introduction

The standard deals with the issues involved in accounting for foreign currency transactions and foreign operations i.e., to decide which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements.

Important points/disclosures

AS 11

Applicable

- (a) In accounting for transactions in foreign currencies.
- (b) In translating the financial statements of foreign operations.
- (c) Accounting for foreign currency transactions in the nature of forward exchange contracts.

Not applicable for

- (a) Specifying the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.
- (b) Presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation, which are addressed in AS 3 'Cash flow statement'.
- (c) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- (d) Restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

Definitions of the Terms used in the Standard

A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

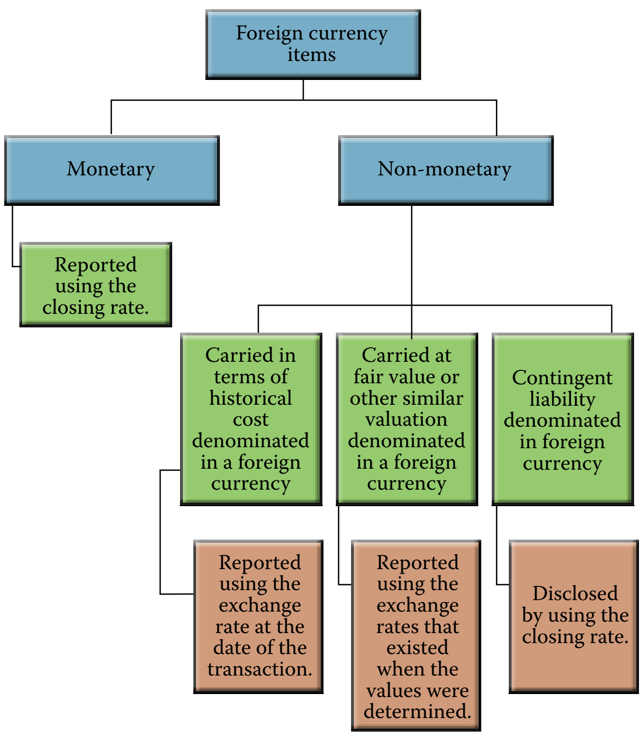
- Buys or sells goods or services whose price is denominated in a foreign currency or
- Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency or
- Becomes a party to an unperformed forward exchange contract or
- Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Monetary items	are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. Example, cash, receivables and payables.
Non-monetary items	are assets and liabilities other than monetary items. Examples: fixed assets, inventories and investments in equity shares.
Foreign operation (FO)	is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.
Integral foreign operation (IFO)	is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise and carries on its business as if it were an extension of the reporting enterprise's operations.
Non-integral foreign operation (NFO)	is a foreign operation that is not an integral foreign operation. 'Net investment in a non-integral foreign operation' is the reporting enterprise's share in the net assets of that operation.
Forward exchange contract	an agreement to exchange different currencies at a forward rate.
Forward rate	is specified exchange rate for exchange of two currencies at specified future date.
Foreign currency	is a currency other than the reporting currency of an enterprise.

Initial Recognition

A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

Reporting at each Balance Sheet Date



Recognition of Exchange Differences

- Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.
- An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction.
- When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period.
- When the transaction is settled in a subsequent accounting period, exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.
- Alternatively, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset;
- In other cases, can be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) Account and (amortised over the balance period of such long term assets or liability, by recognition as income or expense in each of such periods)
- Such option is irrevocable and should be applied to all such foreign currency monetary items.

Classification of Foreign Operations as Integral or Non-Integral

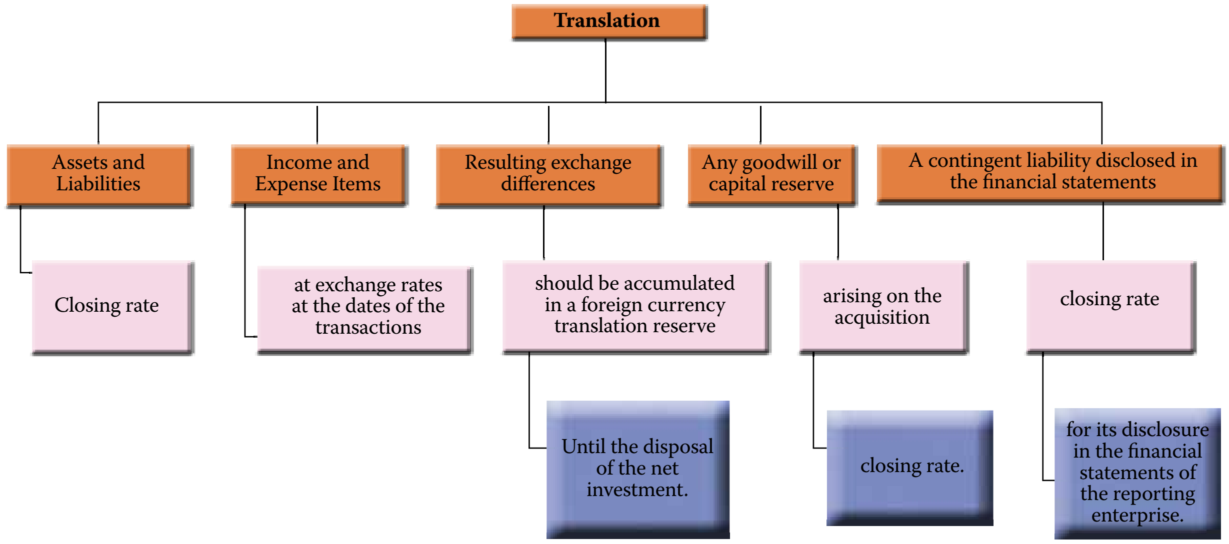
- The method used to translate the financial statements of a foreign operation
- depends on the way in which it is financed
- and operates in relation to the reporting enterprise.
- foreign operations are classified as either 'integral foreign operations' or 'non-integral foreign operations.'

Translation of Integral Foreign Operations (IFO)

- The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.
- The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation.
- The cost of inventories is translated at the exchange rates that existed when those costs were incurred.
- The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined.

Translation of Non-Integral Foreign Operations (NFO)

The translation of the financial statements of a non-integral foreign operation is done using the following procedure:



Procedure of Translation for Non-Integral Foreign Operations (NFO)

For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period is often used to translate income and expense items of a foreign operation.

Incorporation of the financial statements of a non-integral foreign operation in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary.

When the financial statements of a non-integral foreign operation are drawn up to a different reporting date from that of the reporting enterprise, the non-integral foreign operation often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise.

The exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise.

When a non-integral foreign operation is consolidated, but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

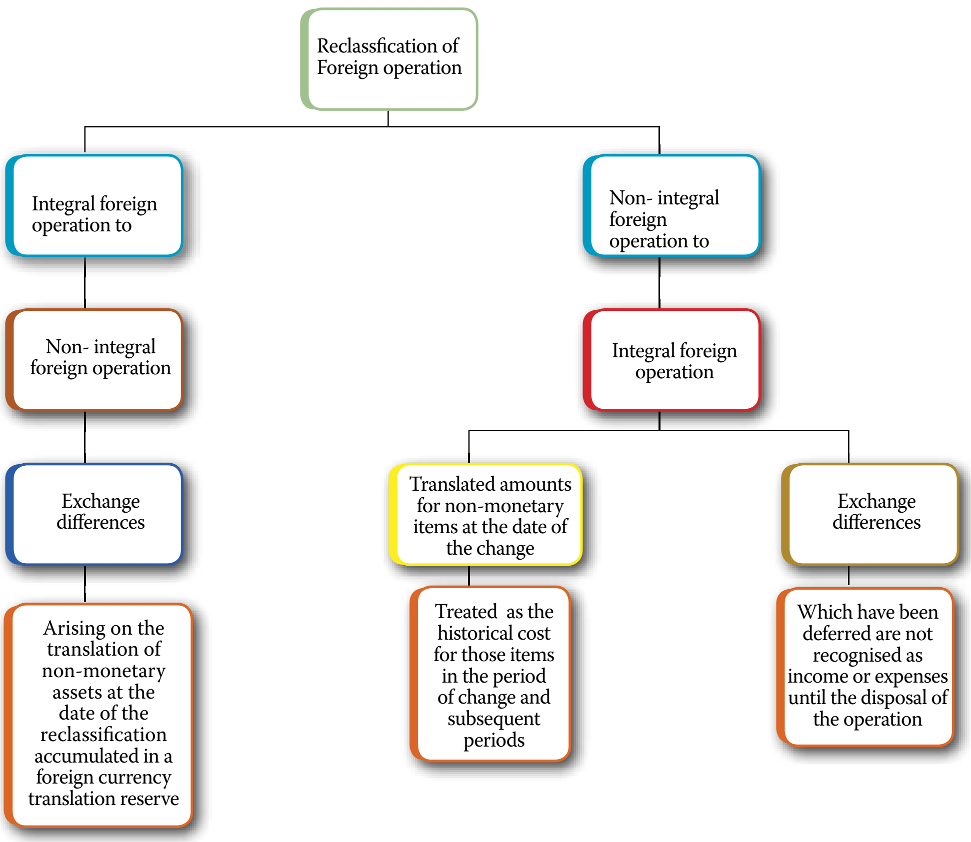
An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part ot: that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. Remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

Indications that a FO is a non-integral foreign operation rather than an integral foreign operation

Indications		
Indications	Control	RE may control the FOA of the FO are carried out with a significant degree of autonomy from those of the **RE**
	Transactions	With the **RE** are not a high proportion of the **FOA**
	Finance	**FOA** are financed mainly from its own operations or local borrowings rather than from RE
	Cost	Costs of labour, material and other components of the FO'S products or services are primarily paid or **settled in the local currency** rather than in the **RE** currency
	Sales	FO's sales are mainly in currencies other than the RE currency
	Cash Flows	RE cash flows are insulated from the day-to-day activities of the FO rather than being directly affected by the FOA
	Sales prices	Sales prices for the FO'S products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation.
	Local sales market	There is an active local sales market for the FO'S products, although there also might be significant amounts of exports.

RE - Reporting Enterprise
FO- Foreign Operation
FOA - Foreign Operation Activities

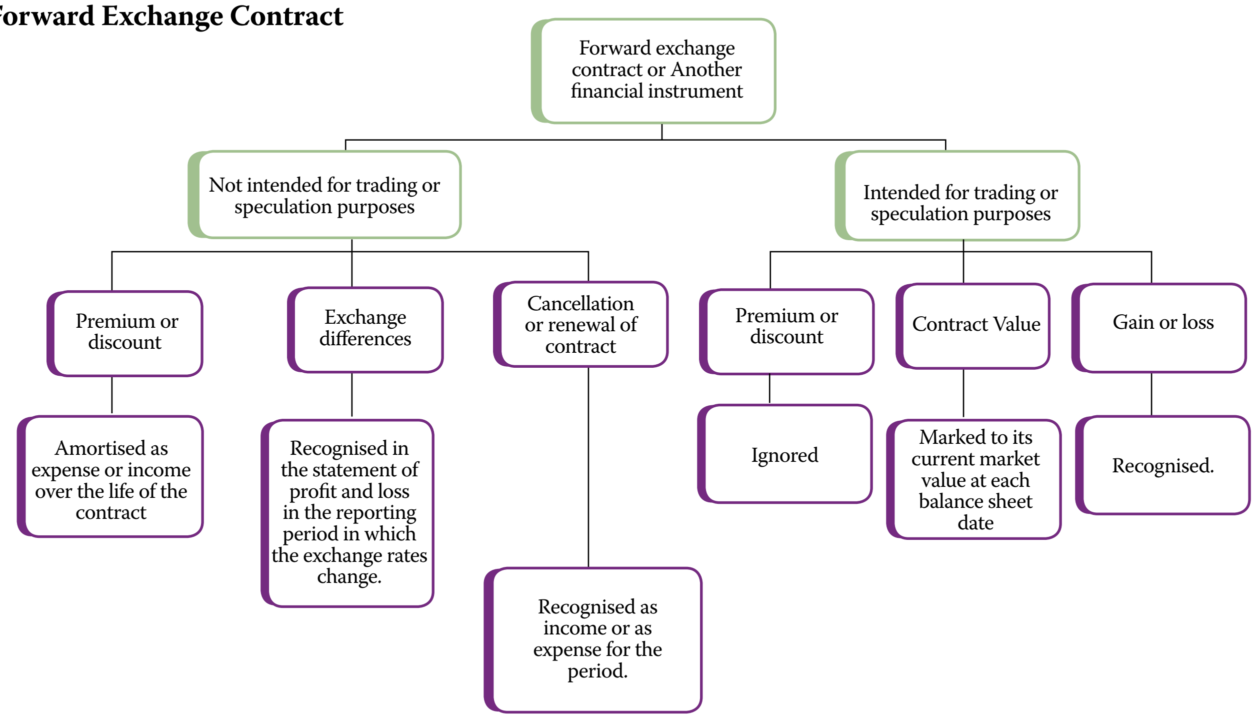
Change in the Classification of a Foreign Operation



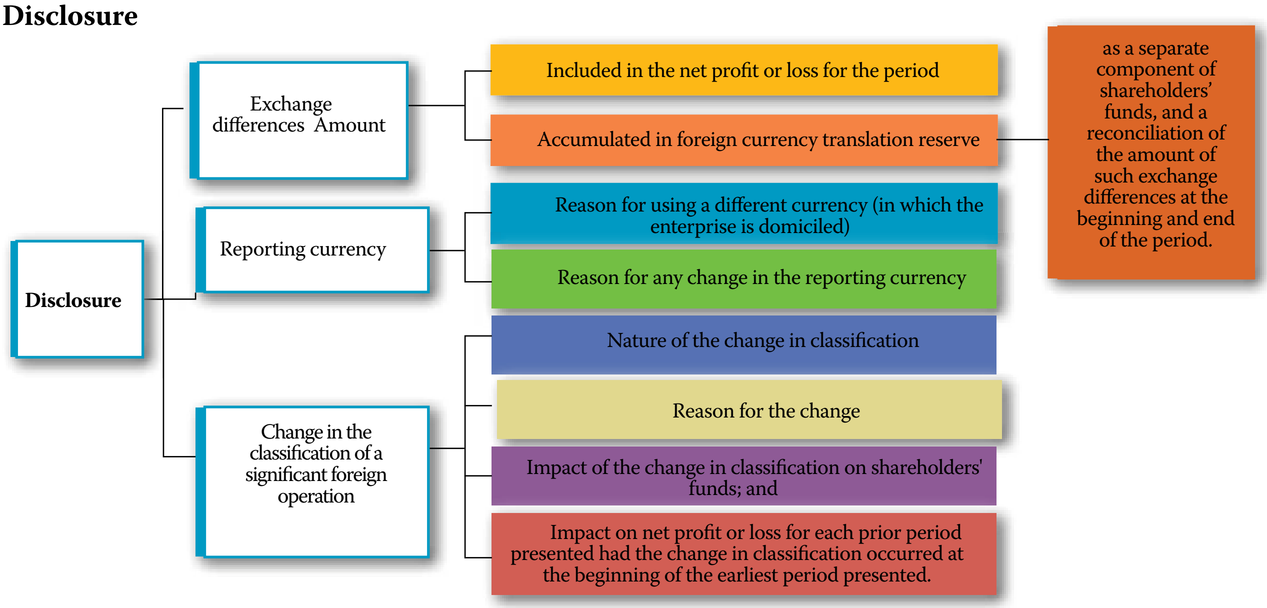
Tax Effects of Exchange Differences

Accounted for in accordance with AS 22. { Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects.

Forward Exchange Contract



Disclosure



Presentation of Foreign Currency Monetary Item Translation Difference Account (FCMITDA)

Debit or credit balance in FCMITDA should be shown on the "Equity and Liabilities" side of the balance sheet under the head 'Reserves and Surplus' as a separate line item.

AS 12 "ACCOUNTING FOR GOVERNMENT GRANTS"

AS 12

Deals with

◊ Accounting for government grants such as subsidies,
◊ Cash incentives,
◊ Duty drawbacks, etc.

Does not deal with:

◊ The special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

◊ Government assistance other than in the form of government grants.

◊ Government participation in the ownership of the enterprise

AS 12 describes

- Treatment of non-monetary government grants;
- Presentation of grants related to specific fixed assets;
- Revenue grants and those in the nature of promoters' contribution;
- Treatment for refund of government grants etc.

Meaning of Government Grants

Assistance by government – in cash or kind – to an enterprise for past or future compliance – with certain conditions

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

Accounting Treatment of Government Grants

Two approaches

'Capital approach'

Grant is treated as part of shareholders' funds

Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds.

'Income approach'

Grant is taken to income over one or more periods.

Income approach may be more appropriate in the case of other grants.

Recognition of Government Grants

A government grant is not recognised until there is reasonable assurance that → Enterprise will comply with the conditions attached to it; and → Grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will befulfilled.

Non-Monetary Government Grants

Non-Monetary Government Grants

Land or other resources,

- Concessional rates → Account at their acquisition cost.
- Free of cost → Recorded at a nominal value.

Presentation of Grants

Presentation of Grants

- Related to Specific Fixed Assets
  - Method I :
    - The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
    - The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
    - Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.
  - Method II:
    - Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
    - Grants related to non-depreciable assets are credited to capital reserve as there is usually no charge to income in respect of such assets.
    - If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.
- Related to Revenue
  - Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.
- In nature of Promoters' Contribution
  - Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Refund of Government Grants

If certain conditions are not fulfilled grants become refundable and are treated as an extraordinary item.

Refund of Government Grant

- Related to Revenue
  - is applied first against any unamortised deferred credit remaining in respect of the grant
  - To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists,
  - the amount is charged immediately to profit and loss statement.
- Related to a Specific fixed asset
  - is recorded by increasing the book value of the asset or by reducing the deferred income balance, as appropriate, by the amount refundable.
  - In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
- In the nature of promoters' contribution
  - Refundable, in part or in full, to the government on non-fulfilment of some specified conditions, the relevant amount recoverable by the government is
    - Reduced from the capital reserve.

Disclosure

- The accounting policy adopted for government grants, including the methods of presentation in the financial statements
- The nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

AS 13 "ACCOUNTING FOR INVESTMENTS"

AS 13 deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

AS 13 does not deal with

- Basis for recognition of interest, dividends and rentals earned on investments which are covered by AS 9
- Operating or finance leases
- Investments on retirement benefit plans and life insurance enterprises
- Mutual funds, venture capital funds and/ or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013

DEFINITION OF INVESTMENTS

Investments are assets held by an enterprise

- for earning income
  - Dividends
  - Interests
  - Rentals
- for capital appreciation or for other benefits

Assets held as Stock-in-trade are not 'Investments'.

Fair value

- Amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.
- Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

Market value

- Amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

CLASSIFICATION OF INVESTMENTS

Classification of Investments

- Current Investments: By nature readily realisable; intended to be held for not more than one year from the date on which such investment is made.
- Long Term Investments: Other than a current investment

Type of acquisition	**Cost of investments**
In Cash/ bank	Cash price including charges such as brokerages, fees and duties
By Issue of shares/ other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up or fair value of investment acquired, whichever is more clearly evident

Accounting for Interest accrued/Dividend declared

- **Pre-acquisition period**: ***Deducted from cost of investment***
- **Post-acquisition period**: ***Recognized as an income***

Accounting for

- Right shares
  - **Subscribed** Cost of shares added to carrying amount
  - **Not subscribed, but sold** Sale proceeds taken to P&L A/c
    - If acquired on cum-right basis & the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.
- Bonus
  - No amount is entered in the capital column of investment account.

CARRYING AMOUNT OF INVESTMENTS

Carrying Amount

- Current investments
  - Lower of cost and fair value.
    - Any reduction to fair value is debited to profit and loss account, however, if fair value of investment is increased subsequently, the increase in value of current investment up to the cost of investment is credited to the profit and loss account (and excess portion, if any, is ignored).
  - Valuation
    - on overall (or global) basis is not considered appropriate; prudent method is to carry investment individually.
- Long term investments
  - carried
    - at cost.
      - Where there is a decline, other than temporary,in the carrying amounts of long term valued investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.
  - Valuation
    - Determined on an individual investment basis.

INVESTMENT PROPERTIES

- An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
- An investment property is accounted for in accordance with cost model as prescribed in AS 10 (Revised), 'Property, Plant and Equipment'.
- The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

DISPOSAL OF INVESTMENTS

Difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the P & L statement.	When part of investment is disposed, carrying amount is allocated to that part on the basis of average carrying amount of total investment.	If investments held as stock-in-trade, cost of stocks disposed calculated as per cost formula as per AS 2.

RECLASSIFICATION OF INVESTMENTS

Reclassification of Investments

- Current to Long-term
  - Transfer at Lower of cost & fair value at the date of transfer
- Long-term to Current
  - Transfer at lower of cost & carrying amount at the date of transfer

DISCLOSURE

1. Accounting policies followed for valuation of investments;
2. Amounts included in profit and loss statement for:
   - Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments.
   - Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid.
   - Profits and losses on disposal of current investments and changes in carrying amount of such investments.
   - Profits and losses on disposal of long term investments and changes in carrying amount of such investments.
3. Significant restrictions on the right of ownership, realizability of investments or remittance of income and proceeds of disposal.
4. Aggregate amount of quoted and unquoted investments, giving aggregate market value of quoted investments.
5. Other disclosures as specifically required by relevant statute governing enterprise.

AS 14 "ACCOUNTING FOR AMALGAMATIONS"

AS 14 (Revised) deals with the accounting to be made in the books of Transferee company in the case of amalgamation and the treatment of any resultant goodwill or reserve.

Objective

- Accounting for amalgamations
- Treatment of any resultant goodwill or reserves
- Disclosures

Scope

This standard deals with Accounting for Amalgamation i.e. acquisition of one entity by the other and the acquired entity ceased to exist	The standard does not deal with cases of acquisitions where one entity is acquired by the other and the acquired entity continues to exist.

Key Terms

Meaning of Amalgamations

In an amalgamation, two or more companies are combined into one by merger or by one taking over the other. *Amalgamation means an amalgamation*

pursuant to the relevant provisions of the Companies Act

includes "merger"

Transferor company	Company which is amalgamated into another company.
Transferee company	Company into which a transferor company is amalgamated.
Reserve	Portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.
Consideration for the amalgamation	Aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.
Fair value	Amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

Types of Amalgamations and Methods of Accounting

Amalgamation may be either in the nature of

Merger	Purchase
Amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies are amalgamations in the nature of merger.	Amalgamations which are in effect a mode by which one company acquires another company and as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued.
Method of Accounting - Pooling of Interest method	Method of Accounting - Purchase method

The standard specifies the conditions to be satisfied by an amalgamation to be considered as amalgamation in nature of merger or purchase.

Conditions for Amalgamation in the nature of Merger and Purchase

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) Consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified above.

Methods of Accounting

Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either

- By incorporating the assets and liabilities at their existing carrying amounts or
- By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation.

Pooling of Interests Method

Pooling of interests is a method of accounting for amalgamations, the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company.

1 Assets, liabilities and reserves of the transferor company to be recorded by the transferee company at existing carrying amounts and in the same form as at the date of the amalgamation.

2 If the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation.

3 The difference between the amount of share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves.

Treatment of Reserves of the Transferor Company on Amalgamation

Treatment of Reserves

Amalgamation in nature of merger

Identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.

Amalgamation in the nature of purchase

Identity of the reserves, other than the statutory reserves is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and if the result of the computation is positive, the difference is credited to Capital Reserve.

Statutory Reserves

Statutory reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute.

Statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g. 'Amalgamation Adjustment Reserve') which is presented as a separate line item under the head "**Reserves and Surplus**".

When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

Balance of Profit and Loss Account

Balance of the Profit and Loss Account appearing in the financial statements of the transferor company

Amalgamation in nature of merger

- Is aggregated with the corresponding balance appearing in the financial statements of the transferee company.
- Alternatively, it is transferred to the General Reserve, if any.

Amalgamation in the nature of purchase

- Debit or credit balance loses its identity.

Treatment of Goodwill

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised on a systematic basis over its useful life.

Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty.

It is considered appropriate to amortise goodwill over a period not exceeding 5 years unless a longer period can be justified.

Disclosure Requirements

For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

- Names and general nature of business of the amalgamating companies;
- Effective date of amalgamation for accounting purposes;
- Method of accounting used to reflect the amalgamation; and
- Particulars of the scheme sanctioned under a statute.

For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

- Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation; and
- Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

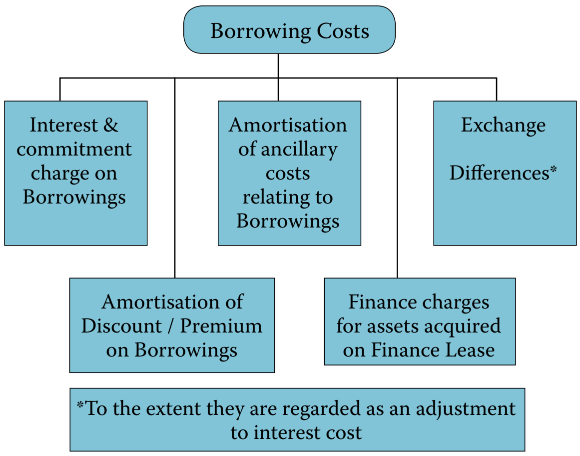
- Consideration for the amalgamation and a description of the consideration paid or contingently payable; and
- Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

AS 16 "BORROWING COSTS"

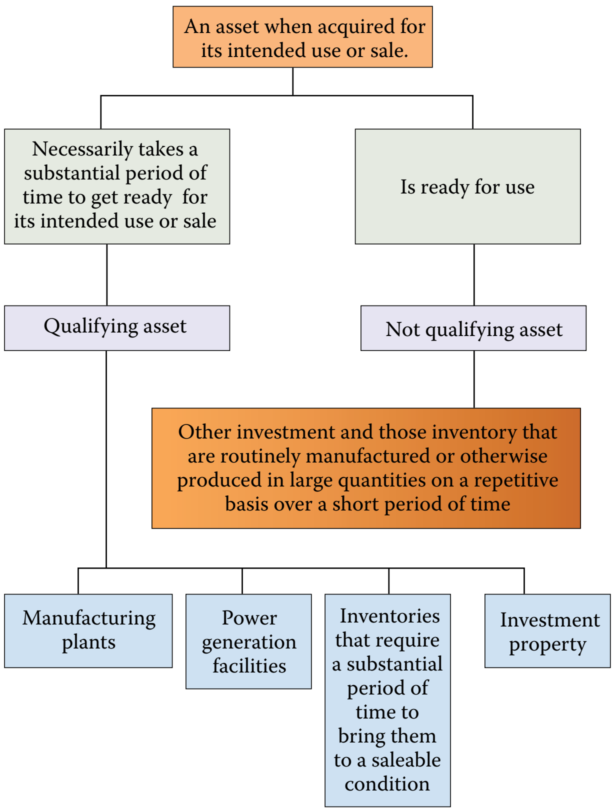
The objective of AS 16 is to account for borrowing costs. It does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability.

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

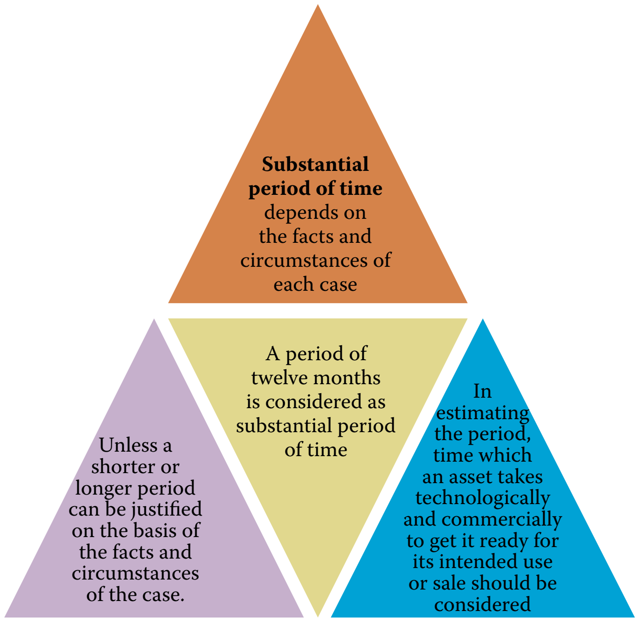
BORROWING COSTS MAY INCLUDE



A QUALIFYING ASSET



SUBSTANTIAL PERIOD OF TIME



EXCHANGE DIFFERENCES ON FOREIGN CURRENCY BORROWINGS

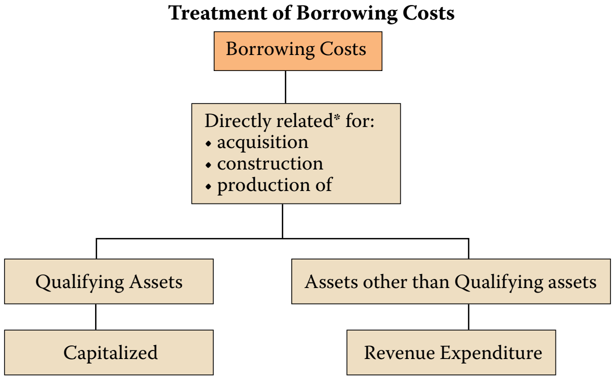
Exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings.

Amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings is considered as borrowing cost to be accounted for under this Standard and the remaining exchange difference, if any, is accounted for under AS 11, 'The Effects of Changes in Foreign Exchange Rates'.

Interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

BORROWING COSTS ELIGIBLE FOR CAPITALISATION

Treatment of Borrowing Costs



*or that could have been avoided if the expenditure on qualifying assets had not been made.

Thus, borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowings

- Specific borrowings
  - Borrowed funds specifically for the purpose of obtaining a particular qualifying asset
  - Borrowing costs that directly relate to that qualifying asset can be readily identified.
  - If funds temporarily invested .
    - Capitalised borrowing costs= borrowing costs less any income earned on the temporary investment of those borrowings
- General borrowings
  - No Direct relationship between particular borrowings and a qualifying asset
  - Amount of borrowing costs eligible for capitalisation determined by applying a capitalisation rate to the expenditure on that asset.
    - The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.
  - The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

EXCESS OF THE CARRYING AMOUNT OF THE QUALIFYING ASSET OVER RECOVERABLE AMOUNT

When the carrying amount or the expected ultimate cost of the qualifying asset

↓

Exceeds its recoverable amount or net realisable value,

↓

Carrying amount is written down or written off in accordance with the requirements of other Accounting Standards.

↓

In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

COMMENCEMENT OF CAPITALISATION

The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied

- **Expenditure for the acquisition, construction or production of a qualifying asset is being incurred:**
  - Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset. The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to which the capitalisation rate is applied in that period.
- **Borrowing costs are being incurred.**
- **Activities that are necessary to prepare the asset for its intended use or sale are in progress:**
  - The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

SUSPENSION OF CAPITALISATION

Capitalisation of borrowing costs

- Suspended
  - during extended periods in which active development is interrupted.
- Not suspended
  - during a period when substantial technical and administrative work is being carried out.
  - when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

CESSATION OF CAPITALISATION

- Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.
- When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

DISCLOSURE

The financial statements should disclose:

- The accounting policy adopted for borrowing costs; and
- The amount of borrowing costs capitalised during the period.

AS 17 "SEGMENT REPORTING"

The objective AS 17 is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Information about segments helps users of financial statements to:

- Better understand the performance of the enterprise;
- Better assess the risks and returns of the enterprise; and
- Make more informed judgements about the enterprise as a whole.

For Companies - AS 17 is not mandatory for SMCs.
For Non-companies - AS 17 is not mandatory for entities falling in Level II and Level III.

SCOPE

- AS 17 should be applied in presenting general purpose financial statements.
- An enterprise should comply with the requirements of this Standard fully and not selectively.
- If a single financial report contains both consolidated financial statements and separate financial statements of parent, segment information need to be presented only on basis of the consolidated financial statements.

DEFINITION OF THE TERMS USED IN THE ACCOUNTING STANDARD

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

- The nature of the products or services
- The nature of the production processes
- The type or class of customers for the products or services
- The methods used to distribute the products or provide the services
- If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

- Similarity of economic and political conditions;
- Relationships between operations in different geographical areas;
- Proximity of operations;
- Special risks associated with operations in a particular area;
- Exchange control regulations; and
- The underlying currency risks.

A **reportable segment** is a business segment or a geographical segment identified on the basis of definitions of business segment and geographical segment for which segment information is required to be disclosed by this Standard.

Identifying Reportable Segments as Primary Segment or Secondary Segment

- If the risks and returns of an enterprise are affected predominantly by the differences in the products and services, its primary segment will be business segment and geographic segment will be secondary.
- If the risks and returns of an enterprise are affected predominantly by the fact that it operates in different geographical areas, its primary segment will be geographical segment and business segment will be secondary.

A single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country.

The risks and returns of an enterprise are influenced both by the geographical location of its operations (where its products are produced or where its service rendering activities are based) and also by the location of its customers (where its products are sold or services are rendered).

The definition allows geographical segments to be based on either:

- Location of production or service facilities and other assets of an enterprise; or
- Location of its customers.

CRITERIA FOR IDENTIFYING REPORTABLE SEGMENTS

- **Revenue Test** Segment revenue >= 10% of all segment revenues
- **Result Test** Segment result >= 10% of higher of segments in profit or loss
- **Assets Test** Segment assets >= 10% of total assets of all segments
- **Management choice**- Management may designate any segment as reportable segment despite its size even if tests are not satisfied

75% Test- Is external revenue of reportable segment < 75% of enterprise revenue

- Previous year's segment information to continue in current year
- If inconsistent, previous year figures to be regrouped to fall in line with current year

In the last test (75% Test), if total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds in other tests, until at least 75 per cent of total enterprise revenue is included in reportable segments.

SEGMENT REVENUE

Segment revenue

Is aggregate of
- Portion of enterprise revenue that is directly attributable to a segment,
- Relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and
- Revenue from transactions with other segments of the enterprise.

Does not include
- Extraordinary items as defined in AS 5.
- Interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and
- Gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

SEGMENT EXPENSE

Segment expense

Is aggregate of
- Expense resulting from the operating activities of a segment that is directly attributable to the segment, and
- Relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment,
- Expense relating to transactions with other segments of the enterprise.

Does not include
- Extraordinary items as defined in AS 5.
- Interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature.
- Losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature.
- Income tax expense.
- General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.

SEGMENT RESULT

is segment revenue → less → segment expense.

SEGMENT ASSETS

Segment assets

Operating assets
- that are employed by a segment in its operating activities and
- that either are directly attributable to the segment or
- can be allocated to the segment on a reasonable basis.

Include
- If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.

Do not include
- income tax assets;
- assets used for general enterprise or head-office purposes.

Segment assets are determined after deducting related allowances/ provisions that are reported as direct offsets in the balance sheet of the enterprise.

Segment liabilities

- **Operating liabilities:** that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.
- **Include:** If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities.
- **Examples:** trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services.
- **Does not include:**
  - income tax liabilities;
  - borrowings and other liabilities that are incurred for financing rather than operating purposes.

Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

TREATMENT OF INTEREST FOR DETERMINING SEGMENT EXPENSE

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

In case interest is included as a part of the cost of inventories where it is so required as per AS 16, read with AS 2 (Revised), and those inventories are part of segment assets of a particular segment, such interest should be considered as a segment expense. In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.

ALLOCATION

There is a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for purpose of measuring the segment revenue, segment expense, segment assets, and segment liabilities of reportable segments.

Segment revenue, segment expense, segment assets and segment liabilities are determined before intra-enterprise balances and intra-enterprise transactions are eliminated as part of the process of preparation of enterprise financial statements, except to the extent that such intra-enterprise balances and transactions are within a single segment.

While the accounting policies used in preparing and presenting the financial statements of the enterprise as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as identification of segments, method of pricing inter-segment transfers, and basis for allocating revenues and expenses to segments.

PRIMARY AND SECONDARY SEGMENT REPORTING

Primary Reporting Format

An enterprise should disclose the following for each reportable segment identified as primary segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

(b) segment result;

(c) total carrying amount of segment assets;

(d) total amount of segment liabilities;

(e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

(f) total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and

(g) total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation:

segment revenue should be reconciled to enterprise revenue	segment result should be reconciled to enterprise net profit or loss	segment assets should be reconciled to enterprise assets	segment liabilities should be reconciled to enterprise liabilities.

SECONDARY SEGMENT INFORMATION

If primary format is business segment, it should also report the following information:

- segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue;
- the total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments; and
- the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all segments.

If primary format is geographical segments (whether based on location of assets or location of customers), it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue or whose segment assets are 10 per cent or more of the total assets of all business segments:

- segment revenue from external customers;
- the total carrying amount of segment assets; and
- the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).

If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the enterprise should also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more of total enterprise amounts:

- the total carrying amount of segment assets by geographical location of the assets
- the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets.

OTHER DISCLOSURES

Other Disclosures

- In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers.
- The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.
- An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

AS 18 "RELATED PARTY DISCLOSURES"

AS 18 prescribes the requirements for disclosure of related party relationship and transactions between the reporting enterprise and its related parties. The requirements of the standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

Related Parties and Related Party Relationships

Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

AS 18 deals only with related party relationships in sitiuations when:

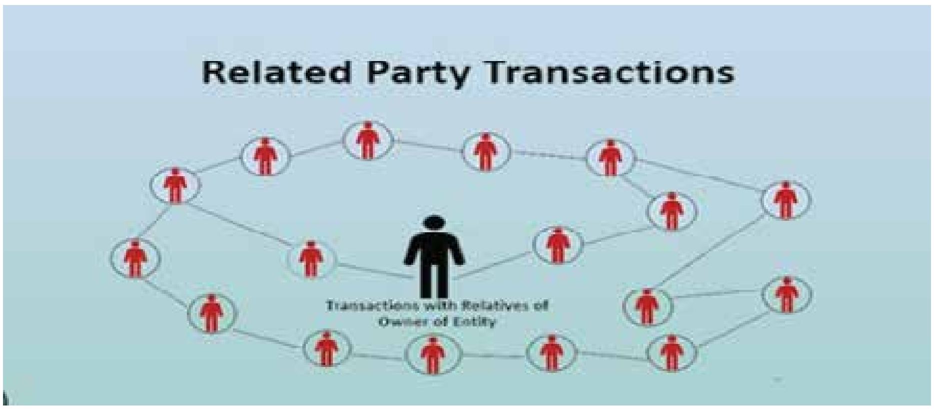
(a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries).

(b) Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.

(c) Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual.

(d) Key management personnel and relatives of such personnel

(e) Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.



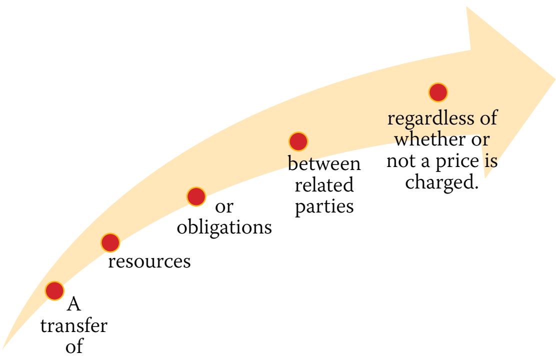
In the context of AS 18, following are deemed not to be related parties:

- Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings).
- A single customer, supplier, franchiser, distributor or general agent with whom an enterprise transacts a significant volume of business.
- Providers of finance, Trade unions, Govt. agencies and public utilities in the course of their normal dealings with an enterprise.

No disclosure is required in consolidated financial statements in respect of intra-group transactions.

Key Terms

Related Party Transaction



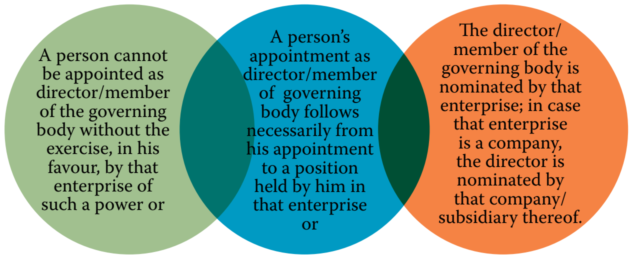
Control

Control includes

- Ownership, directly or indirectly, of more than one half of the voting power of an enterprise
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise
- Substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

For the purpose of AS 18, an enterprise is considered to **control the composition** of the board of directors of a company or governing body of an enterprise, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors/members of the governing body of that company/enterprise.

An enterprise is deemed to have the power to appoint a director/ member of the governing body, if any of the following conditions are satisfied:

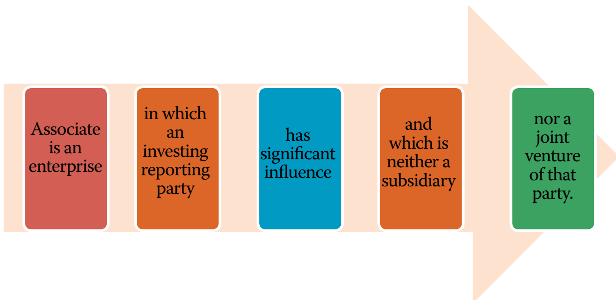


Substantial Interest

An enterprise/individual is considered to have a substantial interest in another enterprise if

- That enterprise or individual owns, directly or indirectly, 20% or more interest in the voting power of the other enterprise
- That individual owns, directly or indirectly, 20% or more interest in the voting power of the enterprise.

Associate



Significant Influence

Significant influence is participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

Significant influence may be gained by share ownership, statute or agreement.

As regards share ownership, if an investing party holds, directly or indirectly, through intermediaries, 20% or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case.

A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

Key Management Personnels are

Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

In relation to an individual, Relative means

Spouse, son, daughter, brother, sister, father and mother

Any person who may be expected to influence

or be influenced by, that individual and which is neither a subsidiary

in his/her dealings with the reporting enterprise.

Joint Venture and Joint Control

Joint Venture is → A contractual arrangement → Whereby two or more parties → Undertake an economic activity → Which is subject to joint control.

Joint Control is → Contractually agreed → Sharing of power → To govern the financial and operating policies → Of an economic activity.

Holding Company

A company having one or more subsidiaries is a holding company.

Subsidiary Company

A company is Subsidiary

- in which another company (the holding company) holds, either by itself and/ or through one or more subsidiaries, more than one-half, in nominal value of its equity share capital; or
- of which another company (the holding company) controls, either by itself and/ or through one or more subsidiaries, the composition of its board of directors.

Fellow Subsidiary

Company is considered to be a → fellow subsidiary → of another company → if both are subsidiaries of the → same holding company.

The Related Party Issue

Related party relationships are a normal feature of commerce and business.

Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties.

The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur.

Sometimes, transactions would not have taken place if the related party relationship had not existed.

Disclosure

Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

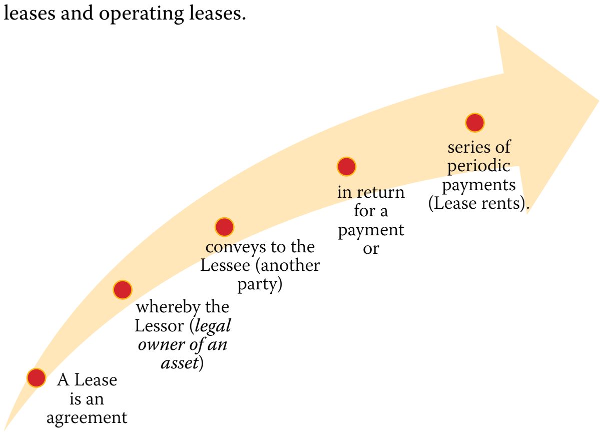
- The name of the transacting related party;
- A description of the relationship between the parties;
- A description of the nature of transactions;
- Volume of the transactions either as an amount or as an appropriate proportion;
- Any other elements of the related party transactions necessary for an understanding of the financial statements;
- Amounts or appropriate proportions of outstanding items pertaining to related parties at balance sheet date and provisions for doubtful debts due from such parties at that date;
- Amounts written off or written back in the period in respect of debts due from or to related parties.

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

No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

AS 19 "LEASES"

The objective of AS 19 is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.



Scope

AS 19 applies to all leases other than:

- Lease agreements to explore for or use of natural resources such as oil, gas, timber metals and other mineral rights.
- Licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights.
- Lease agreements to use lands.
- Agreements that are contracts for services, that do not transfer right to use assets from one contracting party to the other.

Key Terms

Non-cancellable lease is a lease that is cancellable

- Upon the occurrence of some remote contingency; or
- With the permission of the lessor; or
- If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
- Upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

The **lease term is the non-cancellable period** for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Minimum Lease Payments

Minimum lease payments are

the payments over the lease term

that the lessee is

to make excluding contingent rent,

costs for services and

taxes to be paid by and

reimbursed to the lessor,

together with:

(a) in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or

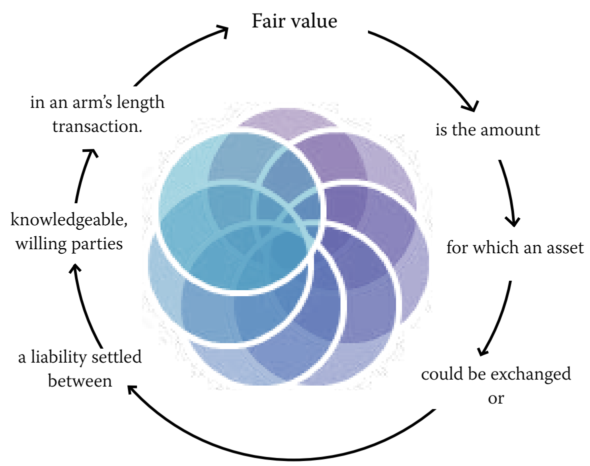
(b) in the case of the lessor, any residual value guaranteed to the lessor:

(i) by or on behalf of the lessee; or

(ii) by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

Fair Value



Economic Life

Economic life is either: the period over which an asset is expected to be economically usable by one or more users; or the number of production or similar units expected to be obtained from the asset by one or more users.

Useful Life

Useful life of a leased asset is either: Period over which the leased asset is expected to be used by the lessee; OR Number of production or similar units expected to be obtained from the use of the asset by the lessee.

Residual Value

Residual value is the estimated fair value at the end of the lease term.

Guaranteed Residual Value

Guaranteed residual value is:
in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable).

in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

Unguaranteed Residual Value

Amount by which the residual value of the asset Exceeds Its guaranteed residual value.

Gross Investment

Aggregate of Minimum lease payments Under a finance lease From the standpoint of the lessor.

Unearned Finance Income

Difference between:

Gross investment in the lease; and

Present value of

(i) Minimum lease payments under a finance lease from the standpoint of the lessor; and

(ii) Any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Net investment in the lease is the gross investment in the lease **less** unearned finance income.

Interest rate implicit in the lease

Discount rate that, at the inception of the lease, causes the aggregate present value of	Minimum lease payments under a finance lease from the standpoint of the lessor; and	Any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Lessee's Incremental Borrowing Rate of Interest

is the rate of interest

the lessee would have to pay on a similar lease or,

if that is not determinable,

the rate that, at the inception of the lease,

the lessee would incur to borrow over a similar term

and with a similar security, the funds necessary to purchase the asset.

Contingent Rent

Contingent rent is that portion of the lease payment

that is not fixed in amount but is based on a factor

other than just the passage of time

Types of Leases

For accounting purposes, leases are classified as

Finance leases

A lease that transfers substantially, all the risks and rewards incident to ownership of an asset. Title may or may not be eventually transferred.

Operating leases

A lease is classified as an *Operating Lease,* if it does not transfer substantially all the risk and rewards incident to ownership.

Indicators of Finance Lease

Situations, which would normally lead to a lease being classified as a finance lease are:

- Lease transfers ownership of the asset to the lessee by the end of the lease term.
- Lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised.
- Lease term is for the major part of the economic life of the asset even if title is not transferred.
- At the inception of the lease, present value of the minimum lease payment amounts to at least substantially all of the fair value of the leased asset.
- Leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Indicators of situations which individually or in combination could also lead to a lease being classified as a finance lease are:

- If the lessee can cancel the lease and the lessor's losses associated with the cancellation are borne by the lessee.
- If gains or losses from the fluctuations in the residual value accrue to the lessee
- If the lessee can continue the lease for a secondary period at a rent, which is substantially lower than market rent.

Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term.

Accounting for Finance Leases (Books of Lessee)

On the date of inception of lease, lessee should show it as an asset and corresponding liability at lower of:

(i) Fair value of leased asset at the inception of the lease

(ii) Present value of minimum lease payments from the standpoint of the lessee (present value to be calculated with discount rate equal to interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used). Lease payments to be apportioned between the finance charge and the reduction of the outstanding liability.

Finance charges to be allocated to periods during the lease term so as to produce a constant rate of interest on the remaining balance of liability for each period.

A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in AS 10 (Revised), Property, Plant and Equipment. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

Computation of Interest Rate implicit on Lease (IRR)

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

→ Minimum lease payments under a finance lease from the standpoint of the lessor; and

\+ Any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Disclosures made by the Lessee in case of Finance Lease

The lessee should, in addition to the requirements of AS 10 (Revised) and the governing statute, make the following disclosures for finance leases:

(a) Assets acquired under finance lease as segregated from the assets owned;

(b) For each class of assets, the net carrying amount at the balance sheet date;

(c) Reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
  (i) not later than one year;
  (ii) later than one year and not later than five years;
  (iii) later than five years;

(d) Contingent rents recognised as expense in the statement of profit and loss for the period;

(e) Total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date; and

(f) General description of the lessee's significant leasing arrangements including, but not limited to, the following:
  (i) the basis on which contingent rent payments are determined;
  (ii) the existence and terms of renewal or purchase options and escalation clauses; and
  (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Accounting for Finance Leases (Books of Lessor)

The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.
In a finance lease, the lessor recognises the net investment in lease which is usually equal to fair value as receivable by debiting the Lessee A/c.

Recognition of Finance Income

The unearned finance income is recognised over the lease term based on a pattern reflecting a constant periodic return on the net investment in lease outstanding.

Initial Direct Costs

For finance leases, initial direct costs incurred to produce finance income are either recognised immediately in the statement of profit and loss or allocated against the finance income over the lease term.

Review of Unguaranteed Residual Value by Lessor

AS 19 requires a lessor to review unguaranteed residual value used in computing the gross investment in lease regularly. In case any reduction in the estimated unguaranteed residual value is identified, the income allocation over the remaining lease term is to be revised. An upward adjustment of the estimated residual value is not made.

Manufacturer or Dealer Lessor

The manufacturer or dealer lessor should recognise the transaction of sale in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales.

Initial direct costs should be recognised as an expense in the statement of profit and loss at the inception of the lease.

Disclosures

The lessor should make the following disclosures for finance leases:

(a) Reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:
  (i) not later than one year;
  (ii) later than one year and not later than five years;
  (iii) later than five years;

(b) Unearned finance income;

(c) Unguaranteed residual values accruing to the benefit of the lessor;

(d) Accumulated provision for uncollectible minimum lease payments receivable;

(e) Contingent rents recognised in the statement of profit and loss for the period;

(f) General description of the significant leasing arrangements of the lessor;

(g) Accounting policy adopted in respect of initial direct costs.

Accounting for Operating Leases

Accounting treatment in the Books of lessee

Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss of a lessee on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Disclosures by Lessees

Lessees are required to make following disclosures for operating leases:

(a) Total of future minimum lease payments under non-cancelable operating leases for each of the following periods:

(i) not later than one year;
(ii) later than one year and not later than five years;
(iii) later than five years;

(b) Total of future minimum sublease payments expected to be received under non-cancelable subleases at the balance sheet date;

(c) Lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) Sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) General description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;
(ii) the existence and terms of renewal or purchase options and escalation clauses; and
(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Accounting Treatment in the books of Lessor

The lessor should present an asset given under operating lease as fixed assets in its balance sheets.

Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

Depreciation of leased assets should be charged in books of lessor on a basis consistent with the normal depreciation policy of the lessor for similar assets.

The impairment losses on assets given on operating leases are determined and treated as per AS 28*.

Disclosures by Lessors

As per AS 19, the lessor should, in addition to the requirements of AS 10 (Revised)* and the governing statute, make the following disclosures for operating leases:

(a) For each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and

(i) the depreciation recognised in the statement of profit and loss for the period;
(ii) impairment losses recognised in the statement of profit and loss for the period;
(iii) impairment losses reversed in the statement of profit and loss for the period;

(b) Future minimum lease payments under non-cancelable operating leases in the aggregate and for each of the following periods:

(i) not later than one year;
(ii) later than one year and not later than five years;
(iii) later than five years;

(c) Total contingent rents recognised as income in the statement of profit and loss for the period;

(d) General description of the lessor's significant leasing arrangements; and

(e) Accounting policy adopted in respect of initial direct costs.

Sale and Leaseback

One vendor sells an asset for cash and then takes it back from the buyer on lease.

Lessee or seller receives cash immediately and makes periodic payment in the form of lease rents for right to use the property.

Accounting treatment of a sale and lease back depends upon the type of lease involved.

Lease payments and the sale price are generally interdependent as they are negotiated as a package.

** AS 10 and AS 28 are not covered in the syllabus of Paper 5.*

Where sale and leaseback results in finance lease

The excess or deficiency of sales proceeds over the carrying amount should not be recognized immediately but deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Where sale and leaseback results in operating lease

Case 1: Sale price = Fair Value

Profit or loss should be recognised immediately.

Case 2: Sale Price < Fair Value

Profit should be recognised immediately. The loss should also be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.

Case 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

If the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

Sale price established at fair value	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fair value
Profit	No profit	Recognise profit immediately	Not applicable
Loss	No loss	Not applicable	Recognise loss immediately
Sale price below fair value (paragraph 50)			
Profit	No profit	Recognise profit immediately	No profit (note 1)
Loss not compensated by future lease payments at below market price	Recognise loss immediately	Recognise loss immediately	(note 1)
Loss compensated by future lease payments at below market price	Defer and amortise loss	Defer and amortise loss	(note 1)
Sale price above fair value (paragraph 50)			
Profit	Defer and amortise profit	Defer and amortise profit	Defer and amortise profit (note 2)
Loss	No loss	No loss	(note 1)

Note 1: Circumstances that require the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2: Profit would be the difference between fair value and sale price as the carrying amount would have been written down to fair value in accordance with AS 19.

AS 20 "EARNINGS PER SHARE"

The objective of AS 20

is to describe principles
for determination and presentation
of earnings per share
which will improve comparison of performance
among different enterprises
for the same period and
among different accounting periods
for the same enterprise.

Earnings per share (EPS) is a financial ratio indicating the amount of profit or loss for the period attributable to each equity share and AS 20 gives computational methodology for determination and presentation of basic and diluted earnings per share.

This Accounting Standard is mandatory for all companies. However, disclosure of diluted earnings per share (both including and excluding extraordinary items) is not mandatory for SMCs.

In consolidated financial statements, the information required by AS 20 should be presented on the basis of consolidated information.

Key Terms

Equity Shares

An equity share is a share other than a preference share.

Preference Share

Preference share Carrying preferential rights to dividends and repayment of capital.

A Financial Instrument

Any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise.

Financial Asset

A financial asset is any asset that is

- Cash
- A contractual right to receive cash or another financial asset from another enterprise
- A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
- An equity share of another enterprise.

Financial Liability

- Any liability that is a
- Contractual obligation to deliver cash or another financial asset
- To another enterprise or to exchange financial instruments
- With another enterprise under conditions that are potentially unfavourable.

Potential Equity Share

A financial instrument or → Other contract → That entitles, or may entitle, → Its holder to equity shares.

Share Warrants or Options

Financial instruments that give the holder right to acquire equity shares.

Fair Value

Fair value is the amount → for which an asset could be exchanged, → or a liability settled, → between knowledgeable, willing parties → in an arm's length transaction.

Basic Earnings Per Share

Basic earnings per share is calculated as

$$\frac{\text{Net profit (loss) attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}}$$

For calculating basic earnings per share, the **net profit or loss for the period attributable to equity shareholders** should be the net profit or loss after deducting preference dividends and any attributable tax thereto for the period.

All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period.

Amount of preference dividends for the period that is deducted from the net profit for the period is:	Amount of any preference dividends on non-cumulative preference shares provided for in respect of the period; and
	Full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been provided for.

If an enterprise has more than one class of equity shares, net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Earnings Per Share

The number of shares used in the denominator for basic EPS should be the weighted average number of equity shares outstanding during the period.

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

Partly paid equity shares

(i) Are treated as a fraction of an equity share

(ii) to the extent that they were entitled

(iii) to participate in dividends

(iv) relative to a fully paid equity share

Where an enterprise has equity shares of **different nominal values** but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include: bonus issue or share splits.

In a **rights issue**, the exercise price is often less than the fair value of the shares. A rights issue usually includes a bonus element.

The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following adjustment factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.

Diluted Earnings per Share

Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period, that is:

The net profit for the period attributable to equity shares is:

- Increased by the amount of dividends recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period;
- Increased by the amount of interest recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period; and
- Adjusted for the after-tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

The weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value. The amount of the dilution is fair value less the issue price. Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:

(a) A contract to issue a certain number of equity shares at their average fair value during the period. The shares to be so issued are fairly priced and are assumed to be neither dilutive nor anti-dilutive.
(b) A contract to issue the remaining equity shares for no consideration. Such equity shares generate no proceeds and have no effect on the net profit attributable to equity shares outstanding.

Dilutive Potential Equity Shares

Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities.

In considering whether potential equity shares are dilutive or anti-dilutive, each issue or series of potential equity shares is considered separately rather than in aggregate.

Potential equity shares are weighted for the period they were outstanding.

Restatement

If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented.

If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares.

Presentation

An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period.

AS 20 requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative .

Disclosure

An enterprise should disclose

- Where the statement of profit and loss includes extraordinary items basic and diluted EPS computed on the basis of earnings excluding extraordinary items (net of tax expense).
- The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period.
- The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share and a reconciliation of these denominators to each other.
- The nominal value of shares along with the earnings per share figures.

If an enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to equity shareholders, such amounts should be calculated using the weighted average number of equity shares determined in accordance with AS 20.

AS 22 "ACCOUNTING FOR TAXES ON INCOME"

AS 22 prescribes the accounting treatment of taxes on income and follows the concept of matching expenses against revenue for the period. Taxable income may be significantly different from the accounting income posing problems in matching of taxes against revenue for a period

DIVERGENCE BETWEEN TAXABLE INCOME AND ACCOUNTING INCOME

Differences between taxable income and accounting income

- Timing differences
  - For a period that originate in one period and are capable of reversal in one or more subsequent periods.
- Permanent differences
  - For a period that originate in one period and do not reverse subsequently

DEFINITIONS

Accounting income (loss)	Net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.
Taxable income (tax loss)	Amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.
Tax expense (tax saving)	Aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.
Current tax	Amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.
Deferred tax	Tax effect of timing differences.

RECOGNITION

Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.

Permanent differences do not result in deferred tax assets or deferred tax liabilities.
Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate.
Such matching may result into timing differences.
Tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.

While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation.

RE-ASSESSMENT OF UNRECOGNISED DEFERRED TAX ASSETS

- At each balance sheet date,
- an enterprise re-assesses unrecognised deferred tax assets.
- Recognises previously unrecognised deferred tax assets
- to the extent that it has become reasonably certain or virtually certain,
- as the case may be,
- that sufficient future taxable income will be available against which such deferred tax assets can be realised.

MEASUREMENT

Measurement

- Current tax
  - Amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.
- Deferred tax assets and liabilities
  - Measured using the tax rates and tax laws that have been enacted by the balance sheet date.
  - should not be discounted to their present value.

REVIEW OF DEFERRED TAX ASSETS

The carrying amount of deferred tax assets should be reviewed at each balance sheet date.

An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, so that sufficient future taxable income will be available against which deferred tax asset can be realized.

Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, so that sufficient future taxable income will be available.

DISCLOSURE

Statement of profit and loss

- Under AS 22, there is no specific requirement to disclose current tax and deferred tax in the statement of profit and loss.
- Considering the requirements under the Companies Act, 2013, the amount of income tax and other taxes on profits should be disclosed.
- AS 22 does not require any reconciliation between accounting profit and the tax expense.

Balance sheet

- The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts.
- Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
- The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

PRESENTATION

An enterprise should offset

- **Assets and liabilities representing current tax if the enterprise:**
  - has a legally enforceable right to set off the recognised amounts and
  - intends to settle the asset and the liability on a net basis.
- **Deferred tax assets and deferred tax liabilities if**
  - enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and
  - deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

TRANSITIONAL PROVISION

On the first occasion that the taxes on income are accounted for in accordance with this Statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Statement as deferred tax asset/ liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets.

The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Statement had been in effect from the beginning.

AS 24 "DISCONTINUING OPERATIONS"

The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

Discontinuing Operation

A discontinuing operation is a component of an enterprise

- That the enterprise, pursuant to a single plan*
- That represents a separate major line of business or geographical area of operations
- That can be distinguished operationally and for financial reporting purposes.

*(i) *Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership or*

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

(iii) Terminating through abandonment.

To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinated plan.

A component can be distinguished operationally and for financial reporting purposes if these conditions are met:

- Operating assets and liabilities of the component can be directly attributed to it.
- Its revenue can be directly attributed to it.
- Majority of its operating expenses can be directly attributed to it.

Assets, liabilities, revenue, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. If debt is attributable to a component, the related interest and other financing costs are similarly attributed to it.

Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations.

Initial Disclosure Event

With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the events, whichever occurs earlier:

- Enterprise has entered into a binding sale agreement for substantially all of the assets attributable to discontinuing operation or
- Enterprise's board of directors or similar governing body has
  - Approved a detailed, formal plan for the discontinuance and
  - Made an announcement of the plan.

Recognition and Measurement

This AS does not provide any guidelines

- For recognizing and measuring,
- Effect of discontinuing operations,
- Relevant Accounting Standards should be referred.

Presentation and Disclosure

Initial Disclosure
An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s).
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.
- The business or geographical segment(s) in which it is reported.
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto.
- The date and nature of the initial disclosure event.
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.
- The date or period in which the discontinuance is expected to be completed if known or determinable.
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

Other Disclosures

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

- For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation:
  (i) the amount of the pre-tax gain or loss
  (ii) income tax expense relating to the gain or loss
- The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed. Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefore and its effect should be disclosed.

Separate disclosure for each discontinuing operation

Any disclosures required by AS 24 should be presented separately for each discontinuing operation.

Presentation of the Required Disclosures

All disclosures should be presented in the notes to the financial statements except these disclosures which should be shown on the face of the statement of profit and loss:

- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto
- The amount of the pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

Restatement of Prior Periods

Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations.

Disclosure in Interim Financial Reports

Disclosures in an interim financial report in respect of a discontinuing operation

- Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and
- Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

AS 26 "INTANGIBLE ASSETS"

The objective of AS 26 is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. AS 26 also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

Scope

AS 26 should be applied by all enterprises in accounting for intangible assets, except

- Intangible assets that are covered by another Accounting Standard.
- Financial assets.
- Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.
- Intangible assets arising in insurance enterprises from contracts with policyholders.

AS 26 applies to

- Other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises.

AS 26 also applies to

- Expenditure on advertising, training, start - up cost.
- Research and development activities.
- Right under licensing agreements for items such as motion picture films, video recordings.
- Patents, copyrights.
- Trademarks.
- Goodwill.

Key Terms

Asset

An asset is a resource: Controlled by an enterprise as a result of past events and From which future economic benefits are expected to flow to the enterprise.

Monetary Assets

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Non-monetary assets are assets other than monetary assets.

Amortisation

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

Depreciable Amount

The cost of an asset **Less** its residual value.

Useful Life

Useful life is either

(a) Period of time over which an asset is expected to be used by the enterprise; or

(b) Number of production or similar units expected to be obtained from the asset by the enterprise.

Fair Value

Fair value of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

An Active Market

- A market where all the conditions exist
- Items traded within the market are homogeneous.
- Willing buyers and sellers can normally be found.
- Prices are available to the public.

Impairment Loss

Amount by which → carrying amount of an asset → exceeds → its recoverable amount.

Carrying Amount

Amount at which an asset is recognised in the balance sheet,

net of any accumulated amortisation and accumulated impairment losses thereon.

Financial Asset

A financial asset is any asset that is

- Cash.
- A contractual right to receive cash or another financial asset from another enterprise.
- A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable.
- An ownership interest in another enterprise.

Intangible Assets

An intangible asset is

An identifiable Non-monetary asset

Without physical substance

Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

If an item covered by AS 26 does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.

Identifiability

The definition of an intangible asset requires that an intangible asset be *identifiable*. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill.

An intangible asset can be clearly distinguished from goodwill if the asset is *separable*. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

If an asset generates *future economic benefits* only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

Control

An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits.

Future economic benefit is also flown from the skill of labour and customer loyalty but usually this flow of benefits cannot be controlled by the enterprise. Hence, these items don't even qualify as intangible asset.

Future Economic Benefits

The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise. Use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and Initial Measurement of an Intangible Asset

The recognition of an item as an intangible asset requires an enterprise to demonstrate

- It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise
- The cost of the asset can be measured reliably.

An intangible asset should be measured initially at cost.

Separate Acquisition

If an intangible asset is acquired separately; cost of the intangible asset can usually be measured reliably.

Cost of an intangible asset comprises its purchase price including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the asset ready for its intended use.

If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise: asset is recorded at its fair value or the fair value of the securities issued whichever is more clearly evident.

Acquisition as part of an Amalgamation

- Intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with AS 14 (Revised).
- A transferee recognises an intangible asset that meets the recognition criteria, even if that intangible asset had not been recognised in the financial statements of the transferor and
- If the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill.

Acquisition by way of a Government Grant

If an intangible asset is acquired free of charge,

or for nominal consideration,

by way of a government grant,

it should be accounted for on the basis of their acquisition cost or for nominal consideration.

Internally Generated Goodwill

Internally generated goodwill
is not recognised as an asset
because it is not an identifiable resource
controlled by the enterprise
that can be measured reliably at cost.

Internally Generated Intangible Assets

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

- Research Phase
- Development Phase

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

Research Phase

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

No intangible asset arising from research or from the research phase should be recognised. Expenditure on research or on the research phase should be recognised as an expense when it is incurred.

Development Phase

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

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

a. The technical feasibility of completing the intangible asset so that it will be available for use or sale.

b. Its intention to complete the intangible asset and use or sell it.

c. Its ability to use or sell the intangible asset.

d. How the intangible asset will generate probable future economic benefits.

e. The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset and

f. Its ability to measure the expenditure attributable to the intangible asset during its development reliably.

Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, for creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. The cost includes

- Expenditure on materials and services used or consumed in generating the intangible asset.
- Salaries, wages and other employment related costs of personnel directly engaged in generating asset.
- Any expenditure that is directly attributable to generating the asset.
- Overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset.

The costs which are not components of the cost of an internally generated intangible asset:

- Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use.
- Clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance and
- Expenditure on training the staff to operate the asset.

Recognition of an Expense

Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

- It forms part of the cost of an intangible asset that meets the recognition criteria.
- The item is acquired in an amalgamation in the nature of purchase and cannot be recognized as an intangible asset.

In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. Expenditure on research is always recognised as an expense when it is incurred.

Expenses recognised as expenses cannot be reclassified as cost of intangible asset in later years.

Nature of Expenditure	Accounting treatment
Planning	Expense when incurred
Application and Infrastructure Development	Apply the requirements of AS 10
Graphical Design and Content Development	If a separate asset is not identifiable, then expense when incurred, unless it meets the recognition criteria
Operating	Expense when incurred, unless in rare circumstances it meets the criteria, in which case the expenditure is included in the cost of the web site
Other	Expense when incurred

Subsequent Expenditure

Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless

- It is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and
- Expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

Subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance is always recognised as an expense to avoid the recognition of internally generated goodwill.

Measurement Subsequent to Initial Recognition

After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation Period

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. Amortisation should commence when the asset is available for use.

AS 26 adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

- Amortises the intangible asset over the best estimate of its useful life.
- Estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss and
- Discloses the reasons why the presumption is rebutted and the factors that played a significant role in determining the useful life of the asset.

Amortisation Method

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the *straight-line method*, the *diminishing balance method* and the *unit of production method*. The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period.

Residual Value

Residual value is the amount, which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

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

- There is a commitment by a third party to purchase the asset at the end of its useful life.
- There is an active market for the asset and:
  - i. Residual value can be determined by reference to that market and
  - ii. It is probable that such a market will exist at the end of the asset's useful life.

Review of Amortisation Period and Amortisation Method

The amortisation period and the amortisation method should be reviewed at least at each financial year end.

If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

Retirements and Disposals

An intangible asset should be derecognised (eliminated from the balance sheet) if

- Disposed
- When no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

Disclosure

The financial statements should disclose for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets

- Useful lives or the amortisation rates used.
- Amortisation methods used.
- Gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period.
- A reconciliation of the carrying amount at the beginning and end of the period showing:
  - I. Additions, indicating separately those from internal development and through amalgamation.
  - II. Retirements and disposals.
  - III. Impairment losses recognised in the statement of profit and loss.
  - IV. Impairment losses reversed in the statement of profit and loss.
  - V. Amortisation recognised during the period and
  - VI. Other changes in the carrying amount during the period.

Other Disclosure

The financial statements should also disclose:

a. If an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use.

b. A description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole.

c. The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities and

d. The amount of commitments for the acquisition of intangible assets.

AS 29 "PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS"

AS 29 lays down appropriate accounting for contingent assets. The objective of AS 29 (Revised) is to ensure appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities.

Scope

AS 29 should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, other than

Those resulting from financial instruments that are carried at fair value;
Those resulting from executory contracts except where the contract is onerous*;
Those arising in insurance enterprises from contracts with policy-holders; and
Those covered by another Accounting Standard.

** An 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.*

Key Terms

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

A **Provision** is a liability which can be measured only by using a substantial degree of estimation.

A **Liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

An **Obligating event** is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

A **Contingent liability is**:

(a) A possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) A present obligation that arises from past events but is not recognised because

(i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) A reliable estimate of the amount of the obligation cannot be made.

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

Present obligation - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not

Possible obligation - an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

A **Restructuring** is a programme that is planned and controlled by management, and materially changes either:

(a) The scope of a business undertaken by an enterprise; or
(b) The manner in which that business is conducted.

Provisions

A provision should be recognised when:

(a) An enterprise has a present obligation as a result of a past event;

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

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

Present Obligation

An enterprise should determine whether a present obligation exists at the balance sheet date by taking account of all available evidence.

Where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and

Where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

Past Event

A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

No provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.

It is only those obligations arising from past events existing independently of an enterprise's future actions that are recognised as provisions.

An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified.

Probable Outflow of Resources Embodying Economic Benefits

For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. An outflow of resources or other event is regarded as probable if the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

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

Reliable Estimate of the Obligation

The use of estimates is an inherent part of preparing financial statements and does not undermine their reliability. Provisions require a greater degree of estimation than most other items, but it should not be impossible to determine a range of possible outcomes.

In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability will, instead, be disclosed as a contingent liability.

Contingent Liabilities

An enterprise should not recognise a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

Contingent Assets

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise.

An enterprise should not recognise a contingent asset, since this may result in the recognition of income that may never be realised.

A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority where an inflow of economic benefits is probable.

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised.

Table- Provisions and contingent liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of:
(a) a present obligation the one whose existence at the balance sheet date is considered probable; or
(b) a possible obligation the existence of which at the balance sheet date is considered not probable.

There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.	*There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.*	*There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.*
A provision is recognised. Disclosures are required for the provision.	No provision is recognised. Disclosures are required for the contingent liability.	No provision is recognised. No disclosure is required.

Measurement- Best Estimate

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

The estimates of outcome and financial effect are determined by the judgment of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

Risks and Uncertainties

The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

Future Events

It is only those obligations arising from past events that exist independently of the enterprise's future actions that are recognised as provisions.

Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted.

Expected Disposal of Assets

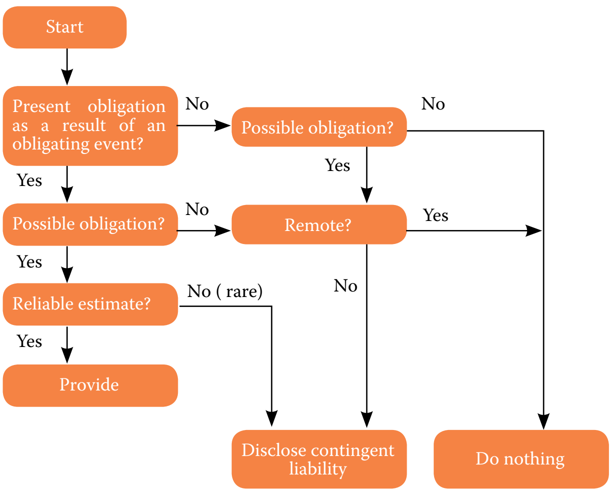
Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the Accounting Standard dealing with the assets concerned.

Reimbursements

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation.

Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.	*The obligation for the amount expected to be reimbursed remains with the enterprise and it is virtually certain that reimbursement will be received if the enterprise settles the provision.*	*The obligation for the amount expected to be reimbursed remains with the enterprise and the reimbursement is not virtually certain if the enterprise settles the provision.*
The enterprise has no liability for the amount to be reimbursed.	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. The amount recognised for the expected reimbursement does not exceed the liability.	The expected reimbursement is not recognised as an asset.
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement.	The expected reimbursement is disclosed.

Decision Tree



Changes in Provisions

Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

Note: As per the amendment made in AS 29 (Revised) pursuant to MCA notification dated 30 March 2016, effective from financial year 2016-17, all the existing provisions for decommissioning, restoration and similar liabilities should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.

Use of Provisions

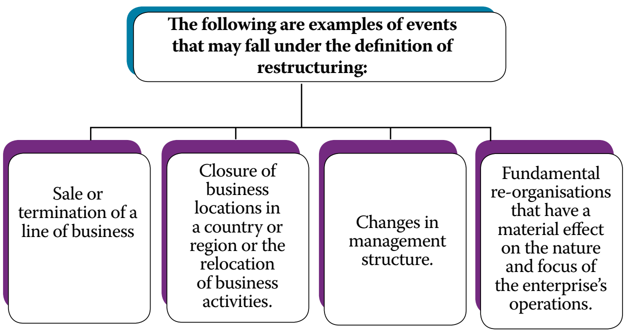
A provision should be used only for expenditures for which the provision was originally recognised. Only expenditures that relate to the original provision are adjusted against it.

Application of the Recognition and Measurement Rules

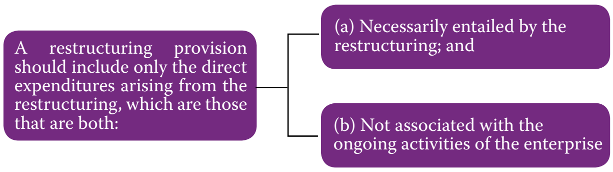
Future Operating Losses

Future operating losses do not meet the definition of a liability and the general recognition criteria, therefore provisions should not be recognised for future operating losses.

Restructuring



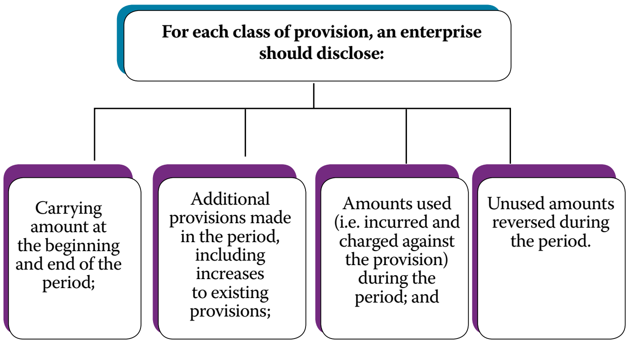
A provision for restructuring costs is recognised only when the recognition criteria for provisions are met. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.

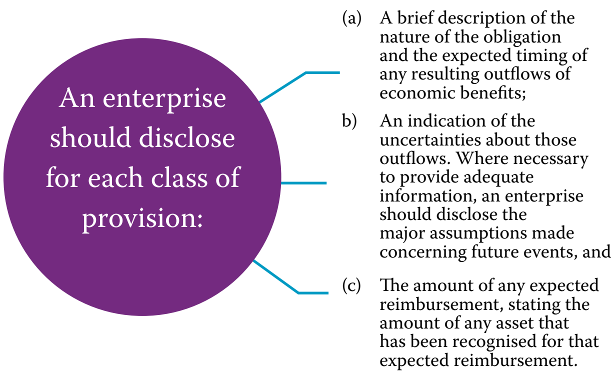


Identifiable future operating losses up to the date of a restructuring are not included in a provision.

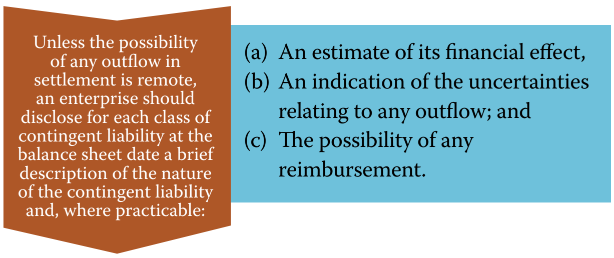
Gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure





Note: SMCs are exempt from the above disclosure requirements.



Where any of the information required by the standard is not disclosed because it is not practicable to do so, that fact should be stated.

Part II

INDIAN ACCOUNTING STANDARDS

INDIAN ACCOUNTING STANDARD (IND AS) 1: PRESENTATION OF FINANCIAL STATEMENTS

Objective

- Ind AS 1 prescribes the basis for presentation of general purpose financial statements **to ensure comparability**
  - With the entity's financial statements of previous periods
  - With the financial statements of other entities
- Ind AS 1 sets out
  - Overall requirements
    - For the presentation of financial statements
  - Guidelines
    - For their structure
  - Minimum requirements
    - For their content

Scope

- Applicability
  - Ind AS 1 is applied in preparing and presenting general purpose financial statements in accordance with Ind AS
    - To all entities
      - Presenting consolidated financial statements in accordance with Ind AS 110
      - Presenting separate financial statements in accordance with Ind AS 27
- Non-applicability
  - Ind AS 1 does not apply to the structure and content of condensed interim financial statements prepared in accordance with Ind AS 34 (except paras 15-35).
- Ind AS 1 uses terminology suitable for profit-oriented entities including public sector business entities
  - Therefore, entities with not-for-profit activities may apply this Standard, by amending the descriptions used for financial statements themselves
- Entities whose share capital is not equity may need to adapt the financial statement presentation of members' interests

Complete set of financial statements

includes

- A balance sheet
  - As at the end of the period
  - Of the preceding period (comparative information for all amounts reported in the current period's financial statements)
  - At the beginning of the preceding period **when**
    - An entity applies an accounting policy **retrospectively**; or
    - An entity makes a **retrospective restatement** of items in its financial statements; or
    - An entity **reclassifies items** in its financial statements.
- A statement of profit and loss
- A statement of changes in equity
- A statement of cash flows
  - For the period
  - Of the preceding period (comparative information for all amounts reported in the current period's financial statements)
- Notes, comprising significant accounting policies and other explanatory information
  - Comparative information for narrative and descriptive information shall be given if it is relevant for understanding the current period's financial statements

Note:

1. *An entity shall present a **single** statement of profit and loss, **with profit or loss and other comprehensive income (OCI) presented in two sections.** The sections shall be **presented together,** with the **profit or loss section presented first** followed directly by the other comprehensive income section.*
2. *Reports and statements presented outside financial statements are outside the scope of Ind AS.*
3. *An entity is not required to present the related notes to the opening balance sheet as at the beginning of the preceding period.*

General features

Presentation of True and Fair View and compliance with Ind ASs → Going concern → Accrual basis of accounting → Materiality and aggregation → Offsetting → Frequency of reporting → Comparative information → Consistency of presentation

Comparative information → Minimum comparative information → Additional comparative information → Change in accounting policy, retrospective restatement or reclassification

Note: *The above general features have been summarised below.*

Presentation of True and Fair View and compliance with Ind ASs

- Of the financial position
- Of the financial performance
- Of the cash flows of an entity

Presentation of a true and fair view requires an entity to

- To select and apply accounting policies as per Ind AS 8
- To present information, in a manner that provides relevant, reliable, comparable and understandable information
- To provide additional disclosures, if required, to enable users to understand the impact of particular item

When an entity departs from a requirement of an Ind AS (in extremely rare circumstances), it shall disclose

- Management's conclusion that the financial statements present a true and fair view
- Management's compliance with applicable Ind ASs, except departure from a particular requirement to present a true and fair view
- • The title of the Ind AS departed
  • The nature of the departure
  • The treatment that the Ind AS would require
  • The reason why that treatment would be so misleading; and
  • The treatment adopted
- For each period presented, the financial effect of the departure on each item in the financial statements

Note:
1. *An entity shall make an explicit and unreserved statement of compliance of **ALL** Ind AS in the notes.*
2. *An entity shall not describe financial statements as complying with Ind ASs unless they comply with **all** the requirements of Ind ASs.*
3. *An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.*

Going concern	⏩ An entity shall prepare financial statements on a going concern basis unless management ☐ intends to liquidate the entity or ☐ to cease trading, or ☐ has no realistic alternative but to do so. ⏩ When management has significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose ☐ the basis on which it prepared the financial statements and ☐ the reason why the entity is not regarded as a going concern.
	To assess going concern basis, management may need to consider a wide range of factors like ⏩ current and expected profitability, ⏩ debt repayment schedules and ⏩ potential sources of replacement financing
Accrual basis of accounting	⏩ An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. ⏩ When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses.
Materiality and aggregation	⏩ **Present separately** each material class of **similar items**. ⏩ **Present separately** items of a **dissimilar** nature or function **only** if it is material or required by law (even if it is immaterial). ⏩ If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. ⏩ Do not reduce the understandability of its financial statements by ☐ obscuring material information with immaterial information; or ☐ aggregating material items that have different natures or functions.
Offsetting	Offsetting of assets and liabilities or income and expenses is not allowed unless required or permitted by an Ind AS or except when offsetting reflects the substance of the transaction or other event
Frequency of reporting	An entity shall present a complete set of financial statements (including comparative information) at least annually.
Comparative information	Refer chart 3 of Ind AS 1 for minimum and additional comparative information.

Change in accounting policy, retrospective restatement or reclassification	When an entity reclassifies comparative amounts, it shall disclose (including as at the beginning of the preceding period): (a) the nature of the reclassification; (b) the amount of each item or class of items that is reclassified; and (c) the reason for the reclassification.
	When it is impracticable to reclassify comparative amounts, an entity shall disclose: (a) the reason for not reclassifying the amounts, and (b) the nature of the adjustments that would have been made if the amounts had been reclassified.
Consistency of presentation	An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless: (a) presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or (b) an Ind AS requires a change in presentation.

STRUCTURE AND CONTENT	
Identification of the financial statements	An entity shall clearly identify each financial statement and the notes. It shall display prominently: (a) the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period; (b) whether the financial statements are of an individual entity or a group of entities; (c) the date of the end of the reporting period or the period covered by the set of financial statements or notes; (d) the presentation currency; and (e) the level of rounding used in presenting amounts in the financial statements. The rounding off is acceptable as long as the entity discloses it and does not omit material information.

Information to be presented in the balance sheet	⏩ The balance sheet shall present line items and additional line items (including by disaggregating the line items listed in paragraph 54), headings and subtotals. ⏩ Presents current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet. ⏩ It shall not classify deferred tax assets (liabilities) as current assets (liabilities). **Exception** An entity may present all assets and liabilities in order of liquidity but shall disclose the amount expected to be recovered or settled (a) no more than twelve months after the reporting period, and (b) more than twelve months after the reporting period. ⏩ An entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and more relevant.
Current assets	⏩ Classify an asset as current when: (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle; (b) it holds the asset primarily for the purpose of trading; (c) it expects to realise the asset within twelve months after the reporting period; or (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period. ⏩ Classify all other assets as non-current. *Note: The term 'non-current' includes tangible, intangible and financial assets of a long-term nature.*
Operating cycle	⏩ It is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. ⏩ When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. ⏩ The same normal operating cycle applies to the classification of an entity's assets and liabilities.
Current liabilities	⏩ An entity shall classify a liability as current when: (a) it expects to settle the liability in its normal operating cycle; (b) it holds the liability primarily for the purpose of trading; (c) the liability is due to be settled within twelve months after the reporting period; or (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. ⏩ An entity shall classify all other liabilities as non-current. ⏩ An entity classifies some operating items like trade payables and some accruals for employee and other operating costs (part of the working capital) as current liabilities even if they are due to be settled more than twelve months after the reporting period. ⏩ Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.
Information to be presented either in the balance sheet or in the notes	Disclose sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.
Statement of Profit and Loss	⏩ The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections: (a) profit or loss; (b) total other comprehensive income; (c) comprehensive income for the period, being the total of profit or loss and other comprehensive income. ⏩ An entity shall **not** present any items of income or expense as extraordinary items. ⏩ An entity shall present an analysis of expenses recognised in profit or loss using a **classification based on the nature of expense method.** ⏩ An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.
Information to be presented in the other comprehensive income (OCI) section	⏩ Present line items for the amounts for the period of: (a) items of OCI classified by nature and grouped into those that: (i) will not be reclassified subsequently to profit or loss; and (ii) will be reclassified subsequently to profit or loss when specific conditions are met. (b) the share of OCI of associates and joint ventures accounted for using the equity method, separated into the share of items that: (i) will not be reclassified subsequently to profit or loss; and (ii) will be reclassified subsequently to profit or loss when specific conditions are met. ⏩ Disclose the amount of income tax relating to each item of OCI, including reclassification adjustments, either in the statement of profit and loss or in the notes. ⏩ Present items of OCI either (a) net of related tax effects, or (b) before related tax effects with one amount shown for the aggregate amount of income tax relating to those items. ⏩ If an entity elects alternative (b), it shall allocate the tax between the items that might be reclassified subsequently to the profit or loss section and those that will not be reclassified subsequently to the profit or loss section.

Reclassification adjustment	⏩ When amounts previously recognised in other comprehensive income are reclassified to profit or loss they are referred as reclassification adjustments. ⏩ It is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss. ⏩ These amounts may have been recognised in OCI as unrealised gains in the current or previous periods. ⏩ Those unrealised gains must be deducted from OCI in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice. ⏩ An entity may present reclassification adjustments in the statement of profit and loss or in the notes. ⏩ An entity presenting reclassification adjustments in the notes presents the items of OCI after any related reclassification adjustments. ⏩ Reclassification adjustments **do not** arise on changes in revaluation surplus or on reameasurements of defined benefit plans since they are recognised in OCI and are not reclassified to profit or loss in subsequent periods. Changes in revaluation surplus may be transferred to retained earnings in subsequent periods as the asset is used or when it is derecognised. ⏩ Reclassification adjustments **do not** arise if a cash flow hedge or the accounting for the time value of an option (or the forward element of a forward contract or the foreign currency basis spread of a financial instrument) result in amounts that are removed from the cash flow hedge reserve or a separate component of equity, respectively, and included directly in the initial cost or other carrying amount of an asset or a liability. These amounts are directly transferred to assets or liabilities.
Information to be presented in the statement of changes in equity (SOCE)	SOCE includes the following information: (a) total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests; (b) for each component of equity, the effects of retrospective application or retrospective restatement; (c) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from: (i) profit or loss; (ii) other comprehensive income; (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and (iv) any item recognised directly in equity such as amount recognised directly in equity as capital reserve.

Information to be presented in the statement of changes in equity (SOCE) or in the notes	⏩ Present, either in SOCE or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share. ⏩ Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period **except** for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions. ⏩ Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an Ind AS requires retrospective adjustment of another component of equity. ⏩ Standard requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. ⏩ These adjustments are disclosed for each prior period and the beginning of the period.
Notes -Structure	⏩ The notes shall: (a) present information about the basis of preparation of the financial statements and the specific accounting policies; (b) disclose the information required by Ind ASs that is not presented elsewhere in the financial statements; and (c) provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them. ⏩ Present notes in a systematic manner ⏩ Cross-reference each item in the balance sheet and in the statement of profit and loss, and in the statements of changes in equity and of cash flows to any related information in the notes.
Notes - Disclosure of accounting policies	⏩ An entity shall disclose its significant accounting policies comprising: (a) the measurement basis (or bases) used in preparing the financial statements; and (b) the other accounting policies used that are relevant to an understanding of the financial statements. ⏩ Additionally, it shall disclose, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. ⏩ Disclosure of an accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material.
Notes -Sources of estimation uncertainty	An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature, and (b) their carrying amount as at the end of the reporting period.

Components of other comprehensive income (OCI)

- changes in revaluation surplus
- reameasurements of defined benefit plans
- gains and losses arising from translating the financial statements of a foreign
- gains and losses from investments in equity instruments designated at fair value through OCI
- gains and losses on financial assets measured at fair value through OCI
- the effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through OCI
- for particular liabilities designated as at FVTPL, the amount of the change in fair value that is attributable to changes in the liability's credit risk
- changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value
- changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument

INDIAN ACCOUNTING STANDARD (IND AS) 2: INVENTORIES

Scope of Ind AS 2

Non-applicability of Ind AS 2

- Financial instruments (Ind AS 32 and Ind AS 109)
- Biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (Ind AS 41)
- Measurement of inventories
  - At NRV in accordance with well-established practices in those industries for inventories held by
    - Producers of
      - Agricultural products
      - Forest products
    - Agricultural produce after harvest
    - Minerals and mineral products
    - Changes in NRV are recognised in profit or loss in the period of the change
  - At fair value less costs to sell
    - Commodity broker-traders
      - Changes in fair value less costs to sell are recognised in profit or loss in the period

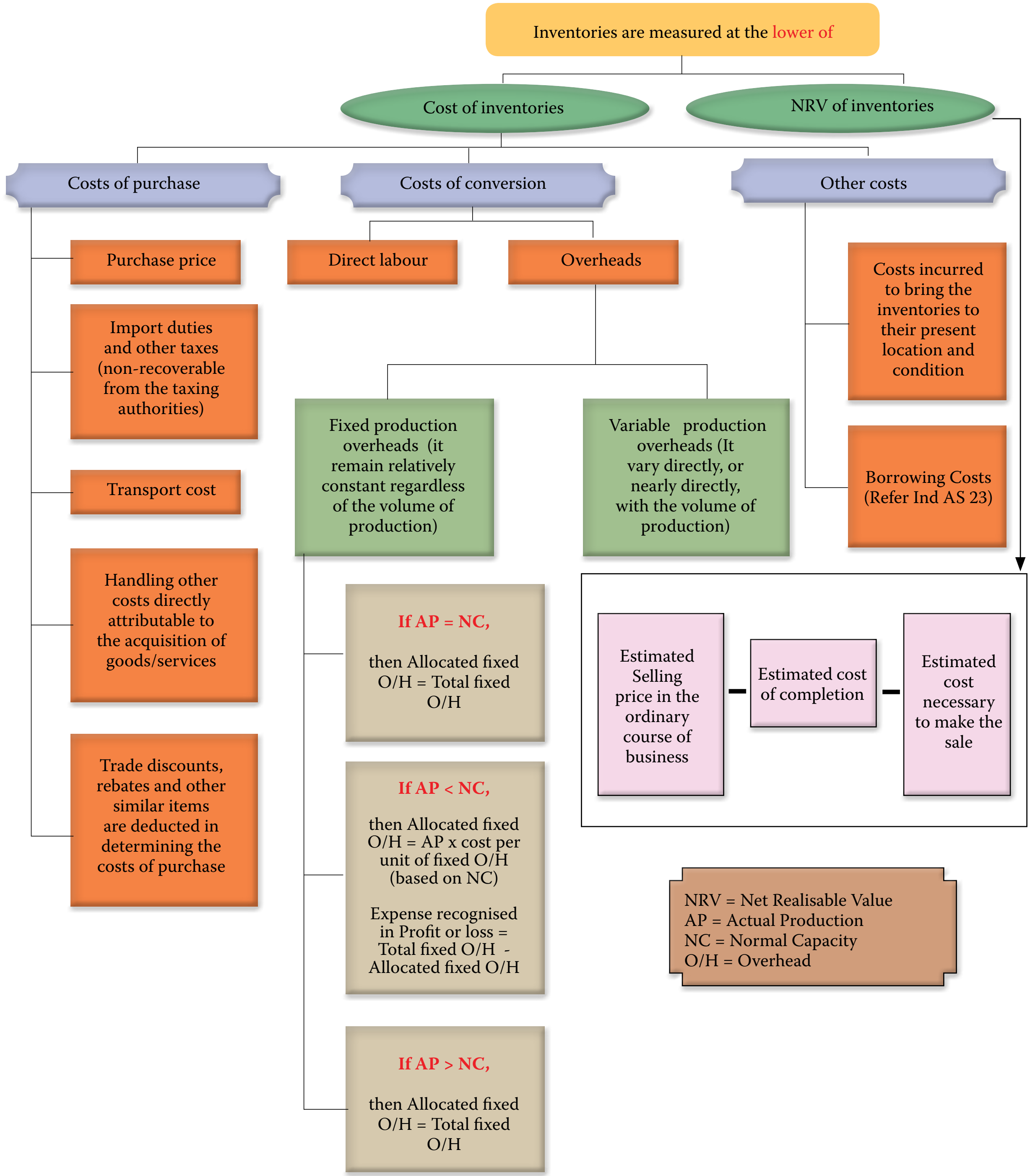
** NRV- Net Realisable Value*

Definition of Inventories

Inventories are assets held

- For sale in the ordinary course of business
  - It includes goods purchased and held for resale
- In the process of production for such sale
  - It includes finished goods produced, or work in progress, or materials and supplies awaiting use in the production process
- In the form of materials or supplies to be consumed in
  - Production process
  - Rendering of services
    - Costs incurred to fulfill a contract with a customer that do not give rise to inventories are accounted for in accordance with Ind AS 115

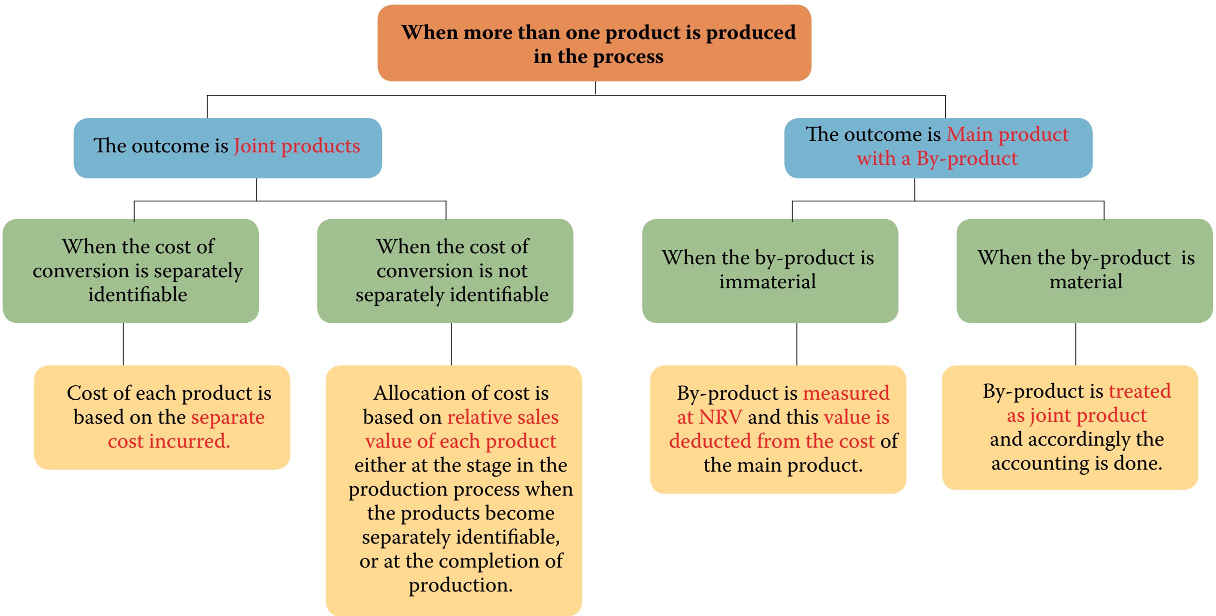
Measurement of Inventories



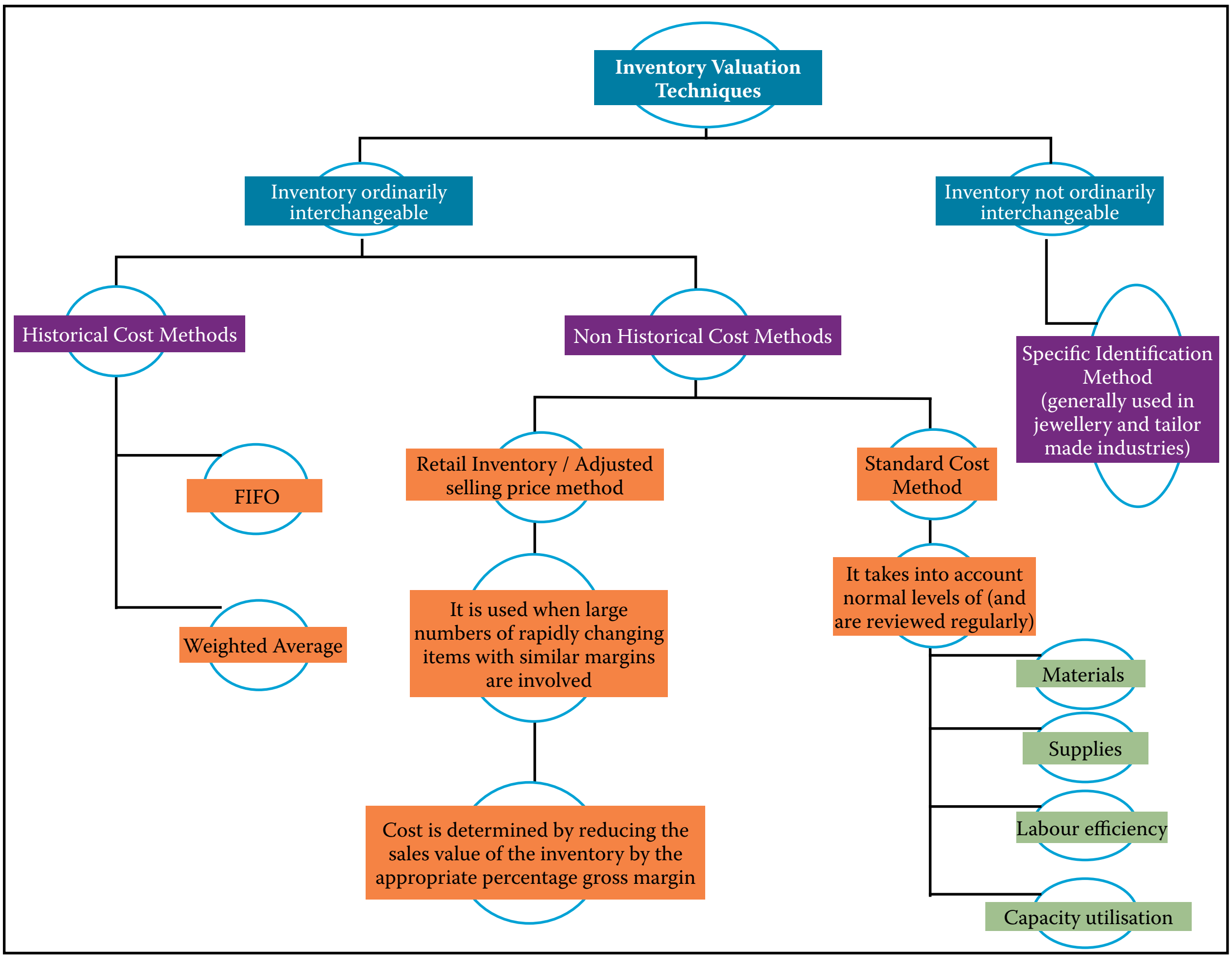
Costs excluded from the cost of inventories and recognised as expenses

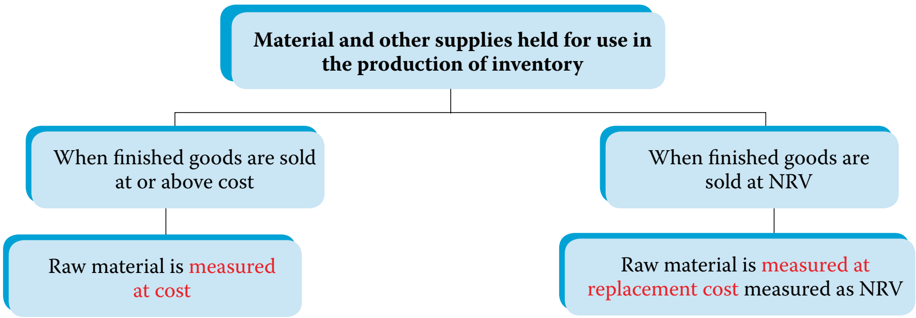
- Abnormal amounts of wasted materials, labour or other production costs.
- Storage costs (If those costs are not necessary in the production process before a further production stage).
- Administrative overheads that do not contribute to bringing inventories to their present location and condition.
- Selling costs.
- Interest expenses (financial element in deferred settlement terms).

Allocation of cost to joint products and by-products



Cost Formulas

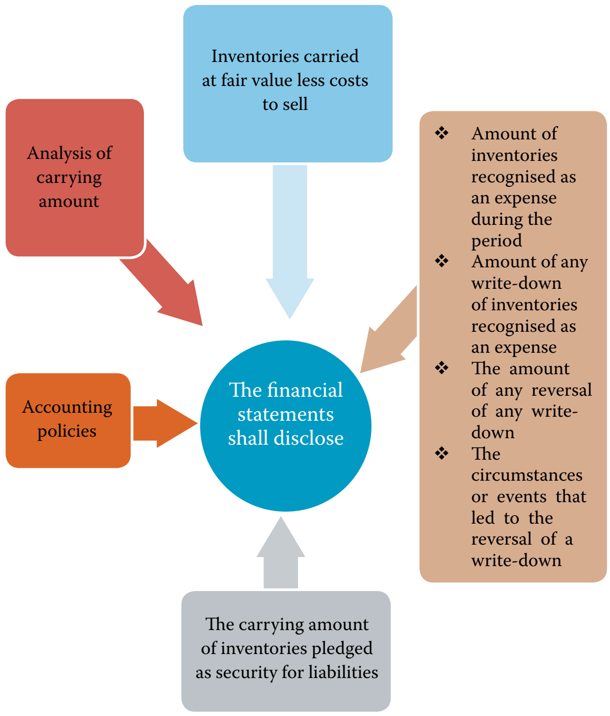




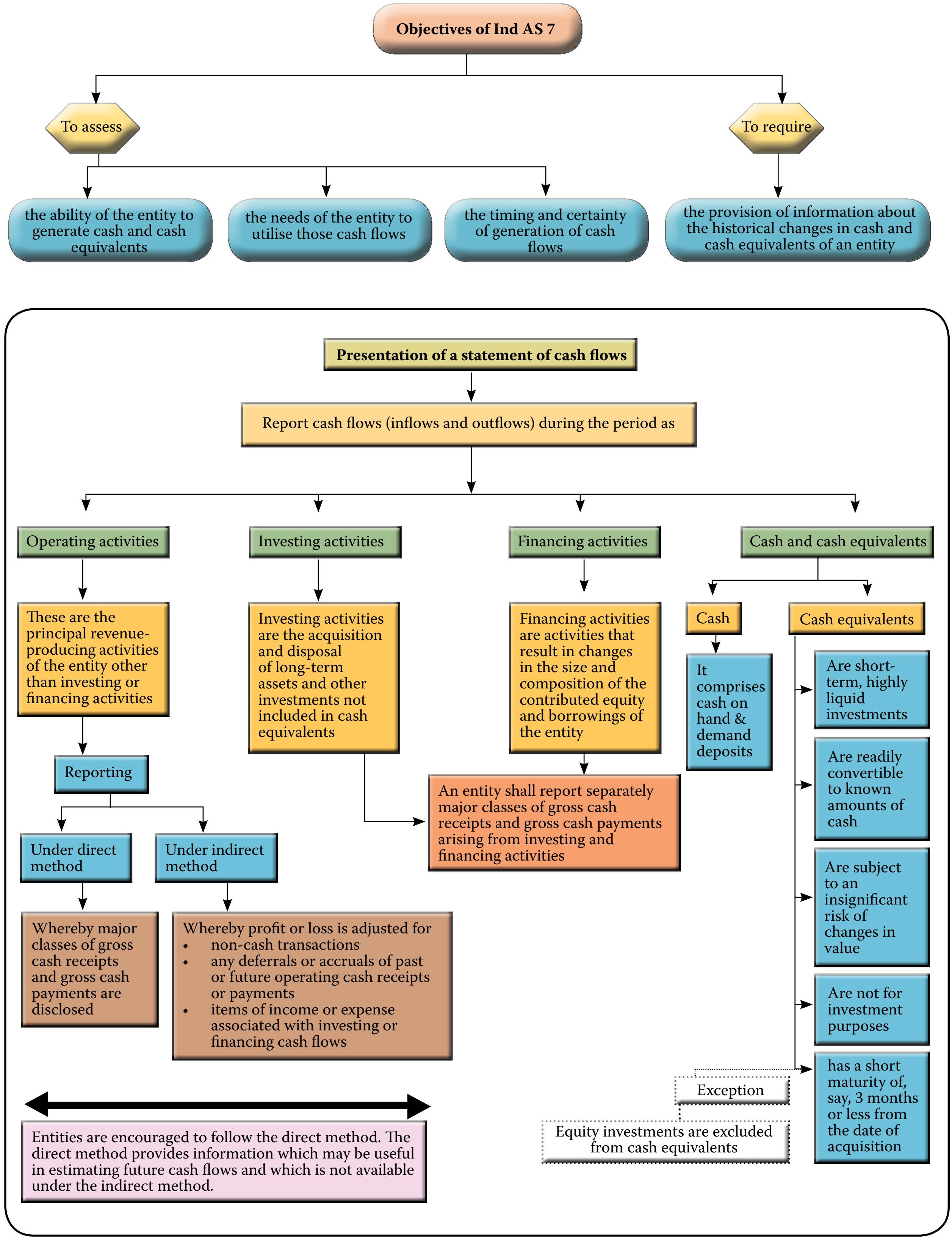
Important points of Ind AS 2 to be remembered

NRV	**It is an entity specific value**
Inventories comprising agricultural produce that an entity has harvested from its biological assets	They are measured on initial recognition at their fair value less costs to sell at the point of harvest.
New assessment of NRV	❖ A new assessment is made of NRV in each subsequent period. ❖ When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in NRV, the amount of the write-down is reversed (i.e. the reversal is limited to the amount of the original write-down)
Sale of inventories	❖ When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period the sale is recognised. ❖ If NRV is less than cost, then the difference and all losses of inventories shall be recognised as an expense in that period. ❖ When in later year, if NRV increases then difference to the extent of cost shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Disclosure



INDIAN ACCOUNTING STANDARD (IND AS) 7: STATEMENT OF CASH FLOWS



Cash flows arising from operating activities

Key indicator of the extent to which the operations of the entity have generated sufficient cash flows to
- repay loans
- maintain the operating capability of the entity
- pay dividends
- make new investments without recourse to external sources of financing

Primarily derived from the principal revenue-producing activities of the entity

Generally, result from the transactions and other events that enter into the determination of profit or loss

Examples

(a) Cash receipts from the sale of goods and the rendering of services
(b) Cash receipts from royalties, fees, commissions and other revenue
(c) Cash payments to suppliers for goods and services
(d) Cash payments to and on behalf of employees
(e) Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits
(f) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
(g) Cash receipts and payments from contracts held for dealing or trading purposes
(h) Cash flows arising from the purchase and sale of dealing or trading securities
(i) Cash advances and loans made by financial institutions since they relate to their main revenue-producing activity

Cash flows arising from financing activities

Useful in predicting claims on future cash flows by providers of capital to the entity

Examples

(a) Cash proceeds from issuing shares or other equity instruments;
(b) Cash payments to owners to acquire or redeem the entity's shares;
(c) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
(d) Cash repayments of amounts borrowed; and
(e) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Cash flows arising from investing activities

Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows

Only expenditures that result in a recognised asset in the balance sheet are eligible for classification as investing activities

Examples

(a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;
(b) Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
(c) Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
(d) Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
(e) Cash advances and loans made to other parties (other than advances and loans made by a financial institution);
(f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
(g) Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
(h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

***Note:** When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.*

Reporting cash flows on a net basis

Other than financial institutions

Cash flows arising from operating, investing or financing activities may be reported on a net basis

- Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity
  - Examples of cash receipts and payments referred to in paragraph 22(a) are:
    - (a) The acceptance and repayment of demand deposits of a bank;
    - (b) Funds held for customers by an investment entity; and
    - (c) Rents collected on behalf of, and paid over to, the owners of properties.
- Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short
  - Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayment of:
    - (a) Principal amounts relating to credit card customers;
    - (b) The purchase and sale of investments; and
    - (c) Other short-term borrowings, for example, those which have a maturity period of three months or less.

Financial institutions

Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:

(a) Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) The placement of deposits with and withdrawal of deposits from other financial institutions; and

(c) Cash advances and loans made to customers and the repayment of those advances and loans.

Foreign currency cash flows

Arising from transactions in a foreign currency

Recorded in an entity's functional currency

Foreign currency amount ✖ Exchange rate between the functional currency and the foreign currency at the date of the cash flow

Of a foreign subsidiary

Cash flows of a foreign subsidiary ✖ Exchange rates between the functional currency and the foreign currency at the dates of the cash flows

Note:

1. *Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21.*
2. *A weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary.*
3. *Ind AS 21* ***does not permit*** *use of the exchange rate at the end of the reporting period when translating the cash flows of a foreign subsidiary.*

Important Points

1.	Unrealised gains and losses arising from changes in foreign currency exchange rates	are not cash flows.
2.	The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency	is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period.
		is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

Cash flows arising from taxes on income

- Shall be separately disclosed
- When it is practicable to identify → Tax cash flow is classified as an investing or financing activity as appropriate
- When it is impracticable to identify → Shall be classified as cash flows from operating activities when impracticable to identify with financing and investing activities

Note: *When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.*

Investments in subsidiaries, associates and joint ventures	When accounted for by use of the equity or cost method	an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.
	When reporting its interest in an associate or a joint venture using the equity method	Includes in its statement of cash flows: • the cash flows in respect of its investments in the associate or joint venture, and • distributions and other payments or receipts between it and the associate or joint venture.

Interest and Dividends

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

In case of financial institutions
- Interest paid → Classified as cash flows arising from operating activities
- Interest and dividends received → Classified as cash flows arising from operating activities
- Dividends paid → Classified as cash flows from financing activities

In the case of other entities
- Dividends paid → Classified as cash flows from financing activities
- Interest paid → Classified as cash flows from financing activities
- Interest and dividends received → Classified as cash flows from investing activities → They are returns on investments

Classified as cash flows from financing activities → They are costs of obtaining financial resources

Changes in ownership interests in subsidiaries and other businesses

Cash flows arising from
- Obtaining control of subsidiaries or other businesses
- Losing control of subsidiaries or other businesses

Shall be classified as investing activities

Shall be presented separately → The cash flow effects of losing control are not deducted from those of obtaining control

Shall disclose, in aggregate, during the period
- The total consideration paid or received
- The portion of the consideration consisting of cash and cash equivalents
- The amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost
- The amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category

Need not apply to an investment in a subsidiary measured at fair value through profit or loss (FVTPL)

Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control → Shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity

Important points/disclosures

Investing and financing transactions that do not require the use of cash or cash equivalents	▸▸ Shall be excluded from a statement of cash flows ▸▸ Disclosed elsewhere in the financial statements
Components of cash and cash equivalents	▸▸ Disclose the components of cash and cash equivalents ▸▸ Shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet ▸▸ Disclose the policy which entity adopts in determining the composition of cash and cash equivalents.
Other Disclosures	Disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held and are not available for use by the group ***Note:*** *The requirements shall be equally applicable to the entities in case of separate financial statements also.*

INDIAN ACCOUNTING STANDARD (IND AS) 8: ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Objective and Scope

Is to prescribe

- The criteria for selecting and changing accounting policies
- The accounting treatment and disclosure of
  - Changes in accounting policies
  - Changes in accounting estimates
  - Corrections of errors

Important Definitions

1.	**Accounting policies**	Specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements
2.	**A change in accounting estimate**	⏩ It is an **adjustment** of **the carrying amount of an asset or a liability**, or **the amount of the periodic consumption of an asset.** ⏩ Change in accounting estimates result from new information or new developments. ⏩ It is **not corrections of errors.** ⏩ Effect of such a change is given **prospectively**.
3.	**Prior period errors**	⏩ They are omissions from, and misstatements in, the entity's financial statements **for one or more prior periods arising from a failure to use, or misuse of, reliable information** ⏩ Such errors include the effects of ☐ mathematical mistakes, ☐ mistakes in applying accounting policies, ☐ oversights or misinterpretations of facts, and ☐ fraud.
4.	**Retrospective application**	It is applying a new accounting policy to transactions, other events and conditions **as if that policy had always been applied unless it is impracticable to do so.**
5.	**Retrospective restatement**	It is correcting the recognition, measurement and disclosure of amounts of elements of financial statements **as if a prior period error had never occurred.**

Accounting Policies

- Selection and application of accounting policies
  - When an Ind AS specifically applies to a transaction, other event or condition → The accounting policy(s) applied to the item shall be determined as per that Ind AS
  - When no Ind AS specifically applies to a transaction, other event or condition → Management shall use its judgement in developing and applying an accounting policy (Refer Note 1)
- Changes in accounting policies (Refer Note 3)
  - If the change is required by an Ind AS
  - If the change results providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows

  → When an entity changes an accounting policy voluntarily, it shall apply the change retrospectively, if specific transitional provisions does not apply to that change. (Refer Note 4)

Retrospective application of a change in accounting policy
Adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. Usually the adjustment is made to retained earnings.

Exception

When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented,

⏩ apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable.

If it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods,

⏩ adjust the comparative information to apply the new accounting policy **prospectively** from the earliest date practicable.

Notes:
1. *For judgement, management may also first consider the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices,*
2. *An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions.*
3. *The following are **not changes in accounting policies:***
   (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and
   (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.
4. *Early application of an Ind AS is not a voluntary change in accounting policy.*

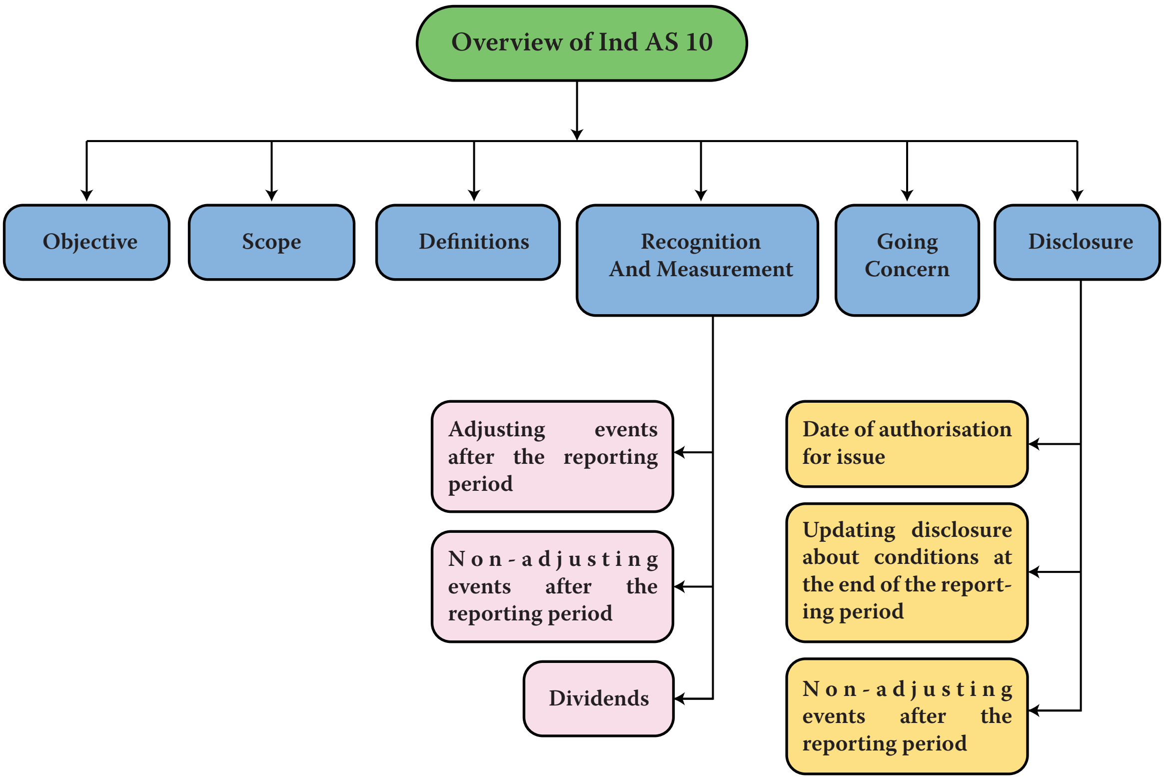
Changes in Accounting Estimates

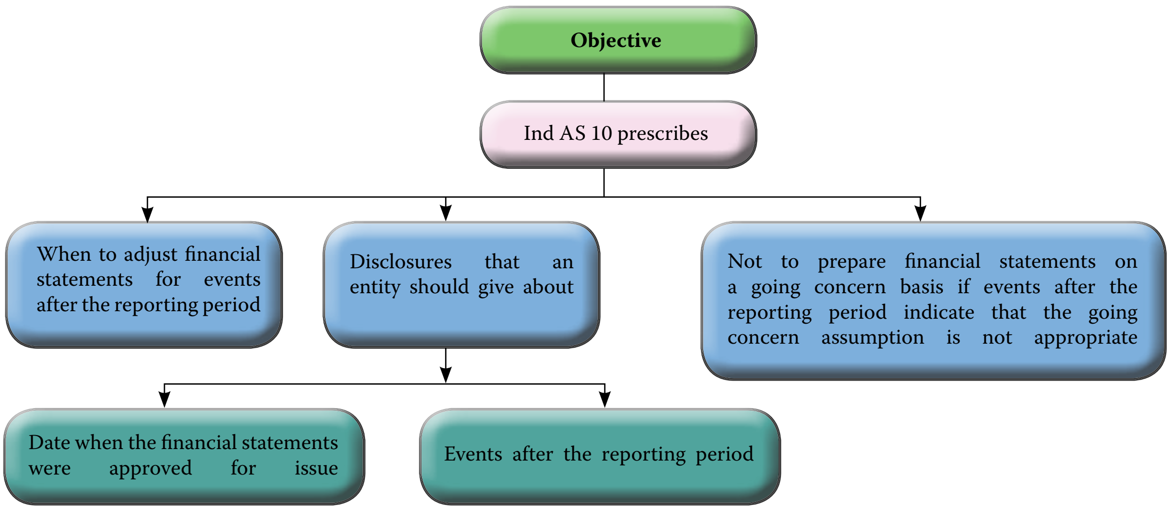
Reasons for revision in accounting estimates	1. When a change occur in the circumstances on which the estimate was based 2. When a change is as a result of new information or more experience.
Nature of change in accounting estimates	⏩ A change in accounting estimates neither relates to prior periods nor is a correction of an error. ⏩ When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.
Treatment of a change in accounting estimates	⏩ The effect of change in an accounting estimate, shall be recognised **prospectively** by including it in profit or loss in: ☐ the period of the change, if the change affects that period only; or ☐ the period of the change and future periods, if the change affects both. ⏩ To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Errors

Stage of occurrence of errors	Errors can arise in respect of the **recognition, measurement, presentation or disclosure of elements of financial statements.**
Effects of errors	Financial statements **will not be considered as complied with Ind ASs** if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.
Nature of correction of errors	Corrections of errors are distinguished from changes in accounting estimates.
Accounting treatment for correction of such errors	⏩ Prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period ⏩ An entity shall correct material prior period errors **retrospectively** in the first set of financial statements approved for issue after their discovery by: ☐ restating the comparative amounts for the prior period(s) presented in which the error occurred; or ☐ if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented. The correction of a prior period error is **excluded** from profit or loss for the period in which the error is discovered. **Exception** When it is impracticable to determine the amount of an error (eg a mistake in applying an accounting policy) for all prior periods, the entity restates the comparative information **prospectively from the earliest date practicable.**

INDIAN ACCOUNTING STANDARD (IND AS) 10: EVENTS AFTER THE REPORTING PERIOD





Events after the reporting period

- Both favourable and unfavourable
- That occur between the end of the reporting period and the date when the financial statements are approved
  - By the Board of Directors in case of a company
  - By the corresponding approving authority in case of any other entity

Adjusting events: Those that provide evidence of conditions that existed at the end of the reporting period

Non-adjusting events: Those that are indicative of conditions that arose after the reporting period

Carve Out: Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an **adjusting event.**

Recognition, Measurement and Disclosure

Adjusting events after the reporting period

Adjust the amounts recognised in the financial statements to reflect it

Examples of adjusting events:

(a) Adjust any previously recognised provision or recognises a new provision when the related court case is settled before the financial statements are approved as per Ind AS 37

(b) Account for the impairment (if any) on receipt of information after the reporting period like:

  (i) the bankruptcy of a customer that occurs after the reporting period; and

  (ii) the sale of inventories after the reporting period may give evidence about their NRV at the end of the reporting period.

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

(d) the determination after the reporting period of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments

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

Non-adjusting events after the reporting period

Do not adjust the amounts recognised in the financial statements to reflect it

Example of a non-adjusting event

A decline in fair value of investments between the end of the reporting period and the date when the financial statements are approved for issue

If non-adjusting events after the reporting period are material, then **disclose**

- the nature of the event; and
- an estimate of its financial effect, or a statement that such an estimate cannot be made.

Important points to remember

S. No.	Item	Timing	Treatment	Reason
1	Dividends	Declared after the reporting period but before approval of financial statements	⏩ Do not recognise it as a liability at the end of the reporting period. ⏩ Disclosed in the notes	No obligation exists at that time
2.	Going concern	If management determines after the reporting period either that it intends to liquidate the entity or to cease trading	⏩ Do not prepare the financial statements on a going concern basis; or ⏩ Make necessary disclosure of not following going concern basis or events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern	The deterioration in operating results and financial position after the reporting period may be so pervasive that it may require a fundamental change in the basis of accounting
3.	Date of approval of financial statements for issue	Approved after the reporting period	Disclose the date when the financial statements were approved for issue **and** who gave that approval	Important for users to know when the financial statements were approved for issue because the financial statements do not reflect events after this date
4.	Updating disclosure about conditions at the end of the reporting period	Received information after the reporting period	Update disclosures that relate to new information / conditions	When the information does not affect the amounts that it recognises in its financial statements, disclosures are required

Distribution of Non-cash Assets to Owners as dividend by an entity

Timing of recognition of dividend payable by an entity

When the dividend is appropriately authorised / approved by the relevant authority, eg the shareholders or the management as per the jurisdiction

Measurement of a dividend payable by an entity

- Measure a liability at the **fair value of the assets to be distributed**
- If an entity gives a choice of receiving either a non-cash asset or a cash alternative,
  - estimate both the fair value of each alternative and the associated probability of owners selecting each alternative.
- At the end of each reporting period and at the date of settlement
  - review and adjust the carrying amount of the dividend payable, with any changes recognised in equity as adjustments to the amount of the distribution
- Account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable on its settlement
  - by recognising the difference, if any, in profit or loss.

Presentation and disclosures by an entity

Presentation
The difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable is presented as a separate line item in profit or loss

Disclosure
An entity shall disclose
(a) the carrying amount of the dividend payable at the beginning and end of the period; and
(b) the increase or decrease in the carrying amount recognised in the period as result of a change in the fair value of the assets to be distributed.

If dividend is declared to distribute a non-cash asset (non-adjusting event), disclose with respect to the asset to be distributed:
(a) its nature;
(b) its carrying amount and fair value at the end of the reporting period; and
(c) if carrying amount and fair value is different than the information about the method(s) used to measure that fair value.

INDIAN ACCOUNTING STANDARD (IND AS) 12: INCOME TAXES

Objective

Prescribe the accounting treatment for income taxes

Accounting for the current and future tax consequences of

Future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet

If probable that recovery or settlement of the carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, entity should recognise a DTL (DTA), with certain limited exceptions

Transactions and other events of the current period that are recognised in an entity's financial statements

Transactions and Events recognised outside P/L

Related Tax effects recognised in OCI

Related Tax effects recognised in SOCE

Transactions & Events recognised in P/L

Related Tax effects also recognised in P/L

Definitions (Para 5)

Accounting Profit / (loss) = profit or loss for a period before deducting tax expense

Add: expenses recognized, but non-deductible for tax purposes e.g. Sec. 43B payments
Add: income not recognized, but included under tax laws e.g. revenue taxed on receipt basis
Less: expenses not recognized, but deductible for tax purposes e.g. accelerated depreciation
Less: income recognized, but not under tax laws e.g. income accrued but taxed on cash basis

Net Taxable Income as per Computation of Income under Tax Laws

Taxable Profit / (loss) = profit / (loss) for a period, determined in accordance with the applicable tax rules

Definitions (Para 5)

Tax Expense (tax income) = Current Tax Expense + Deferred Tax Expense

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

= Taxable Profit / (Loss) x Tax Rate

Debit: Expenses in P/L

Exception: Equity / OCI

Credit: Provision for Tax

Can be offset in B/S against current tax assets if legally enforceable right to set-off the amounts and entity intends to settle on net basis or realize and settle simultaneously *

* Offsetting in Separate FS v/s Consolidated FS

Measured at amounts expected to be paid to tax authorities using enacted / substantively enacted rates: estimate

Definitions (Para 5)

Deferred Tax = amount of income taxes payable (recoverable) in future in respect of the temporary differences, unused tax losses and unused tax credits

Temporary Differences X Tax Rate

Carrying Amount

Tax Base

Deferred Tax: Recognition, Measurement and Presentation

Step 1: Compute Carrying Amounts of Assets and Liabilities

Step 2: Compute Tax Base

Step 3: Compute temporary differences

Step 4: Classify temporary differences into either (a) Taxable Temporary Difference, or (b) Deductible Temporary Difference

Step 5: Identify Exceptions, if applicable

Step 6: Assess Deductible Temporary Differences, Tax Losses and Credits

Step 7: Determine the Tax Rate

Step 8: Calculate and recognise Deferred Tax

Step 9: Accounting of Deferred Tax

Step 10: Offsetting Deferred Tax Assets and Deferred Tax Liabilities, and comply with other requirements of Ind AS

STEP 1: Compute Carrying Amount

What is Carrying Amount?

Balance as per the ledger

Amount at which an asset or liability is recognised in the balance sheet, after making necessary adjustments like depreciation, impairment, etc.

STEP 2: Compute Tax Base

General Cases!!

What is Tax Base of an Asset or Liability?

It is the amount attributed to an Asset or Liability for tax purposes. **(Para 5)**

Tax Base of

Asset

If the Economic Benefits flowing from the Asset are

Taxable
Tax base = amount deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

Non-Taxable
Tax base = Carrying Amount of the Asset

Liability*

Carrying Amount	xxx
Less: Amount deductible for tax purpose in respect of that Liability in future periods, if any	xxx
Tax Base of Liability	xxx

* Revenue received in advance: Tax Base of the resulting liability is its Carrying Amount, less any Revenue that will not be taxable in future periods

STEP 2: Compute Tax Base

Certain Specific Cases

Items having Tax Base but not recognized in the Balance Sheet **(Para 9)**

E.g. preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s) e.g. Sec. 35D

Difference between tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of NIL is a deductible temporary difference that results in a DTA.

Tax Base of an Asset or Liability is not immediately apparent **(Para 10)**

Consider the **fundamental principle** upon which Ind AS 12 is based

Entity shall, with certain limited exceptions, recognise a DTL/DTA whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences.

STEP 3: Compute Temporary Differences

Temporary Differences

Differences between Carrying Amount of an Asset / Liability in the Balance Sheet and its Tax Base

Taxable Temporary Differences

Result in taxable amounts in determining Taxable Profit / (Tax Loss) of future periods when the Carrying Amount of the Asset or Liability is recovered or settled

Carrying Amount of Asset > Tax Base of Asset
Carrying Amount of Liability < Tax Base of Liability

Deductible Temporary Differences

Result in amounts that are deductible in determining Taxable Profit / (Tax Loss) of future periods when the Carrying Amount of the Asset or Liability is recovered or settled.

Carrying Amount of Asset < Tax Base of Asset
Carrying Amount of Liability > Tax Base of Liability

STEP 3: Compute Temporary Differences

Temporary Differences (Ind AS 12) v/s Timing Differences (AS 22) – a wordplay

Temporary Differences

Timing Differences	Other Differences
Example-1: Interest income recognized in income statement on a time proportion basis but recognized in taxable profit on cash basis as and when income is received. **Example-2:** Depreciation used in determining taxable income may differ from that used in determining accounting profit. **Example-3:** Development costs may be capitalized and amortized over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred.	**Example-1: Business Combinations** The identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with Ind AS 103, Business Combinations, but no equivalent adjustment is made for tax purposes. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. **Example-2: Revaluation** Ind AS permit or require certain assets to be carried at fair value or to be revalued, which may not be permitted for tax purposes, giving rise to a temporary difference.

STEP 4: Classify Temporary Differences

What is a DTA/DTL

Deferred Tax Assets (DTA):
These refer to amounts of Income tax recoverable in future periods in respect of:

a. Deductible Temporary Differences,
b. Carry Forward of Unused Tax Losses, and
c. Carry Forward of Unused Tax Credits

Deferred Tax Liabilities (DTL):
These refer to amounts of Income tax payable in future periods in respect of Taxable Temporary Differences.

STEP 4: Classify Temporary Differences

Identification of DTA/DTL

General Rule!!

PARTICULARS	UNDERLYING ASSET (e.g. PPE)	UNDERLYING LIABILITY (e.g. Accrued Expenses)
Carrying Value > Tax Base (Inverse)	Taxable Temporary Difference Deferred Tax Liability (e.g. PPE)	Deductible Temporary Difference ↓ Deferred Tax Asset (e.g. Sec. 43B Items)
Carrying Value < Tax Base (Direct)	Deductible Temporary Difference ↓ Deferred Tax Asset (e.g. Preliminary Expenses)	Taxable Temporary Difference ↓ Deferred Tax Liability (e.g. Loan with Processing Fee)
Carrying Value = Tax Base	No Deferred Tax	No Deferred Tax

Step 5: Identify Exceptions

Recognition of DTA/DTL for Goodwill arising in a Business Combination

↓

Creates a taxable temporary difference

Financial Accounts	Tax Profits
Carrying Amount of Goodwill is computed as per Ind AS 103	- Goodwill not tax deductible - Goodwill not even deductible when subsidiary disposes of underlying business Tax Base is NIL

Treatment of taxable temporary difference

On initial recognition of Goodwill Do NOT recognize DTL (creates a circular reference)	Relating to Initial Recognition of Goodwill e.g. impairment loss Do NOT recognize DTL	Not arising from Initial Recognition of Goodwill e.g. goodwill deductible in tax Recognize DTL

Step 5: Identify Exceptions

Temporary Differences on initial recognition of an Asset or Liability

Case	Treatment
A temporary difference may arise on initial recognition of an asset or liability, e.g. if part or all of the cost of an asset will not be deductible for tax purposes.	Depends on the nature of the transaction that led to the initial recognition of the asset or liability
Nature of the above transaction: a)In a Business Combination (with limited exceptions, identifiable assets and liabilities acquired in a business combination are fair valued at the DOA, but the tax base of the identifiable assets and liabilities are not affected/affected differently)	(a)DTA/DTL is recognised (b)This affects Goodwill or Bargain Purchase Gain, recognised by the Entity
b)If the transactions affects either accounting profit/taxable profit	Recognise DTA / DTL and corresponding income / expense in the Profit or Loss
c)Transaction not falling in (a) or (b) above e.g. purchase of asset or receipt of government grants	DTL/DTA not recognised. Subsequent changes, as the asset is depreciated, is also not recognised.
In accordance with Ind AS 32, Financial Instruments: Presentation, the issuer of a compound financial instrument (for example, a convertible bond) classifies the instrument's liability component as a liability and the equity component as equity. In some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component.	The deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in profit or loss as deferred tax expense (income).

Step 5: Identify Exceptions

Investments in Subsidiaries, Branches and Associates and Interests in Joint Arrangements

- Existence of undistributed profits
- Foreign exchange rate changes
- Reduction to recoverable amount

Deferred Tax Liability

- Recognize DTL except for
  - Control over timing
  - Non-reversal probable
  - Do not recognize DTL

Deferred Tax Asset

- Recognize DTA only when
  - Reversal in foreseeable future
  - Taxable Profit available

Step 5: Identify Exceptions

Items / Situation	Treatment
As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses.	When the **parent has determined** that those profits will not be distributed in the foreseeable future the **parent does not recognise a DTL**. The same considerations apply to investments in branches.
Non-monetary assets and liabilities of an entity (subsidiary / branch) are measured in its functional currency under Ind AS 21. If the entity's taxable profit (loss) (and, hence, its tax base) is determined in a different currency, changes in the exchange rate give rise to temporary differences that result in a recognised DTL/DTA.	The resulting deferred tax is charged or credited to profit or loss.
An investor in an associate does **not** control that entity and is usually not in a position to determine its dividend policy. There is an agreement which requires that the profits of the associate will not be distributed in the foreseeable future.	Investor **recognizes DTL arising from Taxable Temporary Difference** associated with such Investments.
Investor in an associate may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount.	DTL is measured at this amount.
Joint venturer or joint operator **can control the timing of the distribution of its share of the profits of the joint arrangement** and it is probable that its share of the profits will not be distributed in the foreseeable future	**DTL is not recognized.**

Step 6: Assess (also reassess) deductible temporary differences, tax losses and tax credits

Deductible temporary differences reduce the taxable profits of future periods.

An entity should recognise deferred tax assets only when it is **probable that taxable profits will be available** against which the deductible temporary differences can be utilised. (Based on principle of **prudence/conservatism.**)

Recognition of DTA due to...

Deductible Temporary Differences

There are sufficient Taxable Differences
It is probable that Taxable Profit will be available, hence DTA is recognised in the period in which Deductible Temporary Differences arise

There are insufficient Taxable Differences
DTA is recognised to the extent that:

a. **It is probable that Entity will have sufficient Taxable Profit, or**
b. **Tax Planning Opportunities are available to the entity that will create taxable profit in appropriate periods**

**Entity has a history of recent losses OR Carry Forward of Unused Tax Loss/Credits
Strong evidence that future profit may not be available, therefore restricted recognition of DTA**

Step 6: Assess (also reassess) deductible temporary differences, tax losses and tax credits

Existence of taxable temporary differences

The entity at the balance sheet date should see whether there are sufficient taxable temporary differences whose reversal pattern matches with the reversal profile of deductible temporary differences.

Probability of future profits

If it is probable that there will be sufficient taxable profits, then **to the extent of available profits**, deductible temporary differences should be applied for recognition of deferred tax assets.

Availability of Tax Planning Opportunities

Tax planning opportunities: Actions that the entity would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carry forward.
After evaluating the previous criteria, if there are still unrecognised Deductible Temporary Differences, the entity should see whether any tax planning opportunities are available

Step 6: Assess (also reassess) deductible temporary differences, tax losses and tax credits

Reassessment / Review of DTAs

At the end of each reporting period, the Entity should (a) re-assess Unrecognised DTA, and (b) review the Carrying Amount of DTA

Recognize previously unrecognised DTA, if

It has become probable that future taxable profit will allow the previously unrecognised DTA to be recovered.

Reduce the carrying amount of DTA, if

It is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that DTA to be utilized.

Step 7: Determine the tax rate (law)

DTA / DTL shall be measured

at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled;

based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The **measurement** of DTA/DTL shall **reflect the tax consequences** that would follow from the **manner in which the entity expects,** at the end of the reporting period, **to recover or settle the carrying amount** of its assets and liabilities

In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of

a. the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

b. the tax base of the asset (liability).

In such cases, an entity measures DTL/DTA using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Step 7: Determine the tax rate (law)

Distribution of Dividends

In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity.

In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity.

In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

Step 8: Calculate and recognize Deferred Tax

DTA / DTL shall be measured

Taxable Temporary Differences	x	Tax Rate	=	Deferred Tax Liability
Deductible Temporary Differences	x	Tax Rate	=	Deferred Tax Asset

No discounting of Deferred Tax Assets / Liabilities

Tax Rate as applicable in period and expected manner of recovery / settlement based on laws enacted / substantively enacted

Carrying amount of DTA shall be reviewed at the end of each reporting period

Step 9: Accounting of Deferred Tax

Accounting of deferred tax of an event is consistent with accounting for that transaction or event

- Transactions and Events recognised outside P/L
  - Related Tax effects recognised in OCI
    - e.g. revaluation as per Ind AS 16 Property, Plant and Equipment
  - Related Tax effects recognised in SOCE
    - e.g. rectification of errors as per Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- Transactions and Events recognised in P/L
  - Related Tax effects also recognised in P/L

Step 9: Accounting of Deferred Tax

Carrying Amount of DTA/DTL may change even though there is no change in related temporary differences

- e.g. change in tax rates or tax laws
- e.g. reassessment of recoverability of DTAs
- e.g. change in expected manner of recovery of asset

Resulting deferred tax recognized in P/L unless recognized outside P/L

When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders (withholding tax). Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

Step 10: Offsetting DTA and DTL

OFFSETTING

- **Current income tax**
  - **- legally enforceable right**
  - **- intention to settle on net basis**
- **Deferred income tax**
  - **- when current tax can be offset**
  - **- by the same tax authority**

Deferred Tax arising from a Business Combination

Temporary differences arise in a business combination

Identifiable Assets and Liabilities acquired in Business Combination are **recognized at their Fair Values at the Acquisition date** other than exceptions permitted by Ind AS

Tax bases of such identifiable assets and liabilities are **not affected** on Business Combination or are **affected differently**

Examples:

Situation	Result
Carrying Amount is increased to Fair Value, but Tax Base remains at Cost to the Previous Owner (i.e. target) [Para 19]	Taxable Temporary Difference resulting in DTL
Liability assumed is recognized at the acquisition date but related costs are not deducted in determining taxable profits until a later period [Para 26(c)]	Deductible Temporary Difference arises which results in DTA
Fair Value of identifiable asset acquired is less than its tax base [Para 26(c)]	

Resulting DTL/DTA affects Goodwill or Bargain Purchase Gain recognized

Deferred Tax arising from a Business Combination

Recognition Principles for Deferred Tax arising from a Business Combination

Situation	Result
Temporary differences arising in a business combination under Para 19 & 26(c)	a. DTA/DTL is recognized at the acquisition date. It affects amount of goodwill / bargain purchase gain b. DTA shall be recognized to the extent that they meet the recognition criteria in paragraph 24 c. Entity does not recognise DTL arising from the initial recognition of goodwill
Carrying amount of goodwill arising in a business combination is less than its tax base	a. The difference gives rise to a DTA. b. The DTA arising from the initial recognition of goodwill shall be recognised as part of the accounting for a business combination to the extent that it is probable that taxable profit will be available against which the deductible temporary difference could be utilised.
Change in probability of realising a pre-acquisition DTA of the acquirer, as a result of Business Combination - a. An acquirer may consider it probable that it will recover its own DTA not recognised before the business combination e.g., the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree, or b. It is no longer probable that future taxable profit will allow the DTA to be recovered	a. Acquirer recognises a change in the DTA in the period of the business combination, but should not include it as part of the accounting for the business combination b. Hence, acquirer should not take it into account in measuring the goodwill or bargain purchase gain it recognises in the business combination

Deferred Tax arising from a Business Combination

Recognition Principles for Deferred Tax arising from a Business Combination

Situation	Result
Potential benefit of the acquiree's Income Tax Loss Carry Forwards or other DTA does not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently	a. Acquired deferred tax benefits recognised within the measurement period that result from new information about facts and circumstances that existed at the acquisition date shall be applied to reduce the carrying amount of any goodwill related to that acquisition. b. All other acquired deferred tax benefits realised shall be recognised in profit or loss (or, if this Standard so requires, outside profit or loss).

Deferred Tax arising from Share-based Payment Transactions

Recognition Principles for Deferred Tax arising from a SBPT

Situation	Result
Tax deduction (i.e., an amount that is deductible in determining taxable profit) is available in respect of remuneration paid in shares, share options or other equity instruments of the entity. The amount of tax deduction may differ from related cumulative remuneration expense, and may arise in a later accounting period.	Difference between the following is a Deductible Temporary Difference resulting in DTA a. Tax Base of Employee Services received to date (being amount permitted as a deduction in future periods under Tax Laws). b. Carrying Amount of NIL **(since it is technically not an 'obligation', as equity is given).**

E.g.: an entity may **recognise an expense** for the consumption of employee services received as consideration for share options granted, **in accordance with Ind AS 102, Share-based Payment,** and **not receive a tax deduction until the share options are exercised,** with the measurement of the tax deduction based on the entity's share price at the date of exercise.

Deferred Tax arising from Share-based Payment Transactions

If the **amount permitted as a deduction** in future periods **under taxation** laws **is not known at the reporting date,** it shall be **estimated**, based on information available at the end of the period. e.g. tax deduction is based on share price on date of exercising of options, then measurement of deductible temporary difference would be based on entity's share price at the balance sheet date.

Situation	Result
Due to above, the amount of the tax deduction or estimated future tax deduction, measured above may differ from related cumulative remuneration expense	If the **amount of the tax deduction** (or estimated future tax deduction) **exceeds the amount of the related cumulative remuneration expense,** this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, **the excess of the associated current or deferred tax should be recognised directly in equity.**

Change in Tax Status of Entity or its Shareholders

A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets e.g.

a. public listing of an entity's equity instruments
b. restructuring of an entity's equity
c. controlling shareholder's move to a foreign country

Principle: Account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves.

Items	Treatment
Current and deferred tax consequences except items below	Recognised in Profit or Loss
Tax consequences that relate to changes in the recognised amount of equity, in the same or a different period	Charged or credited directly to equity
Tax consequences relating to amounts recognised in OCI	Recognised in OCI

Disclosures

Disclosure 1: Disclose components of tax expenses (income)

Components of tax expense (income) include

- current tax expense (income);
- any adjustments recognised in the period for current tax of prior periods;
- the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;
- the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
- the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
- the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
- deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset; and
- the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Ind AS 8, because they cannot be accounted for retrospectively.

Disclosure 2: Tax related to items charged directly to equity

- Indian Accounting Standards require or permit particular items to be credited or charged directly to equity.
- Examples of items charged directly to equity:
  a. adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error
  b. amounts arising on initial recognition of the equity component of a compound financial instrument
- The current and deferred tax relating to these items have to be recognised and accounted for directly in equity.
- Disclose the aggregate current and deferred tax relating to items that are charged or credited directly to equity.

Disclosure 3: Tax related to items recognised in statement of other comprehensive income

- Indian Accounting Standards require or permit particular items to be recognised in other comprehensive income.
- Examples of items recognised in statement of other comprehensive income:
  a. a change in carrying amount arising from the revaluation of property, plant and equipment (see Ind AS 16);
  b. exchange differences arising on the translation of the financial statements of a foreign operation
- Disclose the amount of income tax relating to each component of other comprehensive income.

Disclosure 4: Explanation of relationship between tax expense (income) and accounting profit

a. In ideal situation, if accounting profit is say ₹ 100 and tax rate is 30%, the tax expense should be ₹ 30. But this is seldom the case due to differences in accounting principles and standards vis–a–vis tax laws.
b. Therefore, Ind AS 12 requires an explanation to be disclosed of the relationship between tax expense (income) and accounting profit in either or both of the following forms
    - a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or
    - a numerical reconciliation between the average effective tax rate (tax expense divided by the accounting profit) and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed.

Disclosure 5: Change in tax rates

An explanation of changes in the applicable tax rate(s) compared to the previous accounting period

Disclosure 6: Unrecognised deductible temporary differences, unused tax losses and unused tax credits

The amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;

Disclosure 7: Temporary differences associated with investments in subsidiaries etc.

The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint arrangements, for which deferred tax liabilities have not been recognised

Disclosure 8: Amount of deferred tax liabilities (assets) or income (expenses)

In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:

a. the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;
b. the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the balance sheet;

Disclosure 9: Discontinued Operations

In respect of discontinued operations, the tax expense relating to:

a. the gain or loss on discontinuance; and
b. the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented

Disclosure 10: Dividend tax

The amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were approved for issue, but are not recognised as a liability in the financial statements

Disclosure 11: Disclosures in case of business combination

If a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre-acquisition deferred tax asset, the amount of that change; and
if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date, a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.

Disclosure 12: Deferred tax asset and evidence thereto where based on future taxable profits

An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

a. the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and
b. the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

Disclosure 13: Tax consequences of distribution of dividends

In the circumstances described in paragraph 52A, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.

Para 52A: In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

Disclosure 14: Tax related contingencies

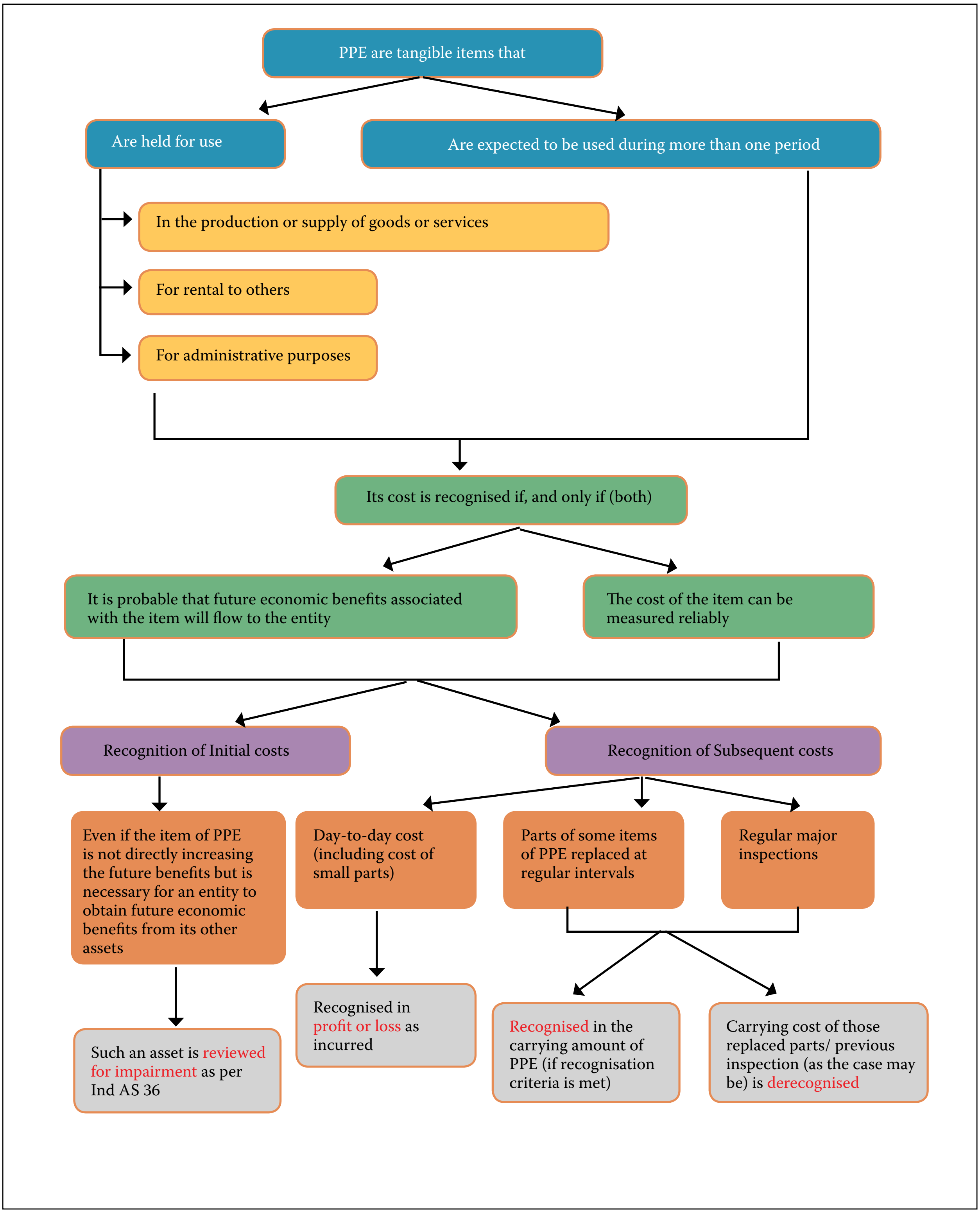
An entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities

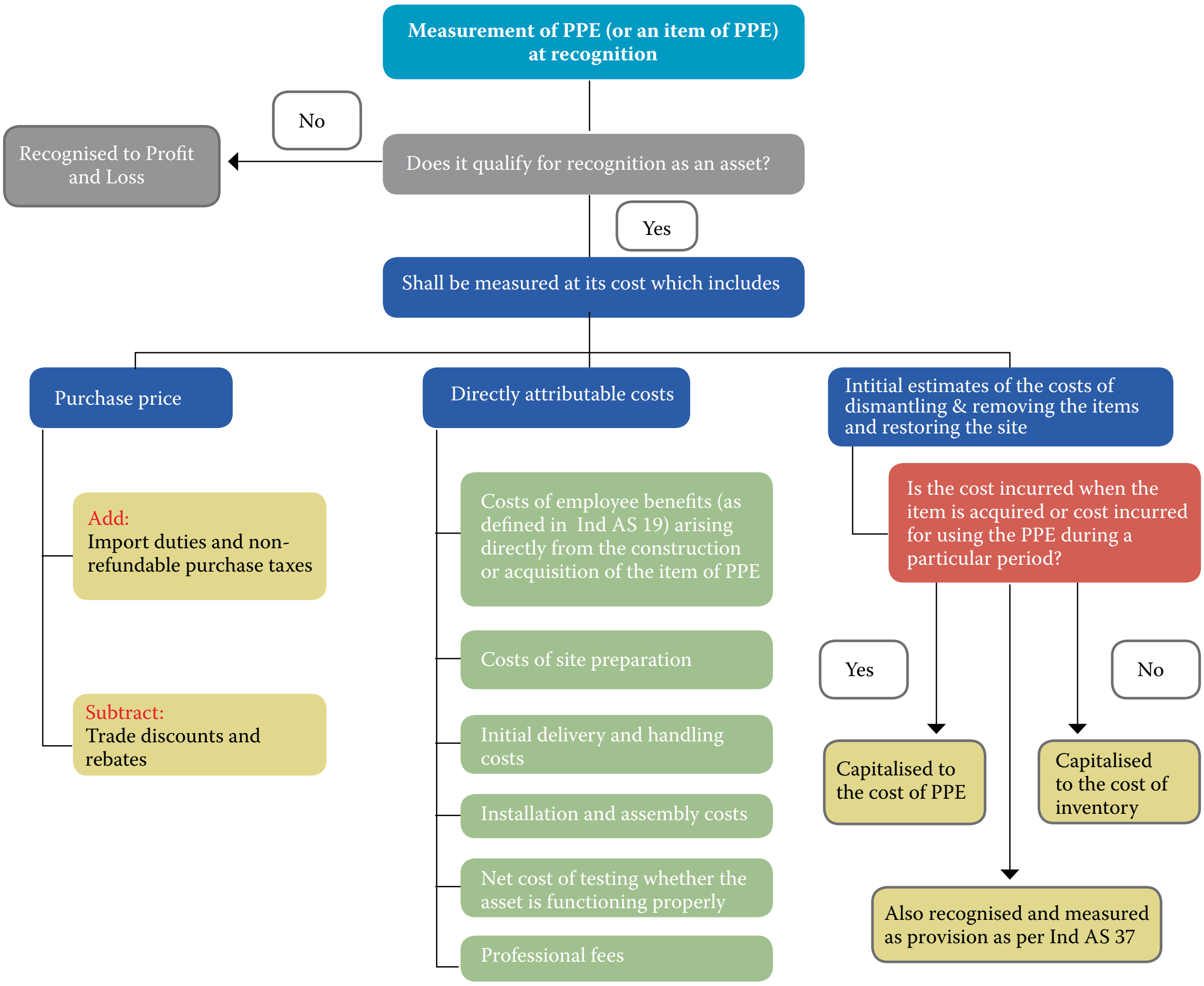
Disclosure 15: Change in tax rates or tax laws

Where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see Ind AS 10, Events after the Reporting Period).

INDIAN ACCOUNTING STANDARD (IND AS) 16 : PROPERTY, PLANT AND EQUIPMENT

PPE and its Recognition

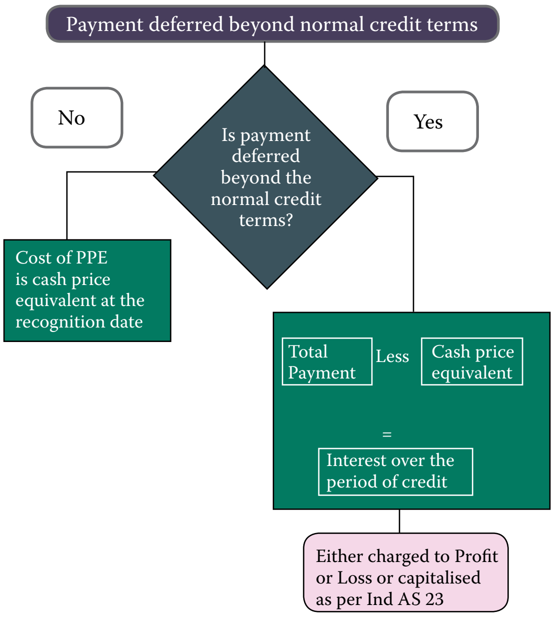




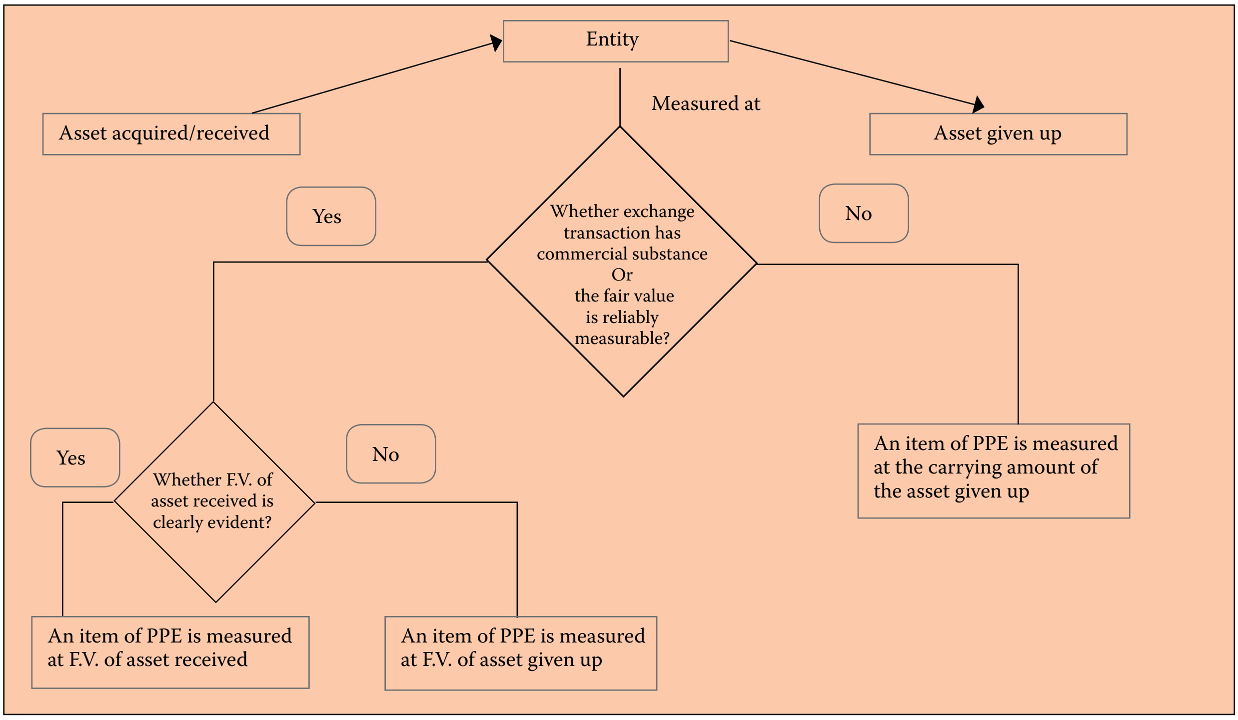
Note:

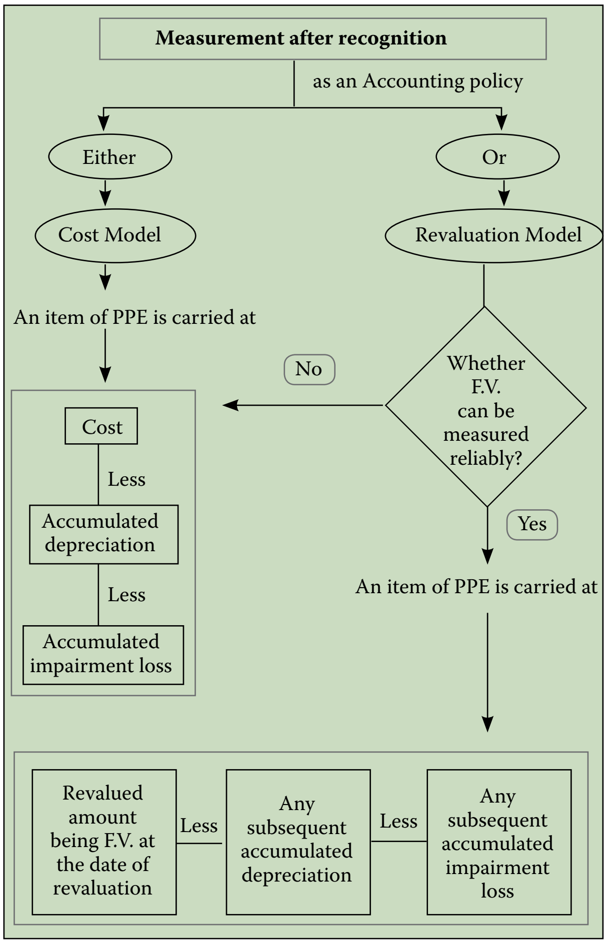
1. Items such as spare parts, stand-by equipment and servicing equipment are recognised when they meet the definition of PPE. Otherwise, such items are classified as inventory.
2. Recognition of costs in the carrying amount of an item of PPE ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.
3. Costs incurred in using or redeploying an item are not included in the carrying amount of that item.
4. Incidental operations that are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses such incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.
5. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. Any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.
6. Bearer plants are accounted for in the same way as self-constructed items of PPE.

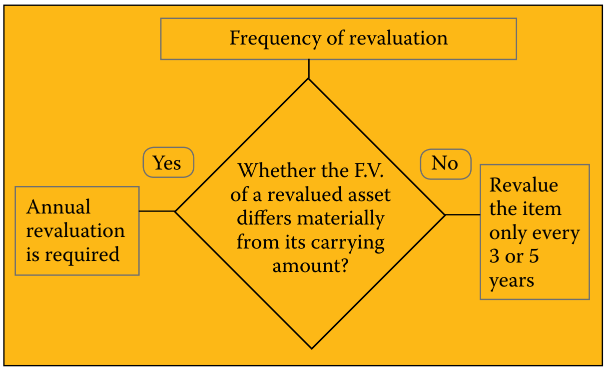
Measurement of Cost



Exchange of Assets





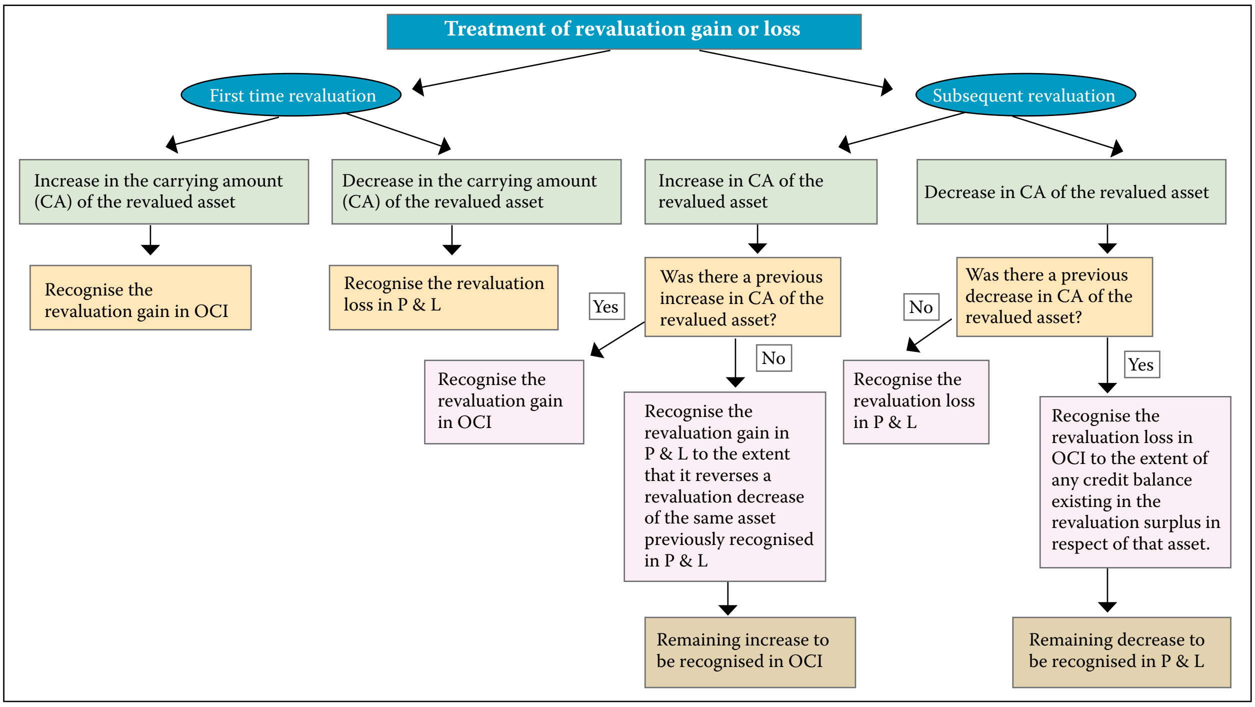


On applying revaluation model – the asset is treated in one of the following ways:

Either	Or
• The gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. • The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.	The accumulated depreciation is eliminated against the gross carrying amount of the asset.
The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for.	

Note:

1. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.
2. Here a class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations.



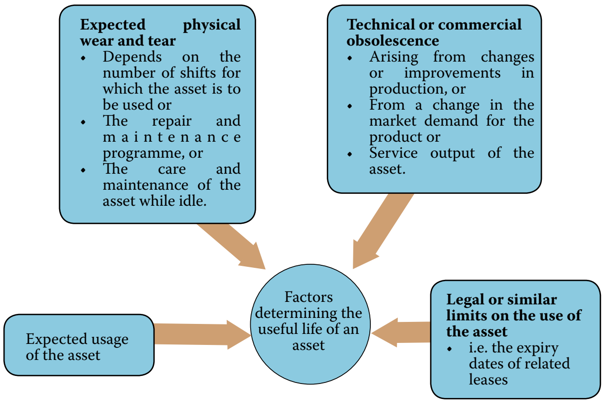
Note:

1. 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 derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of.
2. 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.
3. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

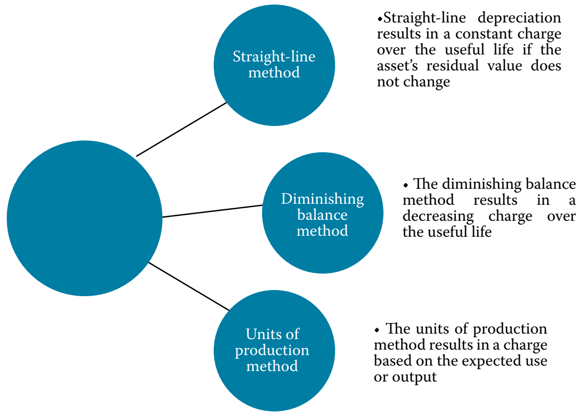
Depreciation = (Cost of the Asset -Residual value)/Useful life of the asset

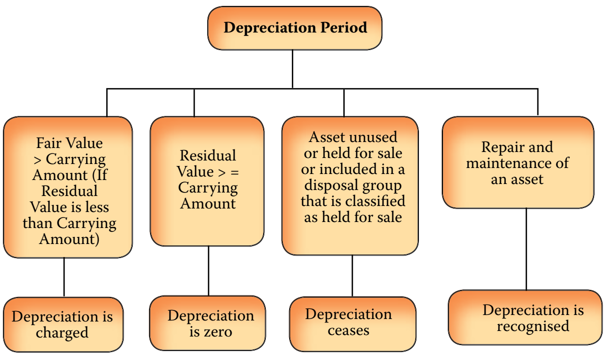
	Particular	Treatment
1	If the cost is significant in relation to total cost of PPE	Separate depreciation is computed for each item of PPE.
2	PPE given as an operating lease	Depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.
3	Grouping of items	If more than one significant parts of an item of PPE have similar useful life and depreciation method then such parts may be grouped in determining the depreciation charge.
4	Remainder insignificant parts of the item of PPE	If an entity has varying expectations for such parts, approximation techniques may be used to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
5	Commencement of depreciation	Depreciation of an asset begins when it is available for use.
6	Treatment of depreciation charge	The depreciation charge for each period shall be recognised in profit or loss if not included in the carrying amount of another asset.
7	Revision in residual value and the useful life of an asset	❖ The residual value and the useful life of an asset shall be reviewed annually. ❖ The change(s) in depreciation on account of revision, if any, shall be accounted for as a change in an accounting estimate as per Ind AS 8
8	Land and Buildings	❖ Land and buildings are separable assets and are accounted for separately, even when they are acquired together. ❖ Land has an unlimited useful life and is not depreciated. ❖ Buildings have a limited useful life and are depreciated. ❖ An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building. ❖ If the cost of land includes the costs of site dismantlement, removal and restoration, then that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. ❖ In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.
9	Depreciation method	❖ The depreciation method applied shall be reviewed annually. ❖ If there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern otherwise the method is applied consistently from period to period. ❖ Such a change shall be accounted for as a change in an accounting estimate as per Ind AS 8.
10	Impairment	Apply Ind AS 36, *Impairment of Assets.*
11	Compensation for impairment	Compensation from third parties for items of PPE that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

Factors determining the Useful Life of an Asset

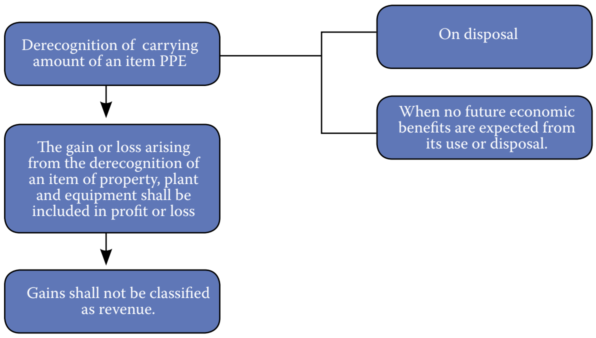


Depreciation Method





Derecognition of PPE



For disclosure requirement, students are advised to refer the study material.

INDIAN ACCOUNTING STANDARD (IND AS) 19: EMPLOYEE BENEFITS

Objective

To prescribe accounting and disclosure for employee benefits

Provides service i.e. works for the entity

Apply Matching Principle!! Match costs to the benefits

Employee

- Entity should recognize liability for Employee Benefits to be paid in the future in respect of services provided by employee.
- As benefit from the service provided by the employee is consumed, the entity should recognize the related employee benefit expense

Employer (Entity)

Benefits (revenue, profits) accrue to the employer

Provides benefits = salary, leave encashment, gratuity, pension etc.

What would happen without Ind AS 19?

Employee Benefit Expenses

Monthly outflows e.g salary, contribution to PF / ESIC etc.

Liability and related expense would be accounted on accrual basis

Matching Principle / Accrual Basis followed!!

Outflows on superannuation / resignation / wage revision e.g. accumulated leave encashment, gratuity etc.

In absence of Ind AS 19

Tendency to account for such expenses on payment basis without accrual of liability over period of service

Matching Principle / Accrual Basis violated!!

Violation of Para 1.17 of the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

Hence Ind AS 19 assumes significant importance since it ensures compliance with the Conceptual Framework

Employee defined (Para 7): Includes full-time, part-time, permanent, casual or temporary basis workforce. Also includes directors and other management personnel

What is covered in Ind AS 19?

Scope of Ind AS 19 (Para 2 and 3)

Applies to

Applied by Employer in accounting for ALL Employee Benefits

Classification of Employee Benefits (Para 5, 8)

Short-term employee benefits	Post-employment benefits	Other long-term employee benefits	Termination Benefits
Within 12 months For current employees Other than termination benefits	• After completion of employment • Other than termination benefits	• Residual category • For current employees	• Result of terminating employment before retirement, either voluntary or otherwise

Excluding

Scope exclusions as per Para 2 & 3

- Employees' Share based payments — Covered under Ind AS 102
- Accounting and Reporting by Employee Benefit Plans

Employee benefits include (Para 6): Benefits provided to employees / dependents / beneficiaries, and may be settled by payments (or provisions of goods or services) made either directly to :
- To the employees, to their spouses, children or other dependents / to legal heirs or nominees or
- To others, such as trusts, insurance companies

Short-term Employee Benefits

Employee benefits due to be settled within twelve months after the end of the period in which the employees render the related service

- Salaries, wages, social security contribution
- Paid annual leave + paid sick leave
- Profit sharing and bonuses
- Non-monetary benefits

Straight forward accounting

- Actuarial assumptions are not required for measuring obligation or the cost
  - **Journal Entry:**
    Expenses (asset) Dr. xxx
    To Liability / Cash xxx
- No possibility of actuarial gain or loss
- Measured on an undiscounted basis at Nominal Value of Cash Flow
- No specific disclosure under Ind AS-19. Other Ind AS like Ind AS-24 may require disclosures
- Change in timing of settlement
  - Entity's expectations of the timing of settlement change temporarily → Reclassification is not needed
  - Entity's expectations of the timing of settlement change is not temporary / characteristics of benefits change → Consider whether definition of short-term benefits is still met

Short-term Employee Benefits

Short-term compensated absences

- Accumulating Paid Absences (Para 15)
  - Can be carried forward for use in future periods if current period's entitlement is not used in full
  - Obligation arises as employees render service that increases their entitlement to future paid absences ← Recognition based on services rendered
    - Vesting → Employees are entitled to a cash payment for unused entitlement on leaving the entity
    - Non-vesting → Employees are not entitled to a cash payment for unused entitlement on leaving the entity → Measurement of obligation is affected if employee leaves before using an accumulated non-vesting entitlement
  - Measuring expected cost of Accumulating Paid Absences: the additional amount an entity expects to pay as a result of the unused entitlement that has accumulated at the Balance Sheet date (Para 16)
- Non-accumulating Paid Absences (Para 18)
  - Cannot be carried forward. They lapse if current period's entitlement is not used in full
  - Obligation arises when absences occur because employee service does not increase the amount of benefit ← Recognition based on absences occurred

Short-term Employee Benefits

Profit-sharing and Bonus Plans

Present obligation

- (Para 20) Plans requiring employees to stay till end of specified period to receive share of profits
  - Employees render services thus increasing amount to be paid if they remain in service
- (Para 21) No legal obligation, but entity has a practice of paying bonus
  - No realistic alternative apart from paying the bonus

Create a constructive obligation on the entity

(Para 23): Recognize as **expense**, and not as a distribution of Net Profit, as the obligation arises from **employee service** and not from a transaction with the entity's owners

Reliable estimate (Para 22)

- Formal plans
  - As per plan formula
- Amounts are determined by the entity
- Past practice gives evidence of the amount

Measurement should reflect the possibility that some employees may leave without receiving share of profits / bonus

(Para 19): **Recognize** expected cost of Profit-sharing Plans and Bonuses when and only when:
- There is a present **legal or constructive** obligation due to past events AND
- **Reliable estimate** of the obligation can be made

Post Employment Benefits

Arrangements whereby entity provides post-employment benefits

Defined Contribution Plans		Defined Benefit Plans
Benefit Plans under which an Entity pays fixed contribution into a separate entity (fund).	Meaning	Benefit plans other than Defined Contribution Plans
Entity's obligation is **limited** to the amount of contributions to the Fund. No need to contribute if fund's assets are insufficient to pay all Employee Benefits.	Entity Obligation	Entity's obligation is to provide the **agreed benefits** to current and former employees
Actuarial Risk + Investment Risk fall on the **Employee**	Risk Bearing	Actuarial Risk + Investment Risk fall on the **Entity**
Straightforward accounting - no actuarial assumptions or discounting of contributions	Accounting	Complex accounting with actuarial assumptions + discounting

Post Employment Benefits

(Para 29) Examples of Cases where entity's obligation is not limited to the amount it agrees to contribute to the fund

When entity has an obligation through:

- a Plan Benefit Formula which is not linked solely to the amount of contributions, and requires entity to contribute if the assets are insufficient to meet the benefits in the Plan Benefit Formula
  e.g. Gratuity is a liability computed as 15 days last-drawn salary for each completed year of service, and has to be discharged regardless of the contribution made to a Plan
- a Guarantee of a specified return on contributions, either directly or indirectly through a plan
- Informal practices giving rise to an obligation e.g. entity increasing benefits in accordance with the inflation rate, even in absence of a legal obligation

Post Employment Benefits

Multi-Employer Plans (Para 8, Paras 32-39)

Meaning → **Pool the assets** contributed by various entities which are not under common control → **Use these assets** to provide benefits to employees of more than one entity → basis → Contribution and benefit levels are determined **without regard to identity** of the entity that employs the employees

Could be Defined Benefit Plan or Defined Contribution Plan (in both cases, other than State Plans)

Classification:
- as Defined Benefit Plan, or
- as Defined Contribution Plan

under the terms of the plan, including any constructive obligation that is beyond formal terms

Accounting Treatment of Multi-Employer Plans
as a Defined Benefit Plan

- Accounting for its proportionate share of the Defined Benefit Obligation, Plan Assets and associated Plan Costs
- Disclosures per Para 135-148
- Recognize liability on the winding-up of, or entity's withdrawal from the Defined Benefit MEP as per Ind AS-37

If adequate information is not available to use Defined Benefit Plan Accounting for a Defined Benefit MEP → Account as if it were a Defined Contribution Plan + Disclosures as per Para 148 + Recognize asset / liability for surplus / deficit

Post Employment Benefits

Multi-Employer Plans (continued)

Accounting Defined Benefit MEP as Defined Contribution Plan

Adequate information not available

such as
- No consistent and reliable basis for allocating Obligation, Plan Assets and Plan Costs to Individual Entities
- No access to information about the plan

Recognize Asset / Liability for Surplus / Deficit

Pursuant to agreement, surplus in the MEP will be distributed to / deficit will be funded by the participants → Recognize asset / liability + corresponding income / expense in Profit or Loss

Additional Disclosure Requirements in respect of MEP Defined Benefit Plans (Para 148)

- **Funding Arrangements,** including method to determine the entity's rate of contributions and any Minimum Funding Requirements
- **Extent to which entity can be liable** to the Plan for Other Entities' Obligations under terms and conditions of the MEP
- **Agreed allocation** of deficit or surplus on winding-up of or on entity's withdrawal from the Plan
- **If DBP is accounted as a DCP,** disclose:
  1. The fact that the Plan is a DBP.
  2. Why sufficient information is unavailable?
  3. Expected contributions to the Plan for the next accounting period.
  4. Information about deficit/surplus in the Plan that may affect future contributions, basis of computing deficit/surplus, entity implications
  5. Indication of level of participation by the entity in the plan compared to other entities

Post Employment Benefits

Group Administration Plans (Para 38)

Meaning → **Pool the assets** contributed by various entities which are not under common control → **Aggregate Single Employer Plans for investment purposes and to lower investment management and administration costs** → basis → Claims of different Employers are segregated for benefit of own employees (identifiable)

Could be Defined Benefit Plan or Defined Contribution Plan (distinct from Multi-Employer Plans)

Classification:
- as Defined Benefit Plan, or
- as Defined Contribution Plan

under the terms of the plan, including any constructive obligation that is beyond formal terms

Easier to Account for

- Information is readily available to treat them as any Single Employer Plan
- Participating entities are not exposed to actuarial risks associated with current and former employees of other entities

Post Employment Benefits

Risk-Sharing Plans (Para 40-42)

Meaning → **Risk-sharing** between various entities under common control → e.g. a parent and its subsidiaries → Not MEPs

Participating in these plans is a Related Party Transaction – disclose information in Separate or Individual Financial Statements per Para 149!!

Information → Participating Entities should **obtain information** about **Plan as a whole** measured in accordance with Ind AS-19 based on assumptions applicable to the Plan as a whole

Accounting for Risk-sharing Plans

- **Contractual arrangement or stated policy exists** for charging Net Defined Benefit Cost for the Plan as a whole, to the individual Group Entities
  - Each Entity should recognize the Net Defined Benefit Cost charged as per the agreement/policy in Separate or Individual Financial Statements
- There is **no agreement or policy** for sharing or charging of cost to the Individual Group Entities
  - Recognize Net Defined Benefit Cost in the Separate Financial Statements of the Group Entity that is legally the **Sponsoring Employer** for the Plan
  - **Other Group Entities** recognize cost equal to **contribution payable** for the period, in their Separate Financial Statements

Post Employment Benefits

Risk-Sharing Plans (continued)

Additional Disclosures (Para 149)

- **Contractual agreement or stated policy** for charging the Net Defined Benefit Cost or the **fact** that no such policy exists
- **Policy** for determining **Contribution** to be paid by the Entity
- Information about Plan as a whole for allocation of Net Defined Benefit Cost
- Information about Plan as a whole for accounting of Contribution Payable

These disclosures can be **cross referenced** to disclosures in another Group Entity's Financial Statements if –

- That Group Entity's Financial Statements separately identify and disclose information about the Plan

and

- That Group Entity's Financial Statements are available to the Users of the Financial Statements on the same terms as the Financial Statements of the Entity, and at the same time as, or earlier than, the Financial Statements of the Entity

Post Employment Benefits

State Plans (Para 43-45)

Meaning → **Established by Legislation** → Cover all entities (or all entities in a particular category) → Operated by National/Local Government or another body not in control or influence of Reporting Entity

Could be Defined Benefit Plan or Defined Contribution Plan

↓

Most cases – entity has only obligation to make contributions upon becoming due. Upon cessation of employing such employees, entity has no obligation to pay benefits earned by such employees in past years

↓

e.g. Provident Fund

Accounting → **Same way as for MEP**

Post Employment Benefits

Insured Benefits (Para 46-49)

= entity pays insurance premiums to fund a Post-Employment Benefit Plan

Case 1

Entity **funds** a post-employment benefit obligation by contributing to an Insurance Policy ← FORM

Entity **retains a legal or constructive obligation** - directly or indirectly through the Insurance Plan - through a mechanism for setting future premiums or through Related Party Relationship with the Insurer ← SUBSTANCE

Not a Defined Contribution arrangement

- Account for Qualifying Insurance Policy as a **Plan Asset**
- Recognize other Insurance Policies as **reimbursement rights**

SUBSTANCE OVER FORM

Case 2

FORM → Insurance policy is in the name of specified Plan participant(s)

Entity's only obligation is to pay the policy premium

SUBSTANCE:

- **Insurer is solely responsible** for paying the benefits. **Entity has no obligations** to pay employee benefits
- Payment of premium is not investment but the **settlement** of the employee benefit obligation

SUBSTANCE OVER FORM

Accounting for Defined Contribution Plans

Straight forward accounting

- Obligation for each period is determined by the amounts to be contributed for that period
- Actuarial assumptions are not required to measure obligation or the expense
- No possibility of actuarial gain or loss
- Obligations are measured on an undiscounted basis

Exception: **not expected to be settled wholly within 12 months after the end of the annual reporting period in which the employees render the related service**

Recognition and Measurement

Date	Particulars	LF	Debit	Credit
xxxxx	Dr. Employee Benefit Expense / Asset		(amount relating to reporting period)	
	Dr. Prepaid Expenses		(amount relating to future periods)	
	Cr. Cash / Bank			(amount paid)
	Cr. Accrued Liability			(amount unpaid)

Disclosure: Disclose amount recognized as an expense for Defined Contribution Plans. Disclose contribution to Defined Contribution Plans for Key Management Personnel under Ind AS-24

Defined Benefit Plans: Issues Involved

An employee joins an entity on 1.4.2016

1.4.2016 (start) | 2022-23 (reporting period) | 31.3.2050 (retire)

PV of Defined Benefit Obligation

Period of Service: 34 years

Current Service Cost

Regular investment in Plan Assets; After 34 years, Investment + Returns on Plan Assets provides cash to pay Retirement Benefits after 34 years

Various Uncertainties involved: high degree of estimation involved

- Will employee continue for 34 years with the company? (Labour Attrition)
- Will employee live for 34 years? (Mortality)
- Will employee be physically fit to work for 34 years? (Disability)
- Discount Rate to be used to discount liabilities to Present Value
- Benefit Levels borne by the company + Future Salary Increase
- Taxes payable on the Income earned by the Plan Assets
- Various other estimates to be made (discussed later)

Accounting for Defined Benefit Plans: The 4-Step Model

Step 1: Determine deficit or (surplus)

1.1 Ultimate Cost of Benefit
1.2 Discount it to determine the present value of defined benefit obligation
1.3 Determine Fair Value of Plan Assets
1.4 Deficit / Surplus = Present Value of Defined Benefit Obligation from 1.2 above (less) FV of Plan Assets from 1.3 above

Step 2: Recognition in the Balance Sheet

The deficit or surplus from Step 1 should be adjusted for any effect of limiting a Net Defined Benefit Asset to the Asset Ceiling (Para 64)

Step 3: Recognition in the Statement of Profit & Loss

The following amounts need to be determined:

- Current Service Cost (Para 70-74, 122A)
- Any Past Service Cost and Gain/Loss on Settlement (Para 99-112)
- Net Interest on the Net Defined Benefit Liability (Asset) (Para 123-126)

Step 4: Determine remeasurements to Other Comprehensive Income

Remeasurement of Net Defined Benefit Liability (Asset) comprises of:

- Actuarial Gains and Losses (Para 128-129)
- Return on Plan Assets excluding Net Interest on the Net Defined Liability (Asset) (Para 130)
- Any change in the effect of Asset Ceiling excluding Net Interest on the Net Defined Benefit Liability (Asset)

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

Multiple Variables
- Final Salaries
- Employee Turnover and Mortality
- Investment Earnings on Plan Assets in case of Funded Plans
- Medical Cost Trends
- Other variables

High degree of uncertainty
- Cannot estimate the amounts as easily as is done, say, in case of depreciation due to uncertainty of each of the multiple variables involved

Long period of time
- Benefits are usually paid after several years, with the transaction horizon extending to a few decades

Thus, the objective = Accounting for these benefits as they accrue + including impact of uncertainties in the amounts accounted

How to achieve the objective?

- A. Apply an actuarial valuation method
- B. Attribute benefits to the periods of service
- C. Make actuarial assumptions

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

A. Actuarial Valuation Method (Para 67-69) → Usage of Projected Unit Credit Method (Para 67) (Also known as Accrued Benefit method pro-rated on service, or, Benefit/Years of Service method)

To determine
- PV of Defined Benefit Obligations
- Related Current Service Cost
- Past Service Cost, where applicable

Application (Para 68)
- (Para 70-74) Each period of service gives rise to additional unit of benefit entitlement
- (Para 75-98) Measures each unit separately to build up the final obligation

The entire post-employment benefit must be discounted even if part of the obligation is due within 12 months of the Balance Sheet date!! (Para 69)

Unit 1	Unit 2	Unit 3	Unit 4	Unit 5	Unit 6	Unit 7	Unit 8	Unit 9	Unit 10

Attribute benefits to the periods of service
- In line with benefit plan formula
- Straight line basis over the period of service giving rise to material benefits

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

B. Attribute benefits to the periods of service (Para 70-74)

In line with benefit plan formula

To determine
- PV of Defined Benefit Obligations
- Related Current Service Cost
- Past Service Cost, where applicable

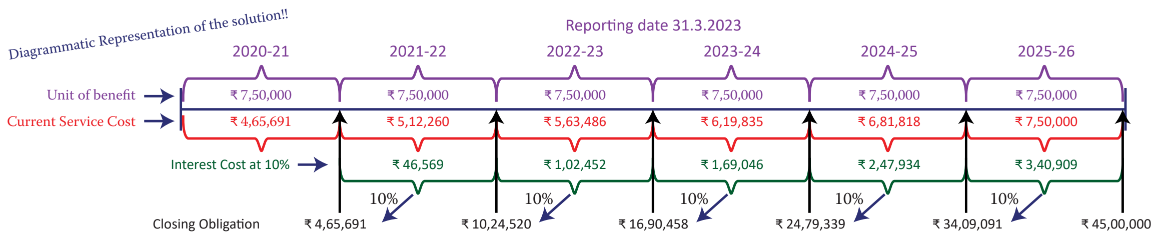
Straight line basis over the period of service giving rise to material benefits

Consider Vesting Requirements under Defined Benefit Plans (Para 72)

Conditional Benefits	Conditional Benefits give rise to obligations under Defined Benefit Plan	Post-employment Benefits payable on occurrence of specified event
• Employment benefits dependent on fulfilment of certain conditions • Such benefits are also said to not be vested until the conditions are fulfilled	• This is because at each successive Balance Sheet date, the amount of service to be rendered by the employee before getting entitled to the benefit is reduced. • In measuring the Defined Benefit Obligation, consider the probability that some employees may not satisfy the vesting condition.	• e.g. Post Employment Medical Benefits payable on occurrence of specified event, even when employee is no longer in service • Obligation is already created when employee renders the service that provides entitlement to the benefit. • The probability that the specified event occurs affects the measurement of the obligation, but does not determine whether the obligation exists.

Concept Illustrated

Illustration:
Acer Ltd. hired a professional in April 2020 for 6 years of service which would terminate in March 2026. Apart from regular salary and annual bonus, Acer Ltd. will pay a lumpsum remuneration of ₹ 45 lakhs to her upon termination of employment. Discount rate used for actuarial valuations is 10% per year.
Show how the obligation builds up over the employee's service. Ignore actuarial assumptions other than presented discount rate.



STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

C. Actuarial Assumptions (Para 75-98)

An entity's best estimates of variables that will determine the ultimate cost of providing post-employment benefits (Para 76)

Demographic Assumptions ← Para 76 → Financial Assumptions

Demographic Assumptions

Relates to future characteristics of current and former employees (and their dependents) who are eligible for benefits. They deal with matters like:
- Mortality rates – during and after employment
- Rates of employee turnover, disability and early retirement
- Proportion of plan members with dependents eligible for benefits
- Proportion of plan members who will select each from payment option available under plan terms
- Claim rates under medical plans

Financial Assumptions

Should be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled. They deal with matters like:
- Discount rates to be in nominal terms, unless real terms are more reliable (e.g. hyper inflation)
- Future salary and benefit levels
- Future medical costs including claim handling costs
- Taxes payable by the plan on contributions relating to service before the reporting date, or on benefits resulting from that service

Can actuarial assumptions change over time? Obviously yes!!
- Experience adjustments (Para 128)
- Effects of changes in actuarial assumptions

} Recognize in Other Comprehensive Income, without reclassification!! [Para 120(c) read with Para 127(a)]

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

C. Actuarial Assumptions (relating to Salary Increases and Changes in Benefits)

- **Defined Benefit Obligation to be measured on a Basis that reflects**
  - Benefits as per Plan Terms
  - Estimated Salary Increases
  - Limit on Employer's Share of Cost of Future Benefits
  - Contribution from Employees or Third Parties
  - Effect of Changes in State Benefits
- **Future Benefit Changes**
  - Formal → Actuarial assumptions should reflect such changes e.g. past history of increasing benefits as per inflation rate, entity is obliged to use surplus in the Plan for benefits of plan participants etc.
  - Informal → Such changes should not be reflected – such changes result in Past Service Cost and Current Service Cost, as applicable
- **Limit on Employer Share**
  - Limit is imposed on contributions
  - → Ultimate cost of benefit considers such limit
  - → Effect of a limit on contributions is determined over shorter of (i) Life of Entity, and (ii) Estimated life of the Plan
- **Other Variables**
  - Reflect changes in variables such as State Medical Care, level of State Retirement Benefits etc. based on past history and reliable evidence

---

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

C. Actuarial Assumptions

- **Mortality**
  - Determined by reference to **best estimates** of mortality of Plan members both during and after employment
  - → Considers expected changes in mortality e.g. by modifying Standard Mortality Tables with estimates of mortality improvements
- **Medical Costs**
  - Considers estimated changes in costs of medical services due to inflation as well as specific changes in medical costs

---

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

Past Service Cost

Change in the PV of the Defined Benefit Obligation for Employee Service in prior periods (Para 8 & 102)

Past Service cost may be positive (increase in PV of DBO) or negative (decrease in PV of DBO)

If Plan Amendment, Curtailment and Settlement happen together, no need to distinguish between Past Service Costs related to them!!

Arises due to

- **Plan Amendment (Para 104)**
  - The introduction or withdrawal of, or changes to, a Defined Benefit Plan
  - New/change in benefit
  - Past service cost | Current
  - Treatment → Recognize past service cost as an expense
  - Timing → Earlier of
    - When plan amendment or curtailment occurs
    - When entity recognizes related restructuring costs or termination benefits
- **Curtailment (Para 105)**
  - A significant reduction by the entity in the number of employees covered by a plan
  - **Exclusions from Past Service Cost (Para 108)**
    - **Items which are actuarial assumptions**
      - → Difference in actual and previously assumed salary increases on obligation to pay benefits for service in prior years
      - Change in estimates of discretionary pension increases where entity has a constructive obligation to grant such increases
    - Actuarial gains / Return from Plan Assets are already recognized in the financial statements
      - Such gains / returns lead to estimates of benefit improvements
      - Entity is obliged to use any surplus in the plan for Plan participants
      - **Such increase in obligation is an actuarial loss**
    - **Estimated costs are recognized as Current Service Cost as the service was rendered**
      - → Increase in already vested benefits (benefits not conditional on Future Employment) when in absence of new/improved benefits, employees complete vesting requirements

STEP 1: Determine Deficit or (Surplus)

1.1 Computing the Ultimate Cost of Benefit to the Entity

Gains and Losses on Settlement

Settlement —transaction→ eliminates all further legal or constructive obligations for part or all of the benefits provided under Defined Benefit Plan → payment of benefits to, or on behalf of, employees as per the plan and included in actuarial assumptions

Old Plan —replaced by→ New Plan with benefits same in substance → Not a settlement

Plan terminated → Obligation settled + Plan ceases to exist = Plan Amendment + Curtailment + Settlement

When any of the above occurs

↓

Recognize and measure any past service cost or Gain/Loss on settlement as per Para 99-101 and 102-112 without considering the effect of Asset Ceiling

↓

After the Plan Amendment, Curtailment or Settlement, the entity shall determine effect of Asset Ceiling and recognize any change in that effect as per Para 57(d)

Gain or Loss on Settlement = PV of Defined Benefit Obligations being settled, as determined on date of settlement − Settlement Price, including any Plan Assets transferred and direct payments made by Entity towards settlement

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STEP 1: Determine Deficit or (Surplus)

1.2 Discount Ultimate Cost of Benefit to determine PV

The entire post-employment benefit must be discounted even if part of the obligation is due within 12 months of the Balance Sheet date!! (Para 69)

Unit 1 | Unit 2 | Unit 3 | Unit 4 | Unit 5 | Unit 6 | Unit 7 | Unit 8 | Unit 9 | Unit 10

Attribute benefits to the periods of service

Which discount rate to use for determining the PV under Defined Benefit Plant? (Para 83-86)

General Rule → Market yields at the end of the reporting period on Government bonds → Currency and term of these bonds must be consistent with that of the Post-employment benefit obligations

Special Rule → For currencies other than INR, for which there is a deep market in High Quality Corporate Bonds → Currency and term of these bonds must be consistent with that of the Post-employment benefit obligations

Nature of Discount Rate

- Reflects
  - Time value of money
  - Estimated timing of benefit payments
- Does not reflect
  - The actual or investment risk
  - The entity-specific credit risk borne by the entity's creditors
  - The risk that future experience may differ from actuarial assumptions

Extrapolating current market rates along the yield curve is allowed in case government bond with matching tenure of post employment benefits are not available

Single weighted-average discount rate may be used that reflects the estimated timing, amount of benefit payments and currency in which benefits are paid

STEP 1: Determine Deficit or (Surplus)

1.3 Determine Fair Value of Plan Assets

Defined Benefit Plan

Fair Value - exit price concept -same definition as per Ind AS 113!

Non-funded / without asset backing

- Provision for Defined Benefit Obligation is made as discussed (non-cash provisions)
- Cash is not set aside
- Risk of cash not available at the time of payment of the Defined Benefit Obligations

2 modes of investments

- Create a separate entity (fund)
  - Investments are held by this entity
  - These investments are to be used solely for payment or funding of Employee Benefits
- Take a Qualifying insurance policy
  - Issued by unrelated party - Ind AS 24
  - Proceeds of the policy are to be used solely for payment or funding of Employee Benefits under Defined Benefit Plans

Not available even for payment to creditors of reporting entity in event of bankruptcy

Funded / with asset backing

- Provision for Defined Benefit Obligation is made as discussed (non-cash provisions)
- Cash is set aside and invested - preferably in risk-free investments like government securities / deposits
- Intention is to make sure cash is available when liability is due

These investments are called plan assets

STEP 1: Determine Deficit or (Surplus)

1.4 Deficit / Surplus

Deficit / Surplus

Present Value of Defined Benefit Obligation (Less) Fair Value of Plan Assets

Present Value of Defined Benefit Obligation

- From Step 1.1 and Step 1.2
- It is the PV, without deducting any Plan Assets, of expected future payments required to settle the obligation resulting from Employee Service in the current and prior periods

(Less)

Fair Value of Plan Assets

- From Step 1.3
- Assets held by Long-term Employee Benefit Fund + Qualifying Insurance Policies

Deficit / (Surplus) = Net Defined Benefit Liability / (Asset)

STEP 1: Determine Deficit or (Surplus)

Other Important Points

- Para 57 - Entity has **more than one** Defined Benefit Plan: Separately apply these procedures for each material plan
- Para 59 – Encouraged, but not mandated to use Qualified Actuary
- Para 59 - Valuation to be done **before** the end of reporting period. Results **updated** up to the end of the Reporting Period
- Para 60 - Estimates, averages, simplified computations may provide reliable approximation in some cases
- Account for legal and **constructive obligation.** It is assumed that benefits continue to be provided under DBP over the remaining working lives of the entity

STEP 2: Recognition in the Balance Sheet

If PV of Defined Benefit Obligation (less) Fair Value of Plan Assets is

Schedule III, Division II, Part I to the Companies Act, 2013

- **Positive**
  - Called as Deficit
  - It becomes "Net Defined Benefit Liability"
  - Entire deficit is recognized in Balance Sheet as
  - 'Provisions' under Non-Current Liabilities
- **Negative**
  - Called as Surplus
  - It becomes "Net Defined Benefit Asset"
  - Para 64: Surplus is recognized in Balance Sheet at least of
    - Surplus as computed above
    - Asset Ceiling determined using discount rate specified in Para 83
  - 'Investments' under Non-Current Assets
  - Asset Ceiling = PV of any Economic Benefits available in the form of refunds from the Plan or Reductions in future contributions to the Plan

Net Defined Benefit Asset under Plan A + Net Defined Benefit Liability under Plan B →

Set-off permitted if and only if:
- Legally enforceable right available to settle obligations of Plan B using surplus of Plan A
- Intends to settle on net basis or realize surplus in Plan A and settle obligation under Plan B simultaneously

Similar offsetting criteria in Ind AS 32!!

STEP 3: Recognition in the Profit & Loss

Recognition principles of Defined Benefit Cost (Para 120)

- **Service Cost**
  - Current Service Cost
  - Past Service Cost
    - Plan amendment
    - Curtailment
  - Gain or Loss on Settlement
  - → Profit or Loss
- **Net interest on the Net Defined Benefit Liability / (Asset)**
  - Change during the period in the Net Defined Benefit Liability / (Asset) that arises from passage of time
  - Interest on Defined Benefit Obligation (Less) Interest earned on Plan Assets
    - Interest on Defined Benefit Obligation: Similar to unwinding of discount in Ind AS 16
    - Interest earned on Plan Assets: Calculated at discount rate determined as per Para 83
  - → Profit or Loss
- **Remeasurements of the Net Defined Benefit Liability / (Asset)**
  - Actuarial Gains and Losses
  - Return on Plan Assets
  - Any change in the effect of Asset Ceiling
  - (Return on Plan Assets and Any change in the effect of Asset Ceiling) excluding amounts included in Net Interest on the Net Defined Benefit Liability (Asset)
  - → Other Comprehensive Income without reclassification to P/L

STEP 3: Recognition in the Profit & Loss

Para 123 - Net interest on the Net Defined Benefit Liability / (Asset)

= Net Defined Benefit Liability / (Asset) x Discount Rate (as per Para 83)

- **Para 123A - General Rule**
  - Net Interest = Opening balance of Net Defined Benefit Liability / (Asset) x Discount Rate determined at the start of the reporting period
  - Consider changes in Net Defined Benefit Liability / (Asset) during the period due to contribution or benefit payments for the purpose of computing Net Interest
- **Para 123A – On Remeasurement as per Para 99**
  - Up to date of remeasurement → Calculate based on opening balances
  - Remainder of the annual reporting period → Calculate based on remeasured balance of Net Defined Benefit Liability / (Asset) and the Discount rate used for remeasurement

Net Interest on the Net Defined Benefit Liability / (Asset) = Interest Cost on Defined Benefit Obligation + Interest Income on Plan Assets + Interest on the effect of Asset Ceiling

Apply above principles individually to the above items

STEP 3: Recognition in the Profit & Loss

Remeasurement of Net Defined Benefit Liability / (Asset)

Para 122A

Determine Current Service Cost using actuarial assumptions **at the start of the annual reporting period**

Net Defined Benefit Liability / (Asset) is remeasured as per Para 99

Determine Current Service Cost for the **remainder of the annual reporting period** using the actuarial assumptions used to remeasure Net Defined Liability / (Asset) as per Para 99(b)

Para 99

Applicable when determining **past service cost**, or a **gain/loss on settlement**

Remeasure Net Defined Benefit Liability / (Asset) using current Fair Value of Plan Assets and current actuarial assumptions, including current Market Interest Rates and other Current Market Price

reflecting

benefits offered under the Plan & the Plan Assets before the Plan Amendment, Curtailment or Settlement

and

benefits offered under the Plan & the Plan Assets after the Plan Amendment, Curtailment or Settlement

Return on Plan Assets

Interest, Dividends and other Income derived from Plan Assets + Realised and Unrealised Gains or Losses on the Plan Assets

(Less)

a. Any Costs of managing Plan
b. Assets, and
Any Tax payable by the Plan itself, other than Tax included in the Actuarial Assumptions used to measure the PV of the Defined Benefit Obligation

Other Administration Costs are not deducted from the Return on Plan Assets

STEP 4: Remeasurements to OCI

Following items are remeasured in OCI without reclassification

Actuarial Gains and Losses

Arise due to, for example:

a. Unexpected fluctuation of employee turnover, early retirement or mortality, increase in salaries, benefits or medical costs **(Past)**
b. Changes to assumptions concerning benefit payment options
c. Change in estimates of future employee turnover, early retirement or mortality, or of increases in salaries, benefits or medical costs **(Future)**
d. Changes in discount rates

Return on Plan Assets

Total Return on Plan Assets – Net Interest on Net Defined Benefit Liability / (Asset)

Change in the effect of Asset Ceiling

Change in effect of Asset Ceiling – Net Interest on Net Defined Benefit Liability / (Asset)

Defined Benefit Plans - Right to Reimbursement

Recognition as Assets

Only when it is **virtually certain** that another party will reimburse some or all of expenditure required to settle Defined Benefit Obligation

Recognize right to reimbursement as a **separate asset**, measured at **Fair Value**

Disaggregate and recognize changes in fair value same as Change in Fair Value of Plan Assets

Components of Defined Benefit Cost as per Para 120 can be **netted off** against Changes in Carrying Amount of Right to Reimbursement

Insurance Policies

Nature	Qualifying Insurance Policy	Not a Qualifying Insurance Policy
Type of Asset	Recognized as a Plan Asset	It is NOT a Plan Asset
Recognition	It is NOT considered as a Reimbursement Right (Para 116 is not applicable)	It is considered as a Reimbursement Right (Para 116 is applicable)
Treatment	Reduced from PV of Defined Benefit Obligation	Treated as a separate asset, carried at Fair Value

Defined Benefit Plans – Specific Disclosures

Characteristics and Risks (Para 139)	Explanation of Amounts in Financial Statements (Para 140-141)	Disaggregation of Fair Value Items (Para 142)	Assets owned / occupied / used etc (Para 143)	Actuarial Assumptions (Para 144)

• Characteristics
  • Nature of Benefit provided by the Plan
  • Regulatory Framework in which the Plan operates
  • Description of any **Other Entity's Responsibilities** for governance of the Plan
• Risks to which plan exposes the entity
• Description of any Plan Amendments, Curtailments and Settlements
	• Reconciliation from Opening Balance to Closing Balance for each of the following:
	  • Net Defined Benefit Liability / (Asset), showing separate reconciliations for Plan Assets, PV of the Defined Benefit Obligation, Effect of the Asset Ceiling
	  • Any Reimbursement Rights
	• Components of Reconciliation:
	  • Current Service Cost
	  • Interest Income or Expense
	  • Remeasurements of Net Defined Benefit Liability / (Asset) with maximum possible breakup
	• Past Service Cost and Gains and Losses arising on Settlements
	• Effects of Changes in Foreign Exchange Rates
	• Contributions to the Plans by Employers and participants
	• Payments from the Plan, showing Settlement payments separately
	• Effects of Business Combinations and Disposals
		• Disaggregate Fair Value of Plan Assets into classes distinguishing nature and risks e.g.:
		  • Cash and Cash Equivalents
		  • Equity Instruments (segregated by Industry Type, Geography, Company size etc.)
		  • Debt Instruments (segregated by Industry Type, Geography, Company size etc.)
		  • Real Estate (segregated by Geography etc.)
		  • Derivatives (segregated by type of underlying risk in the Contract)
		  • Investment Funds (segregated by type of Fund)
		  • Asset-backed Securities
		  • Structured Debt
			• Disclose Fair Value of:
			  • Entity's **own transferable Financial Instruments** held as
			  • Plan Assets, and
			  Plan Assets that are **Property** occupied by, or **other Assets,** used by, the Entity
				• Disclose significant actuarial assumptions made to determine PV of Defined Benefit Obligation
				• Such disclosure should be in absolute terms
				• In respect of grouping of Plans, disclosure shall be in the form of Weighted Averages or relatively narrow ranges

Defined Benefit Plans – Specific Disclosures

Para 145	Para 146	Para 147
• A **Sensitivity Analysis** for each significant actuarial assumption (as disclosed under Para 144) as of the end of the reporting period, showing how Defined Benefit Obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at the date • **Methods and Assumptions** used in preparing sensitivity analysis required above and limitations of those methods • **Changes** from the previous period in the **methods and assumptions** used in preparing Sensitivity Analysis and reasons for such changes.	• Description of any Asset-Liability Matching Strategies used by the Plan or the Entity, including the use of Annuities and other techniques, such as Longevity Swaps, to manage risks	• Description of any Funding Arrangements and Funding Policy that affect future contributions • The expected contributions to the Plan for the next accounting period • Information about the Maturity Profile of the Defined Benefit Obligation. This will include Weighted Average Duration of the Defined Benefit Obligation and may include other information about the distribution of the timing of Benefit Payments, such as Maturity Analysis of the Benefit Payments • These Disclosures provide an indication of the effect of the Defined Benefit Plan on the entity's future cash flows.

Other long-term Employee Benefits

all employee benefits other than short-term benefits, post-employment benefits and termination benefits

- Long-term paid absences
- Jubilee or other long-service benefits
- Long-term disability
- Profit sharing and bonuses
- Deferred Remuneration

Long-term disability:
- If benefit depends on length of service, obligation arises when service is rendered
- If benefit is same regardless of years of service, obligation arises when event occurs that causes long-term disability

Measurement of obligations reflects probability that payment is required and length of time for which payment is expected to be made

No specific disclosures. Disclosure under other Ind AS should be made

Recognition and Measurement

- Deficit or Surplus → Same as applicable for Post-Employment Benefits as per Para 56-59 and 113-115
- Reimbursement Right → Same as applicable for Post-Employment Benefits as per Para 116-119
- Recognition in P&L / Asset → Service Cost + Net Interest on Net Defined Benefit Liability / (Asset) + Remeasurements of the Net Defined Benefit Liability / (Asset)

Termination Benefits

event giving rise to obligation is termination instead of employee service

employee benefits are payable as a result of either

- Employee's decision to accept an offer of benefits in exchange for the termination of employment
- Entity's decision to terminate employment before the normal retirement date

When to recognize? (Para 165)

earlier of

- Date when entity can no longer withdraw the benefits offered
  - (Para 166) Employee's decision
    - Employee accepts the offer (earlier of) Restriction to withdraw the offer takes effect
    - No specific disclosures. Disclosure under other Ind AS should be made
  - (Para 167) Entity's decision
    - Plan of termination:
      - Significant changes to the plan unlikely
      - No. of employees, location, function, time is identified
      - Termination benefits established in the plan
- Date when entity recognizes costs for restructuring which involves payment of termination benefits

Measurement (Para 169-170)
Depends on nature of employee benefit

- Enhancement to Post-Employment Benefits → As post-employment benefits
- Expected to be settled within 12 months → As short-term employee benefits
- Not wholly settled within 12 months → As other long-term employee benefits

Appendix A to Ind AS-19: Application Guidance

Accounting for Contributions from Employees or Third Parties

- Set out in the formal terms of the Plan (or arise from a constructive obligation that goes beyond these terms)
  - Linked to Service
    - Dependent on the number of years in service → Reduce service cost by being attributed to periods of service [Para 93(a)]
      - Changes in contributions
        - **Not** set out in formal terms of the Plan, and **not arising** from constructive obligation → Current and Past Service Cost
        - Set out in formal terms of the Plan, or arising from constructive obligation → Actuarial Gains and Losses
    - Independent of the number of years in service → Reduce service cost in the period in which the related service is rendered [Para 93(b)]; (option) Reduce service cost by being attributed to periods of service [Para 93(a)]
  - Not linked to Service → Affect remeasurements (Para 93)
- Discretionary → Reduce Service Cost upon payment to the Plan (Para 92)

Dotted line indicates option to choose treatment

Appendix B to Ind AS-19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Background about Minimum Funding Requirements

Meaning

A statutory or legislative requirement specifying minimum amount or level of contributions to fund a Post-Employment or Other Long-term Defined Benefit Plan over a period

Why would minimum funding be specified?

Improves security of the Post-Employment Benefit promise made to Members of an Employee Benefit Plan;

Effects

- Limits ability of Entity to reduce future contributions
- **Limit on measurement of Defined Benefit Asset** may cause Minimum Funding Requirements to become **onerous** resulting in liability if required contributions will not be available to Entity once they have been paid.

Scope: Issues addressed in this Appendix

- **When refunds or reduction in future contributions should be regarded as available in accordance with definition of asset ceiling**
- How a minimum funding requirement might **affect the availability** of reductions in future contributions
- **When** a minimum funding requirement might **give rise to liability**

. . . .

Appendix B to Ind AS-19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Principles relating to availability of a refund or reduction in future contributions

Availability of a refund or reduction in future contributions shall be determined in accordance with:
- **Terms and conditions** of the plan, and
- Any **statutory** requirements in the jurisdiction of the plan

Principles

- **Ability to Realize**
- **Immediate Realization not a criteria**

Realizability is possible at **some point** during the life of the Plan or when the Plan Liabilities are settled (Para 8 of Appendix B)

- **Intention of use is not relevant** (Para 9 of Appendix B)
- **Refund / Reductions / Both** (Para 9 of Appendix B)

Determine **maximum** economic benefit available; not to be recognized from combination of refunds and reductions in future contributions based on mutually exclusive assumptions

Disclose key sources of estimation uncertainty that have a significant risk of causing material adjustment to the Carrying Amount of Net Asset or Liability recognized in the Balance Sheet as per Ind AS-1 (Para 10 of Appendix B)

Appendix B to Ind AS-19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Concepts of Economic Benefit available as a refund or reduction in future contributions

Economic Benefit available as a refund

- Unconditional right to refund without any dependence on future uncertain events *
- Measurement
  - = Surplus at the end of the reporting period i.e.

FV of Plan Assets	xxx
Less: PV of DBO	xxx
Surplus	xxx

    Reduce associated costs, if any
- Effect of wind-up Costs
  - Deduct costs to the Plan of settling Plan Liabilities
- No Time Value Adjustments (Para 15 of Appendix B)
  - If the amount of a refund is determined as the full amount or a proportion of the surplus, rather than a fixed amount, even if the refund is realisable only at a future date.

* If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset. (Para 12 of Appendix B)

Economic Benefit available as a contribution reduction

- If there is no Minimum Funding Requirements for contributions related to future service
  - Economic benefit available as contribution reduction is
  - Future Service Cost to the Entity for each period over the shorter of (a) expected life of the Plan, and (b) expected life of the Entity
- Future Service Cost to the Entity **excludes** amounts borne by Employees
- Future Service Cost determined based on:
  - assumptions consistent with those used to determine the Defined Benefit Obligation, and
  - Situation existing at the end of the reporting period as determined by Ind AS-19

Appendix B to Ind AS-19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Effect of a Minimum Funding Requirement on the economic benefit available as a reduction in Future Contributions

Entity shall analyse Minimum Funding Requirement at a given date into:

Contributions required to **cover any existing shortfall** for past service received, on the minimum funding basis

→ These contributions do **NOT** affect Contributions for Future Service

→ If obligation exists under minimum funding requirement to pay contributions to cover such an existing shortfall, determine whether contributions payable will be available as Refund or Reduction in Future Contributions after they are paid into the plan

→ To the extent contribution payable will not be available after they are paid into the Plan – recognize a **Liability** when the obligation arises

→ Liability shall reduce / increase Net Defined Benefit Asset / Liability so that no Gain or Loss is expected to result from applying Para 64

AND

Contributions required to **cover Future Service**

Economic Benefit available as a reduction in future contributions = Amount that reduces future minimum funding requirement contributions for future service because entity made a prepayment + Estimated Future Service Cost in each period less estimated minimum funding requirement contributions that would be required for future service in those periods if were no prepayment

Manner of Estimation

a. Estimate future minimum funding requirement contributions for future service considering the effect of existing surplus determined using minimum funding basis excluding prepayment.
b. Use assumptions consistent with the minimum funding basis, and for factors not specified by that basis, assumptions consistent with those used to determine Defined Benefit Obligation and with situation that exists at the end of the reporting period as determined by Ind AS-19.
c. Estimate shall include any changes expected as a result of the entity paying minimum contributions when due.
d. Estimate shall not include effect of expected changes in terms and conditions of minimum funding basis not substantively enacted at end of reporting period.

Appendix B to Ind AS-19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Effect of a Minimum Funding Requirement giving rise to a liability

- If an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.
- To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the net defined benefit asset or increase the net defined benefit liability so that no gain or loss is expected to result from applying paragraph 64 of Ind AS 19 when the contributions are paid.

INDIAN ACCOUNTING STANDARD (IND AS) 20: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Overview of Ind AS 20

- Government Grants
  - Recognition of Government Grants
    - Reasonable assurance for receipt and compliance
    - Non-monetary government grants
  - Presentation of Government Grants
    - Related to asset
      - Presented in balance sheet by setting up grant as deferred income
      - Alternatively, deduct the grant in arriving at the carrying amount of the asset
    - Related to income
      - Presented as part of profit or loss, either separately or under 'other income'
      - Alternatively, deducted in reporting related expense
  - Repayment of Government Grants
- Government Assistance
- Disclosure

Scope

- Applicable
  - In accounting for
    - Government grants
    - Other forms of government assistance
  - In disclosure of
    - Government grants
    - Other forms of government assistance
- Not applicable
  - (a) To special problems arising in accounting for government grants reflecting the effects of changing prices or supplementary information of a similar nature.
  - (b) To government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability.
    Examples: Income tax holidays, investment tax credits, accelerated depreciation.
  - (c) To government participation in the ownership of the entity.
  - (d) To government grants covered by Ind AS 41, Agriculture.

Recognition of government grant – Only when there is reasonable assurance that:
- Entity will comply with the conditions of the grant
- \+
- Grant will be received

Note:

S. No.	Type	Treatment
1.	Grant whether received in **cash** or as a **reduction of a liability** to the government	Same manner of accounting is followed for all grants
2.	Forgivable loan from government	Treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan
3.	Government loan at a below-market rate of interest	• Treat the benefit as a government grant • Recognise and measure in accordance with Ind AS 109. **Benefit** = Initial carrying value of the loan determined as per Ind AS 109 - the proceeds received
4.	Grants received as part of a package of financial or fiscal aids with conditions attached	• Identify the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. • It may be appropriate to allocate part of a grant on one basis and part on another.
5.	Grant receivable as compensation for expenses or losses already incurred or for immediate financial support with no future related costs	• Recognise in profit or loss of the period in which it becomes **receivable** • Provide disclosure to ensure that its effect is clearly understood.
6.	Government Assistance – No Specific relation to Operating Activities	• Government assistance to entities meets the definition of government grants in Ind AS 20 • Do not credit directly to shareholders' interests. Recognise in profit or loss on a systematic basis.
7.	Government assistance- with no reasonable value	Exclude from the definition of government grants
8.	Transactions with government	Exclude from the definition of government grants

Basic principle for recognition of government grant- Government grants should be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

Non-monetary government grants
- Either: Assess the fair value of the non-monetary asset and account for both grant and asset at that fair value
- Or: Record both asset and grant at a nominal amount

Presentation of government grant
- Related to assets
  - **Either** present in balance sheet by setting up grant as deferred income
  - **Or** deduct the grant in arriving at the carrying amount of the asset
- Related to income
  - Present as part of profit or loss, either separately or under 'other income'
  - Alternatively, deduct in reporting related expense

Repayment of government grant
- Related to income: First applied towards any unapplied deferred credit and then charged to profit and loss account immediately
- Related to assets
  - Either:
    - * Recognise by increasing the carrying amount of the asset
    - * The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be **recognised immediately in profit or loss**
    - * Check the possible impairment of the new carrying amount of the asset
  - Or: Reduce the deferred income balance by the amount payable

INDIAN ACCOUNTING STANDARD (IND AS) 21: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Objective

- To prescribe guidance on
  - Inclusion in the financial statements of the entity
    - Foreign Currency Transactions
    - Foreign Operations
  - Translation of financial statements into presentation currency

Scope

- Scope
  - Applied in
    - Accounting for transactions and balances in foreign currencies, except for derivative transactions and balances covered by Ind AS 109
      - Note:
        1. Foreign currency derivatives not covered by Ind AS 109 are within the scope of Ind AS 21
        2. Ind AS 21 applies for translation of amounts relating to derivatives from functional currency to presentation currency
    - Translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation, or the equity method
    - Translating an entity's results and financial position into a presentation currency
  - Not applied to
    - Hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation
      Note: Ind AS 109 is applied for hedge accounting
    - Presentation of cash flows from transactions in a foreign currency or to translation of cash flows of a foreign operation in the statement of cash flows
    - Long-term foreign currency monetary items for which an entity has opted for the exemption as per Ind AS 101.
      Note: Such an entity may continue to apply the accounting policy as opted under the previous GAAP for such long-term foreign currency monetary items

Key Definitions

1.	**Functional currency**	It is the currency of the primary economic environment in which the entity operates Note: The primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates
2.	**Foreign operation**	It is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity
3.	**Presentation currency**	• It is the currency in which the financial statements are presented. • The presentation currency may be different from the entity's functional currency
4.	**Spot exchange rate**	It is the exchange rate for immediate delivery
5.	**Closing rate**	It is the spot exchange rate at the end of the reporting period
6.	**Exchange difference**	It is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates
7.	**Monetary items**	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency
8.	**Net Investment in Foreign Operation**	It is the amount of the reporting entity's interest in the net assets of that operation

Functional Currency

- The functional currency is normally the currency of the country in which the entity is located. It might, however, be a different currency
- An entity measures its assets, liabilities, equity, income and expenses in its functional currency
- All transactions in currencies other than the functional currency are foreign currency transactions
- For determination of functional currency of an entity, emphasis should be on the currency that determines the pricing of the undertaken transactions, rather than focusing on the currency in which those transactions are denominated
- Once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions

Determination of Functional Currency

Determination of Functional Currency

Of reporting entity (1 and 2)

Of foreign operations of reporting entity (1, 2 and 3)

1. Primary indicators

(a) the currency:
   i. that mainly influences sales prices for its goods and services i.e. currency in which sales prices are denominated and settled; and
   ii. of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services
(b) the currency that mainly influences labour, material, and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled

2. Secondary indicators

(a) the currency in which funds from financing activities are generated; and
(b) the currency in which receipts from operating activities are usually retained

3. Additional indicators

Determining integral operation

Note: In this case, the functional currency will be same to that of the reporting entity

(a) When the activities of foreign operations are carried out as an extension of the reporting entity
(b) When the transactions with the reporting entity are a high proportion of the foreign operation's activities
(c) When cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it
(d) When cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity

Determining non-integral operation

Note: In this case the functional currency may differ to that of the reporting entity

(a) When the activities of foreign operations are carried out with a significant degree of autonomy
(b) When the transactions with the reporting entity are a low proportion of the foreign operation's activities
(c) When cash flows from the activities of the foreign operations does not directly affect the cash flows of the reporting entity and are not readily available for remittance to it
(d) When cash flows from the activities of the foreign operation are not sufficient to service existing and normally expected debt obligation

Note:
When the above indicators are mixed and the functional currency is not obvious, the management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions.
Accordingly, management has to give priority to the primary indicators before considering the other indicators, which provide additional supporting evidence to determine an entity's functional currency.

Monetary & Non-monetary items

Monetary items

The essential feature of it is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency

Examples:
- pensions and other employee benefits to be paid in cash
- provisions that are to be settled in cash
- lease liabilities
- cash dividends that are recognised as a liability
- a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item

Non-monetary items

The essential feature of it is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency

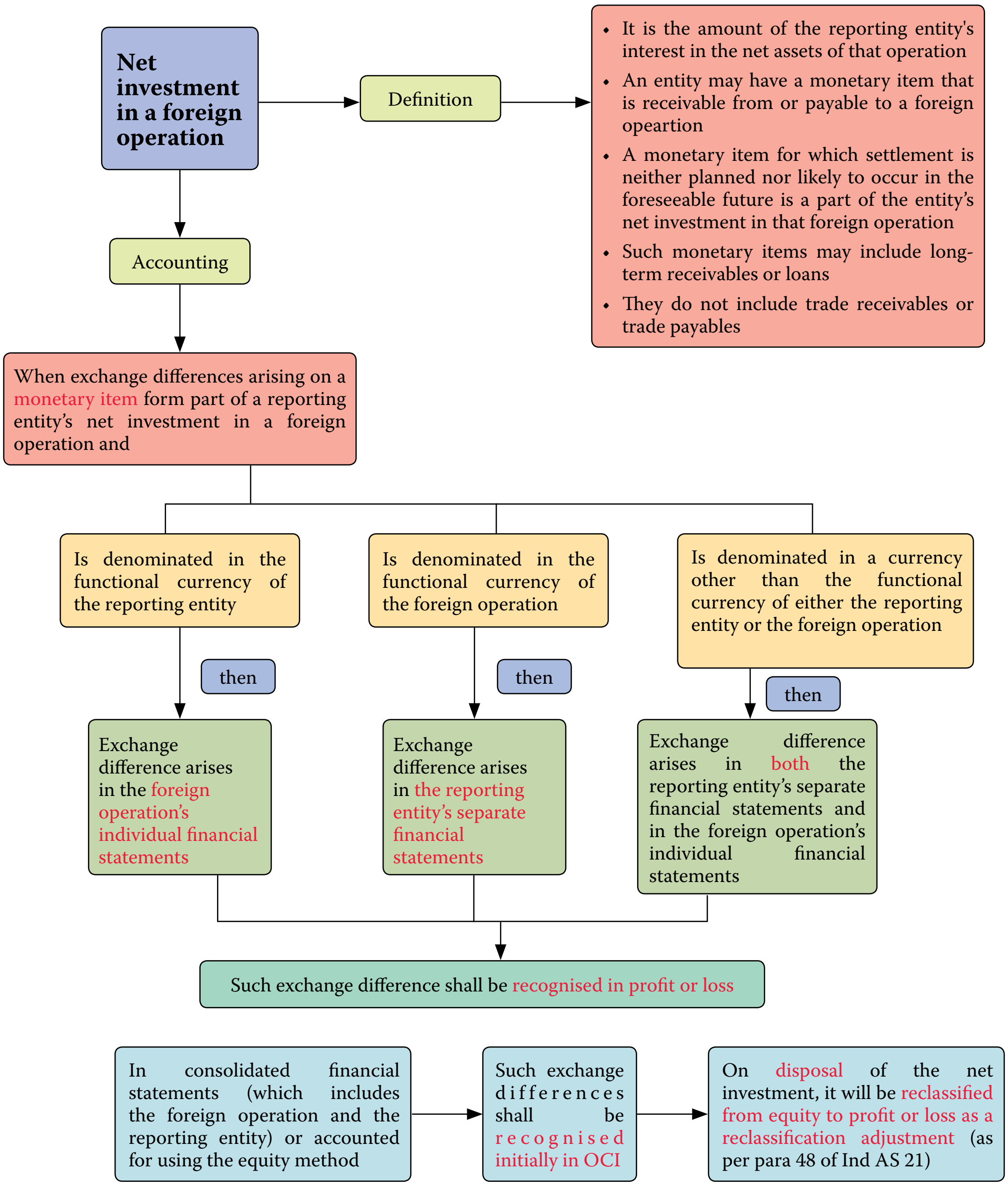
Examples:
- Amounts prepaid for goods and services
- goodwill
- intangible assets
- inventories
- property, plant and equipment
- right-of-use assets
- provisions that are to be settled by the delivery of a non-monetary asset

Reporting of Foreign Currency Transactions

- **Definition** → It is a transaction that is denominated or requires settlement in a foreign currency
- **Inclusion** → Transactions arising when an entity:
  - (a) buys or sells goods or services whose price is denominated in a foreign currency;
  - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
  - (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency
- **Initial recognition** → Recorded on initial recognition in the functional currency
  - Foreign currency amount ✖ Spot exchange rate between the functional currency and the foreign currency at the date of the transaction
  - It is the date on which the transaction first qualifies for recognition. In case of advance receipts or payments, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from advance consideration before the entity recognises the related asset, expense or income
- **Subsequent reporting at the end of each reporting period**
  - Monetary items → translated using the closing rate → Such exchange difference is recognised in profit or loss on that reporting date
  - Non-monetary items
    - measured in terms of historical cost in a foreign currency → translated using the exchange rate at the date of the transaction
    - measured at fair value/NRV/recoverable amount in a foreign currency → translated using the exchange rates at the end of the reporting period
    - The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa
    - If gain or loss on non-monetary item is recognised in OCI, then exchange component of that gain or loss is recognised in OCI
    - If gain or loss on non-monetary item is recognised in P&L, then exchange component of that gain or loss is recognised in P&L

Note:
- For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period.
- If exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Net investment in a foreign operation



Change in Functional Currency

When the change is possible?

Functional currency once determined can be changed only if there is a change to the underlying transactions, events and conditions which determined the earlier functional currency of the entity

Example:
A change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency

How the change is to be accounted?

Apply the translation procedures applicable to the new functional currency prospectively from the date of the change

Translate all items into the new functional currency using the exchange rate at the date of the change

- Exchange differences arising from the translation of a foreign operation previously recognised in OCI, are not reclassified from equity to profit or loss until the disposal of the operation
- Translated amounts of non-monetary items are treated as their historical cost

Translation to the presentation currency

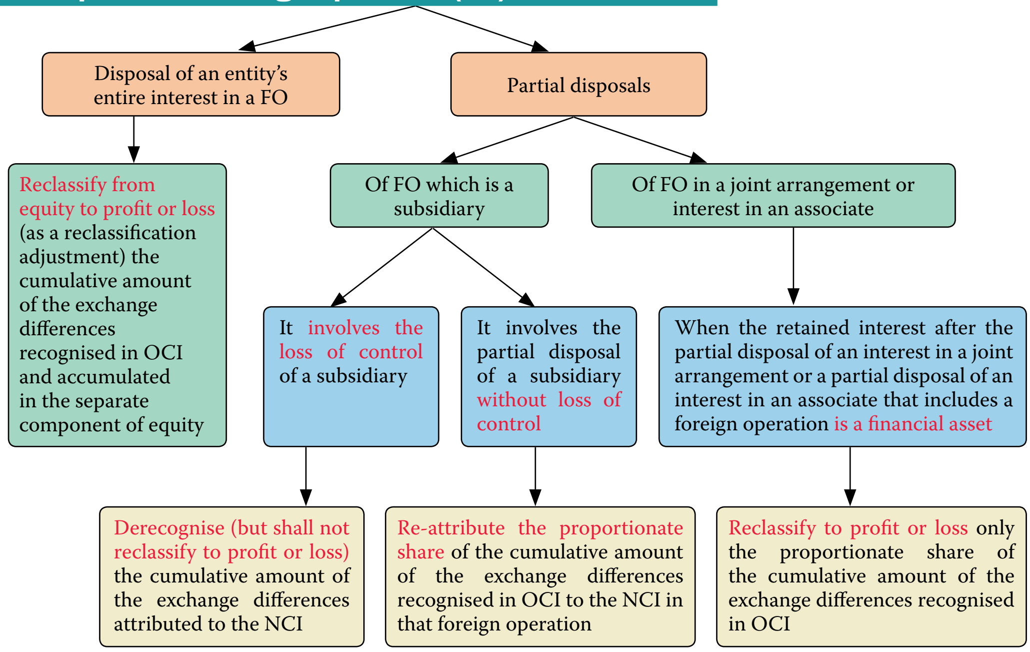
1.	Why to translate?	• An entity may present its financial statements in any currency (or currencies). • If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency
2.	When entity's functional currency is not the currency of a hyperinflationary economy	The results and financial position are translated into a different presentation currency using the following procedures: (see table below)
3.	When entity's functional currency is the currency of a hyperinflationary economy	The results and financial position are translated into a different presentation currency using the following procedures: All amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) are translated at the closing rate at the date of the most recent balance sheet Comparative amounts shall not be adjusted for subsequent changes in the price level or subsequent changes in exchange rates Note: The entity shall restate its financial statements in accordance with Ind AS 29 before applying the translation method, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy.
4.	Translation of a foreign operation (FO) in CFS	• The incorporation of the results and financial position of a FO with those of the reporting entity follows normal consolidation procedures • 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 • Such an exchange difference is recognised either in profit or loss or OCI. (Refer chart on net investment in FO) • Any goodwill arising on the acquisition of a FO and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that FO shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate

Procedures for row 2:

S.N.	Item	Translation procedures
1.	Assets and liabilities (including comparatives)	Translated at the closing rate at the date of that balance sheet
2.	Income and expenses (including comparatives)	Translated at exchange rates at the dates of the transactions
3.	All resulting exchange differences	Recognised in OCI

Note:
Tax effects of all exchange differences
Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects as per Ind AS 12, Income Taxes.

Disposal or partial disposal of a foreign operation (FO)



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

Disclosure

S. No.	Scenarios	Disclose
1.	In case of foreign currency transaction	• The amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at FVTPL as per Ind AS 109 • Net exchange differences recognised in OCI and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period
2.	In case of change in the functional currency of either the reporting entity or a significant foreign operation	• The fact that there is a change in the functional currency • The reason for the change in functional currency; and • The date of change in functional currency
3.	When the presentation currency is different from the functional currency	• The fact that the presentation currency is different from the functional currency; • Disclosure of the functional currency • The reason for using a different presentation currency • Description that the financial statements is complying with all Ind AS
		In case financial statements are not in compliance with all Ind AS, then (a) clearly identify the information as supplementary information to distinguish it from the information that complies with Ind AS; (b) disclose the currency in which the supplementary information is displayed; and (c) disclose the entity's functional currency and the method of translation used to determine the supplementary information

INDIAN ACCOUNTING STANDARD (IND AS) 23: BORROWING COSTS

Borrowing costs

Are interest and other costs incurred for borrowing of funds → Form part of the cost of that asset → If are directly attributable to the
- Acquisition of a qualifying asset
- Construction of a qualifying asset
- Production of a qualifying asset

Other borrowing costs → Recognised as an expense → In the period in which it is incurred

Borrowing Costs includes

Interest expense — Calculated using the effective interest method as described in Ind AS 109

Interest in respect of lease liabilities — Recognised in accordance with Ind AS 116

Exchange differences arising from foreign currency borrowings — Recognised to the extent that they are regarded as an adjustment to interest costs

Note:
With regard to exchange difference required to be treated as borrowing costs:
- The adjustment amount should be equivalent to the exchange loss not exceeding the difference between the cost of borrowing in functional currency vis-a-vis the cost of borrowing in a foreign currency.
- The realised or unrealised gain to the extent of the unrealised exchange loss previously recognised as an adjustment should also be recognised as an adjustment to interest.

Qualifying asset
- that necessarily takes a substantial period of time to get ready for its intended use or sale

Includes
- inventories
- manufacturing plants
- power generation facilities
- intangible assets
- investment properties
- bearer plants

Excludes
- Assets ready for their intended use or sale, when acquired.
- Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time

Borrowing costs eligible for capitalisation = Actual borrowing costs incurred on that borrowing during the period − Investment income on the temporary investment of those borrowings, if any.

Calculation of Borrowing Cost

Borrowing cost on funds borrowed for specific use → Expenditure incurred on QA** x Interest rate on such specific borrowings → Total Borrowing Cost

Borrowing cost on funds borrowed for general use but applied on qualifying asset
- **Step 1 : Calculate Capitalisation Rate (CR)***
- **Step 2 : Calculation of Borrowing cost to be capitalised**
  Expenditure incurred on QA x Capitalisation rate

→ Total Borrowing Cost

*CR = $\dfrac{\text{Weighted average borrowing costs on all outstanding borrowings of the entity (refer Note 3 below for exception)}}{\text{Total outstanding borrowings of the entity during the period (excluding specific borrowings)}}$

**QA = Qualifying Asset

Note:
1. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.
2. In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.
3. All outstanding borrowings of the entity during the period (as stated in the formula) shall exclude borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete

- **Commencement of capitalisation**
  - Starts from the date when the entity first meets **all** of the following conditions:
    - It incurs expenditures for the asset
    - It incurs borrowing costs
    - It undertakes activities that are necessary to prepare the asset for its intended use or sale.

Note:

Expenditures on a qualifying asset include only those expenditures that have resulted in

- payments of cash,
- transfers of other assets or
- the assumption of interest-bearing liabilities.

Expenditures are reduced by

- any progress payments received and
- grants received in connection with the asset

POINTS TO REMEMBER:

	Particular	Detail
1	Suspension of capitalisation	• It is done when active development of a qualifying asset is suspended. • Suspension is not done when an entity carries out substantial technical and administrative work. • An entity does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.
2	Cessation of capitalisation	• When substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. • An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue.
3	When construction of qualifying asset is completed in parts	• If each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

INDIAN ACCOUNTING STANDARD (IND AS) 24: RELATED PARTY DISCLOSURES

Overview of Ind AS 24

- Objective, Scope and Purpose of related party disclosures
- Identification of
  - Related Party (RP)
  - Related party transactions
  - Party that are not related
- Disclosures
  - Irrespective of RP transactions
  - Only when there is RP transactions
  - Exemption from disclosures to Government related entitites

Objective of Ind AS 24

- To ensure that the financial statements contain necessary disclosures with respect to
- To draw attention to the possibility that financial position and profit or loss may have been affected by
  - Related party relationships
  - Related party transactions
  - Outstanding balances with related parties
  - Commitments with related parties

Scope of Ind AS 24

The Standard has to be applied in:

- Identifying related party relationships
- Identifying related party transactions
- Identifying outstanding balances between an entity and its related parties
- Identifying commitments between an entity and its related parties
- Identifying the circumstances in which disclosures of above items are to be made
- Determining the disclosures to be made about the above items
- Disclosures
  - Disclosures are to be made in
    - Individual financial statements
    - Consolidated and separate financial statements
      - Intra-group related party transactions and outstanding balances are eliminated in preparation of CFS
        - **Exception:** If above items (occurred between investment entity and subsidiaries) are measured at FVTPL, then not eliminated
  - Disclosures **not** required when
    - It would conflict with the reporting entity's duties of confidentiality
    - Entity is prohibited by the statute, regulator or similar competent authority to disclose certain information

Purpose of Related Party Disclosures

It is probable that related party relationship may have an effect on the profit or loss and financial position of an entity. The effect gets manifested through:

(a) Transactions that are entered between related parties may not be entered with unrelated parties

Example : An entity may sell goods to its parent at cost. It may not sell goods at cost to an unrelated party.

(b) Transactions with unrelated parties get influenced because of related party relationships

Example : S Limited, a subsidiary of H Limited, in steel manufacturing used to purchase billets from UR Limited. H Limited acquires 100% stake in FS Limited who also manufactures billets. FS Limited is now a fellow subsidiary of S Limited. H Limited instructs S Limited not to purchase billets from UR Limited but from FS Limited.

Determining related party of reporting entity

- Person(s)
  - who has control or joint control over the reporting entity
  - who has significant influence over the reporting entity
  - who is a member of the key management personnel of
    - the reporting entity or
    - a parent of the reporting entity
- Another Entity(ies)
  - It they are members of the same group
  - One entity is an associate or joint venture of the other entity or of a member of a group of which the other entity is a member
  - Both entities are joint ventures of the same third party
  - One entity is a joint venture of a third entity and the other entity is an associate of the third entity
  - The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity
  - If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity
  - The entity is controlled or jointly controlled by a person if they are members of the same group
  - A related person has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)
  - The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity

Important definitions:

Control	Power over the investee when it is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns
Joint Control	Contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control
Significant influence	Power to participate in the financial and operating policy decisions of the investee, but is not control of those policies
Key management personnel (KMP)	Persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity
Close members of the family of a person	Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity including: (a) that person's children, spouse or domestic partner, brother, sister, father and mother; (b) children of that person's spouse or domestic partner; and (c) dependants of that person or that person's spouse or domestic partner.

Unrelated Parties

Two entities
- If a director or other member of KMP is common between them

Two Joint venturers
- If they simply share joint control of JV

- Providers of finance,
- Trade unions,
- Public utilities,
- Departments and agencies of government

- Customer,
- Supplier,
- Franchisor,
- Distributor or
- General agent doing significant business

By virtue of their normal dealing with entity, although they may:

Affect the freedom of action of an entity

Participate in its decision-making process

Disclosure

Mandatory disclosure of relationship, where control exists between a parent and its subsidiaries

Disclosures are must **even when there are no related party transactions**

Disclosures:
- Name of its parent and, if different, the ultimate controlling party
- Nature of related party relationship

Disclosure requirements here are in addition to Ind AS 27 and Ind AS 112

Disclosure required only when there are related party transactions

Compensation to key management personnel
- In total
- And for each category of:

Short-term employee benefits

Post-employment benefits

Other long-term benefits

Termination benefits

Share-based payment

Related party transactions during the year

(a) The nature of the related party relationship
(b) Information about:
- Related party transactions
- outstanding balances including commitments

At minimum, disclosures include:
(a) Amount of transactions
(b) Amount of outstanding balances, including commitments, and:
- Their terms and conditions (including secured/unsecured and nature of consideration paid in settlement)
- Guarantees given or received
(c) Provisions for doubtful debts
(d) Expense recognized during the period in respect of bad or doubtful debts

Disclosures shall be made separately for each of the following categories:
(a) The parent
(b) Entities with joint control of, or significant influence over, the entity
(c) Subsidiaries
(d) Associates
(e) Joint ventures in which the entity is a joint venturer
(f) Key management personnel of the entity or its parent
(g) Other related parties

Provision of key management personnel services that are provided by separate management

Following are examples of transcations that are disclosed if they are with a related party

a	Purchases or sales of goods (finished or unfinished)
b	Purchases or sales of property and other assets
c	Rendering or receiving of services
d	Leases
e	Transfers of research and development
f	Transfers under licence agreements
g	Transfers under finance arrangements (including loans and equity contributions in cash or in kind);
h	Provision of guarantees or collateral
i	Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (as per Ind AS 37) (recognised and unrecognised)
j	Settlement of liabilities on behalf of the entity or by the entity on behalf of that related party
k	Management contracts including for deputation of employees

Note:

- A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.
- If an entity obtains key management personnel services from another entity (the 'management entity'), the entity is not required to apply the requirements to the compensation paid or payable by the management entity to the management entity's employees or directors.
- Related party transactions of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary.
- Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.
- Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties.

Disclosure requirements for Government-related entities

Reporting entity is exempt from the disclosure requirements in relation to
(i) Related party transactions
(ii) Outstanding balances and
(iii) Commitments with

- A government that has control, joint control or significant influence over the reporting entity
- Another entity (that is a related party) because **same government has control,** joint control or significant influence over **both the reporting entity and the other entity**

If a reporting entity applies the exemption, it shall disclose the following about
(i) The transactions and
(ii) Related outstanding balances

- The name of Government
- Nature of the government's relationship with the entity (Whether it has control, joint control or significant influence over the entity)
- Sufficient detail of related party transactions:
  - For each individually significant transaction:
    -Its Nature -Its Amount
  - For other transactions that are collectively significant
    -A qualitative or quantitative indication of their extent

Reporting entity shall consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction such as whether it is:

(a) Significant in terms of size
(b) Carried out on non-market terms
(c) Outside normal day-to-day business operations
(d) Disclosed to regulatory or supervisory authorities
(e) Reported to senior management
(f) Subject to shareholder approval

Note:

- Government refers to government, government agencies and similar bodies whether local, national or international.
- A government-related entity is an entity that is controlled, jointly controlled or significantly influenced by a government.

INDIAN ACCOUNTING STANDARD (IND AS) 27: SEPARATE FINANCIAL STATEMENTS

OBJECTIVE

When an entity prepares *separate financial statements*, to prescribe

Accounting

Disclosures requirements

For investment in

Subsidiaries

Joint Ventures

Associates

Scope of Ind AS 27

Applied in accounting for investments in subsidiaries, joint ventures and associates, *when*

An entity elects

The entity is required by law

to present separate financial statements that comply with Ind AS

Note:
Ind AS 27 does not mandate which entities should produce separate financial statements rather it mandates application of Ind AS 27 when an entity prepares separate financial statements that comply with Ind AS.

Separate Financial Statements

prepared and presented by an investor who has

control of a subsidiary i.e. parent | OR | joint control of an investee | OR | significant influence over an investee

in which the investments are accounted for:

At Cost | OR | **At fair** value in accordance with Ind AS 109

Note: Equity method is not allowed under Ind AS 27

When can an entity prepare and present Separate Financial Statements?

Separate Financial Statements are generally presented *in addition* to Consolidated Financial Statements (CFS)

- CFS are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
- Financial statements in which the equity method is applied are considered as CFS

An entity may present Separate Financial Statement as its only financial statement, if it is:

Exempt from Consolidation OR Exempt from applying Equity Method Accounting as per Ind AS 28 OR An investment entity which applies Consolidation exemption as per Ind AS 110 for all of its subsidiaries

Important Notes:
- Financial statements in which the equity method is applied are not separate financial statements.
- Financial statements of an entity that does not have a subsidiary, associate or joint venturer's interest in a joint venture are not separate financial statements

Example: Following chart represents the group structure of Parent Ltd. and table below it explains the above requirements related to separate financial statements

Parent Ltd. (listed entity)
100% → Subsidiary A — 100% → Entity P
100% → Subsidiary B* — 100% → Entity Q
30% → Associate C — 100% → Entity R
80% → Investment entity D — 100% → Entity S#

* Subsidiary B has availed the exemption from preparation of consolidated financial statements as per paragraph 4(a) of Ind AS 110
\# Entity S does not provide services that relate to the Investment entity D's investment activities
All the above entities are incorporated under the Companies Act, 2013.

Name of the entity	Whether entity prepares consolidated financial statements?	Status for separate financial statements
Parent Ltd.	Yes	Will be prepared as it is required by the Companies Act, 2013
Subsidiary A	Yes	Will be prepared as it is required by the Companies Act, 2013
Subsidiary B	No	Will be prepared as it is required by the Companies Act, 2013 (in this case, entity will present separate financial statements as its only financial statements)
Associate C	Yes	Will be prepared as it is required by the Companies Act, 2013
Investment entity D	No	Will be prepared as it is required by the Companies Act, 2013. Entity will present separate financial statements as its only financial statements
Entity P	No	These entities will prepare their financial statements as required by the Companies Act 2013. However, they will not be termed as separate financial statements since these entities do not have any subsidiary, associate or joint venture.
Entity Q	No	
Entity R	No	
Entity S	No	

Preparation of Separate Financial Statements (for accounting of investments in subsidiaries, associates, and joint ventures)

- **Separate financial statements shall be prepared in accordance with all applicable Ind AS, except** Investments in subsidiaries, joint ventures or, associates shall be accounted for
  - Either: at cost
  - Or: at fair value as per Ind AS 109

- Apply the same accounting for each category of investments → In other words
  - Same accounting for all subsidiaries
  - Same accounting for all associates
  - Same accounting for all joint ventures

- Investments in subsidiaries, joint ventures, and associates classified as held for sale or for distribution to owners (or included in a disposal group that is classified as held for sale or for distribution to owners), they are accounted for:
  - As per Ind AS 105 (Lower of: Carrying amount or fair value less costs to sell), if previously accounted for at cost
  - In accordance with Ind AS 109, if previously accounted for as per Ind AS 109.

- If an entity elects, as per Ind AS 28, to measure its investments in associates or joint ventures at fair value through profit or loss (FVTPL) as per Ind AS 109, it shall also account for those investments in the same way, i.e., as per Ind AS 109 - FVTPL in its separate financial statements.

- If a parent is required, as per Ind AS 110, to measure its investment in a subsidiary at fair value through profit or loss (FVTPL) as per Ind AS 109, it shall also account for its investment in a subsidiary in the same way, i.e., as per Ind AS 109 - FVTPL in its separate financial statements.

Investments held by investment entities and similar entities

Investment entity shall account for the investments in *subsidiaries* **at fair value through profit or loss (FVTPL)** in the separate financial statements too.

When an entity has elected to measure investments in associates and joint ventures (held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds) *at fair value through profit or loss* (FVTPL) as per Ind AS 109, then it shall also account for those investments in the same way, i.e., at fair value through profit or loss (FVTPL) in its separate financial statements.

Accounting when a parent ceases to be an investment entity

↓

Then entity shall account for an investment in a subsidiary in either of the following ways:

- EITHER: Account at cost. The fair value of the subsidiary at the date of the change of status shall be used as the deemed cost at that date
- OR: Continue to account for in accordance with Ind AS 109

Accounting when an entity becomes an investment entity

The entity shall account for an investment in a subsidiary at **fair value through profit or loss (FVTPL)** as per Ind AS 109

Compute the difference between the previous carrying amount of investment in subsidiary and Fair value of investment in subsidiary at the date of the change of status of the investor

- Previous carrying amount of investment in subsidiary *Less* Fair value of investment in subsidiary at the date of the change of status of the investor = **Loss** recognised in profit or loss
- Fair value of investment in subsidiary at the date of the change of status *Less* Previous carrying amount of investment in subsidiary = **Gain** recognised in profit or loss

The cumulative amount of any fair value adjustment previously recognized in OCI in respect of those subsidiaries shall be **reclassified** to profit or loss

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Accounting Treatment of Dividend Income

- Dividend income (from subsidiary, Joint Venture, or associate) is recognized in profit or loss in its Separate Financial Statement
- Dividend income is recognised when entity's right to receive the dividend is established

Dividend is accounted for in Profit and Loss Account irrespective of whether the investment is accounted for
- at Cost; or
- at fair value

Determination of cost of investment of a new entity on reorganisation of the group / (original entity) structure by the parent entity / (original entity)

If reorganisation satisfies **all** the following conditions:

- the new parent **obtains control** of the original parent by **issuing equity instruments** in exchange for existing equity instruments of the original parent;
- the **assets and liabilities** of the new group and the original group are the **same immediately before and after** the reorganisation; and
- **the owners** of the original parent before the reorganisation **have the same absolute and relative interests in the net assets** of the original group and the new group immediately before and after the reorganisation

If the new parent **elects** to account for its investment in the original parent **at cost** then the new parent shall measure cost at the **carrying amount of its share of the equity items** shown in the separate financial statements of the original parent at the date of the reorganisation.

Note:
The requirements of measuring cost of investment by a new parent as discussed above will equally apply in case where an entity that is not a parent (i.e. it does not have a subsidiary) establishes a new parent between itself and its owners.

Significant Disclosure

- An entity is required to apply all applicable Ind AS when providing disclosures in its separate financial statements.
- When a parent qualifies and elects not to prepare consolidated financial statements [Ind AS 110.4(a)] and instead prepares separate financial statements, it is required to disclose:

Dislcosures in separate financial statements		
The fact that: • the financial statements are separate financial statements; • the exemption from consolidation has been used; • the name and principal place of business (and country of incorporation, if different) of the entity whose consolidated financial statements that comply with Ind AS have been produced for public use; and • the address where those consolidated financial statements are obtainable.	A list of significant investments in subsidiaries, joint ventures and associates, including: • the name of those investees. • the principal place of business (and country of incorporation, if different) of those investees. • its proportion of the ownership interest (and its proportion of the voting rights, if different) held in those investees.	A description of the method used to account for those investments

- When an investment entity that is a parent prepares separate financial statements as its only financial statements, it shall disclose that fact.
- When a Parent (other than a parent using the consolidation exemption) or an Investor with (a) joint control of, or (b) significant influence over, an investee prepares separate financial statements, it is required to disclose:

That the financial statements are separate financial statements

A list of significant investments in subsidiaries, joint ventures and associates, including:

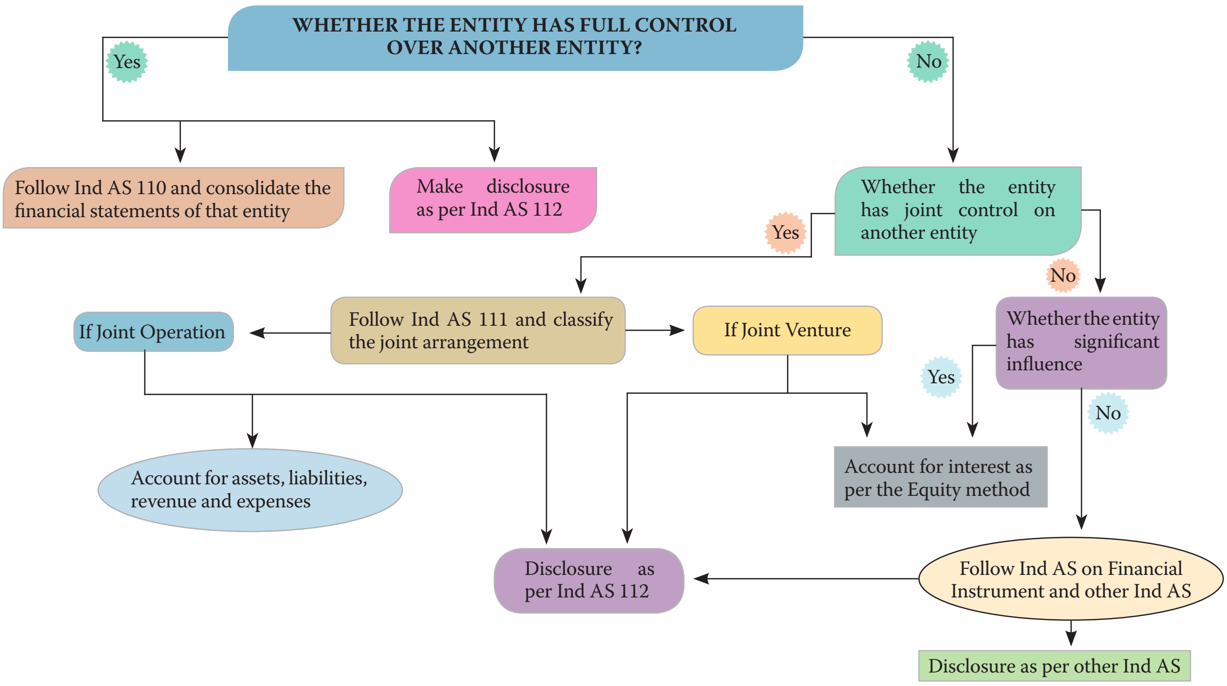
- ☐ The name of those investees
- ☐ The investees principal place of business and country of incorporation
- ☐ The proportion of the ownership interest and its proportion of the voting rights held in those investees
- ☐ A description of the method used to account for the investments

The financial statements prepared in accordance with Ind AS 110, Ind AS 111, or Ind AS 28 to which they relate

Significant Change in Ind AS 27 vis-à-vis IAS 27

- IAS 27 allows the entities to use **equity method** to account for investment in subsidiaries, joint ventures, and associates in their Separate Financial Statements (SFS).
- Since equity method is not a measurement basis like cost and fair value but is a manner of consolidation and would lead to inconsistent accounting conceptually, Ind AS 27 does not allow the entities to use **equity method** to account for investment in subsidiaries, joint ventures, and associates in their SFS.

ACCOUNTING FOR INVESTMENT IN OTHER ENTITY– AN OVERVIEW



INDIAN ACCOUNTING STANDARD (IND AS) 28: INVESTMENT IN ASSOCIATES AND JOINT VENTURES

OBJECTIVE

- To prescribe the accounting for investments in **associates**
- To set out the requirements for the application of **equity method**
  - Equity method is applied in accounting for investments in **associates** and **joint ventures**

SCOPE

Ind AS 28 is applied by **all** entities that are:

- **Investors** with **joint control** of an investee i.e., **joint venture** of the investor
- **Investors** with **significant influence** over an investee i.e., **associate** of the investor

KEY DEFINITIONS	
Consolidated Financial Statements (CFS)	Financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity
Joint arrangement	It is an arrangement in which two or more parties have joint control
Joint control	It is the contractually agreed sharing of control of an arrangement, which exists only **when decisions** about the relevant activities **require the unanimous consent** of the parties sharing control
Joint venture	It is a joint arrangement whereby the parties that have joint control of the arrangement have **rights to the net assets** of the arrangement

WHAT IS AN ASSOCIATE?

An entity over which the investor has

Significant Influence

- It does not imply control or join control of policies of the investee

It is the power to **participate**

- In the **financial policy decisions** of the investee
- In the **operating policy decisions** of the investee

ASSESSMENT OF SIGNIFICANT INFLUENCE

Main Indicator

- Entity holds directly or indirectly (e.g., through subsidiaries)
- **20% or more (up to 50%) of voting power of the investee (a rebuttable presumption)**

Note: This rebuttable presumption is not always decisive

Other Indicators

The power to participate in **the financial and operating policy decisions** of the investee, but not to control them

- Representation on board of directors or equivalent governing body of investee
- *Participation* in policy-making process (including participation in dividend or other distribution decisions)
- Material transactions between investor and investee
- Interchange of managerial personnel
- Provision of essential technical information

OTHER POINTS

- The assessment of the investor having significant influence over the investee requires application of judgement
- Potential voting rights **currently exercisable** (like share warrants, share call options, convertible debts, convertible equity instruments etc.) are considered for computing the voting power percentage
- Examine all facts and circumstances for the computation of potential voting rights, **except**
  (a) management intention and
  (b) financial ability to exercise or convert those potential rights.
- An entity's interest in an associate or a joint venture is determined solely on the basis of **existing ownership interests and does not reflect the possible exercise or conversion of potential** voting rights / other derivative instruments.
  However, when an entity has, in substance, an existing ownership which **currently** gives it access to the returns associated with an ownership interest, then the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights / other derivative instruments.

LOSS OF SIGNIFICANT INFLUENCE

An investor loses significant influence over an investee when it loses the power to participate in investee's

- Financial policy decisions
- Operating policy decisions

The loss of significant influence can occur with or without a change in absolute or relative ownership levels

Example

- When an associate becomes subject to the control of a government, court, administrator, or regulator
- Loss of significant influence may occur because of a contractual arrangement

EQUITY METHOD

An investor is required to account its investments in associates and joint ventures as per:
EQUITY METHOD

- Equity method is not applied for accounting of investments in associates and joint ventures in the separate financial statements of the investor
- In separate financial statements, an investor shall apply the guidance given in Ind AS 27

EQUITY METHOD

1. Investment is initially recognized at cost
2. Subsequently at the reporting date, the carrying amount of investment is adjusted : to recognize the investor's share of post-acquisition profit or loss of the investee
3.
   - Adjustments to the carrying amount of the investment may also arise from changes in the investee's OCI (e.g., due to revaluation of PPE or foreign exchange translation differences)
   - The investor's share of those changes is recognized in OCI of the investor
4. Goodwill remains included in the carrying amount of the investment
5. Distributions received from an investee (e.g., dividend) reduces the carrying amount of investment
6. Equity Method Accounting is applied from the date significant influence arises to the date significant influence ceases
7. The investment, or any retained interest in the investment (not classified as held for sale) shall be classified as a **non-current asset**

Determination of carrying amount of investment under Equity Method

Initial Cost	XXXX
Add/Less: Investor's share of profits / losses	XXXX
Less: Distributions received from the Investee (Dividend is recognised when the right to receive dividend is established)	XXXX
Add/Less: Investor's share arising from changes in investee's OCI	XXXX
Carrying Amount of the Investment	**XXXX**

EQUITY METHOD ACCOUNTING:

			DEBIT	CREDIT
1.	**On Initial Recognition:** Investment in associate To Cash/Bank (Being Investment in associate or, joint venture recognized at cost)	Dr.	XXXX	XXXX
2.	**Goodwill or Capital Reserve:** *Calculate the difference (if any) between:* - Cost (of investment in associate); and - Investor's share of net FV of identifiable assets and liabilities in the investee Then, If **Cost (of investment in associate) > Investor's share of net assets: GOODWILL** If **Cost (of investment in associate) < Investor's share of net assets: CAPITAL RESERVE** **Note for Goodwill:** • Goodwill is **NOT** recognized separately; instead, such goodwill is included in the cost of investment • Goodwill is **NEITHER** amortized **NOR** tested for impairment separately. (The entire investment in associate is tested for impairment as a single asset.) **Note for Capital Reserve:** • Capital Reserve is recognized directly in Equity			
3. **A**	**Subsequently, after initial recognition:** The carrying amount of the investment is increased or decreased by the investor's share of investee's net profit after the acquisition date Investment in associate (in Balance Sheet) To Share in Profit from associate (in Profit/Loss) *In case*, the associate makes loss, then the entry would be: Share in Loss from associate (in Profit/Loss) To Investment in associate (in Balance Sheet)	Dr. Dr.	XXXX XXXX	XXXX XXXX
B	The carrying amount of the investment is increased or decreased by the investor's share of investee's change in OCI Investment in associate (in Balance Sheet) To Share in Changes in OCI from associate (in OCI)	Dr.	XXXX	XXXX
4.	**Distributions received from investee:** Cash/Bank (in Balance Sheet) To Investment in associate (in Balance Sheet)	Dr.	XXXX	XXXX
5.	**Losses exceeding the carrying amount of investment:** • When an associate or joint venture make losses and these losses exceed the carrying amount of the investment, investor cannot bring down the carrying amount of the investment below zero • Instead, the investor stops bringing-in further losses			
6.	**Presentation in the financial statement under equity method accounting:** • A one-line entry in the Profit and Loss Account as: ◆ Investor's share of the associate or joint venture's profit or loss • A separate line item for OCI attributable to the investor's share in investor's OCI • A one-line item in the balance sheet as: ◆ Investment in associate or joint venture			

EXEMPTIONS FROM APPLYING THE EQUITY METHOD

Either

The entity is a parent and is exempt from preparing CFS, by virtue of scope exception under Para 4(a) of Ind AS 110

Or

When **ALL** the following conditions are met:

- Entity is a subsidiary (wholly owned or partially owned) of another entity

  and

  its owners have been informed about and do not object to the entity not applying the Equity Method
- Entity's debt or equity instruments are not traded in a public market (Domestic, Foreign stock exchange or Over the Counter market)
- Entity is not in the process of filing its financial statements for issuing any class of publicly traded securities
- The ultimate (or any intermediate) parent of the investor entity produces CFS (under Ind AS) in which investment in subsidiaries are measured at FVTPL

Investment in an associate or a joint venture is held directly or indirectly by **venture capital and similar entities** like mutual funds, unit trust, etc.

↓

An entity may elect to measure investment in those associates and JVs at **FVTPL as per Ind AS 109 separately** for each investment **at initial recognition**

NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE

If an 'investment' in the investee (associate or joint venture) meets the definition of a **'Non-current asset Held-for-Sale'**

↓

Measure the investment as per Ind AS 105

↓

Lower of:

- Carrying amount
- Fair value less costs to sell (FVLCS)

After disposal, whether 'Retained interest in Investment (if any)' continues to be associate or joint venture?

- Yes → Apply 'Equity method'
- No → Apply 'Ind AS 109'

If an 'investment' in the associate or joint venture, previously classified as held for sale, **no longer meets the criteria** to be so classified

↓

Apply equity method *retrospectively*, as from the date of its classification as held for sale

CHANGE IN OWNERSHIP INTEREST

Whether it results in change in relationship?

Yes

If the investment becomes **subsidiary**

Then the investor
- **Discontinue Equity Method** Accounting and
- Account for the investment **as per Ind AS 103 and Ind AS 110**

If the retained interest in the former associate or joint venture is a **financial asset**

Then
- **Discontinue equity method**
- **Reclassify the gain or loss to profit or loss** on the disposal of the related assets or liabilities.
- **Measure the retained interest at fair value** as per Ind AS 109

Also recognize in Profit or Loss, the difference of:

Fair value of retained interest + Proceeds from disposal of associate or joint venture − Carrying amount of the investment (at the date the equity method was discontinued)

If an investment in **an associate becomes** an investment in a **joint venture**

If an investment in a **joint venture** becomes an investment in **an associate**

- **Continue applying the equity method**
- **Do not measure the retained interest**

No

If reduced ownership (investment) **continues to be classified either as an associate or a joint venture** respectively

The entity shall **reclassify to profit or loss** the proportion of the gain or loss that had previously been recognised in other comprehensive income relating to that reduction in ownership interest

If that gain or loss is required to be reclassified to profit or loss on the disposal of the related assets or liabilities

If an entity discontinues the use of the equity method THEN,
- **A gain or loss (if any) previously recognised in OCI** by the investee (e.g., Cumulative exchange differences relating to a foreign operation) **would be reclassified to profit or loss** on the disposal of the related assets or liabilities
- The entity reclassifies the gain or loss from equity to profit or loss **(as a reclassification adjustment)**

Note: The fair value of retained interest should be regarded as fair value on initial recognition.

EQUITY METHOD PROCEDURES

A. DETERMINATION OF GROUP'S SHARE

A **group's share** in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the **parent and its subsidiaries**

The holdings of the *group's other associates or joint ventures are ignored* for this purpose

When an associate or a joint venture has subsidiaries, associates or joint ventures

The profit or loss, other comprehensive income and net assets taken into account are those recognised in the **associate's or joint venture's financial statements**

After any adjustments necessary to give effect to uniform accounting policies

B. MUTUAL TRANSACTIONS

They are transactions between an investor entity (including subsidiaries) and its associate or joint venture

Eliminate the investor's share in the associate's or the joint venture's gains or losses resulting from these transactions

Gains and losses from such transactions are **recognised** in the investor entity's financial statements **only to the extent of unrelated investors' interests in the associate or joint venture**

Mutual transactions are of two types

Upstream

Example:
Sales of assets from an associate or a joint venture to the investor

When upstream transactions provide evidence of **a reduction in the NRV** of the assets to be purchased or of **an impairment loss** of those assets

The investor shall **recognise its share in those losses**

Share in loss of in Associate/JV Dr.
To Investment in Associate./JV

Downstream

Example:
Sales or contributions of assets from the investor to its associate or its joint venture

When downstream transactions provide evidence of a **reduction in the NRV** of the assets to be sold or contributed, or of **an impairment loss** of those assets

The investor shall **recognise in full those losses**

Loss on sale of asset Dr.
To Asset

Note:

- An entity might contribute a **non-monetary asset** to an associate or a joint venture in exchange of an equity interest in that associate or joint venture. Such contribution of asset shall be accounted in accordance with the **guidance for upstream/ downstream transactions**
- If such contribution of non-monetary asset **lacks commercial substance**, then the gain / loss involved in such transaction is **treated as unrealised** and such **gain / loss is eliminated against the investment value** (i.e., the carrying amount of the investment in associate or joint venture will be equal to the carrying amount of non-monetary asset contributed in exchange)

C. DIFFERENT REPORTING DATES

- The investor uses the most recent available financial statements of the associate when applying the equity method
- If the reporting date of the associate is different to that of the investor, the associate prepares financial statements at the investor's reporting date
- If it is **impracticable** for the **associate** to prepare these financial statements at the investor's reporting date, the investor would **need to make adjustments for significant transactions and events occurring between the date** of the associate's most recent available financial statements, and the reporting date of the investor
- In any case, **the difference** between the end of the reporting period of the associate or joint venture and that of the entity **shall be no more than three months.**

D. UNIFORM ACCOUNTING POLICIES

- Both investor and investee shall apply uniform accounting policies for the similar transactions
- If the accounting policies are not same then **adjustments should be made to align** the accounting policies of associate or joint venture to those of the entity

Two Exceptions to the above rules are

Exception 1
In case of an **associate** (*not joint venture*), the adjustment for uniformity of accounting policies with those of the entity will not be done **if it is impracticable to do so**

Exception 2

- An entity may have interest in **an associate or a joint venture that is an investment entity.**
- Such an associate or a joint venture may also have interest in one or more subsidiaries.
- When this is the case, such associate or joint venture, being an investment entity, would **account for its interest in subsidiaries at fair value**. Hence, in such case, the **entity can elect to retain** the fair value measurement used by the associate or joint venture.

E. CUMULATIVE PREFERENCE SHARES

If an associate or a joint venture has outstanding cumulative preference shares that are:
- held by parties other than the investor entity and
- classified as equity.

The entity computes its share of profit or loss **after adjusting for the dividends on such shares.**
This computation is to be done, irrespective of the fact that whether the dividends have been declared or not

F. Loss making associate or joint venture

- In case of a loss making associate or joint venture, an investor entity's share of losses of such associate or joint venture may equal or exceed its **interest in the associate or joint venture.** In such case, the investor entity discontinues recognizing its share of further losses.
- After the investor entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred **legal or constructive obligations or made payments** on behalf of the associate or joint venture.
- If the associate or joint venture **subsequently reports profits**, the investor entity resumes to recognize its share of those profits **only after** its share of the profits equals the share of losses not recognized.

IMPAIRMENT LOSSES

An entity shall determine whether there is **objective evidence** that the entity's net investment in an associate or a joint venture is impaired

The objective evidence of impairment can arise as a result of:
- one or more events that occurred after the initial recognition of the net investment (a '**loss event**') and
- that loss event (or events) has an **impact on the estimated future cash flows** from the net investment that can be reliably estimated.

It is not necessary to identify a single event that caused impairment. Rather, impairment can be a combined effect of several individual events.

Losses expected as a result of future events, no matter how likely, are not recognized.

Objective evidence that the net investment is impaired includes **observable data** about the following loss events:

- Significant **financial difficulty** of the associate or joint venture
- **Breach of contract**, such as a default in payments by the associate or joint venture
- The entity **granting a concession** to associate or joint venture (because of its financial difficulties
- It becoming probable that the associate or joint venture will enter **bankruptcy or other financial reorganisation**
- **Disappearance of an active market** for the net investment because of financial difficulties of the associate or joint venture
- **Adverse effect** in the environment (technological, market, economic or legal) in which associate or joint venture operates
- **Significant or prolonged decline in the fair value** of an investment in an equity instrument below its cost

Disappearance of an active market because the associate's or joint venture's equity or financial instruments are **no longer publicly traded is not evidence of impairment.**

A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture is not itself evidence of impairment, although it may be evidence of impairment when considered with other available information.

- **If goodwill** on acquisition of associate or joint venture is recognized as **part of the carrying amount of the net investment** in associate or joint venture, **then** such goodwill is **not tested separately** for impairment; **rather the entire carrying amount** of the investment is **tested for impairment as a single asset** when there is objective evidence of impairment.

Any impairment loss recognized is **not allocated** to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture.

Reversal of impairment loss

Any reversal of impairment loss is recognized in accordance with Ind AS 36 *'Impairment of Assets'* to the extent that the recoverable amount of the net investment subsequently increases.

PRESENTATION AND DISCLOSURE

- Investments in associates are **generally classified as** *non-current assets*
- Investments in associates are **only classified as current assets if** they meet the criteria to be **classified as 'held for sale'** in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'

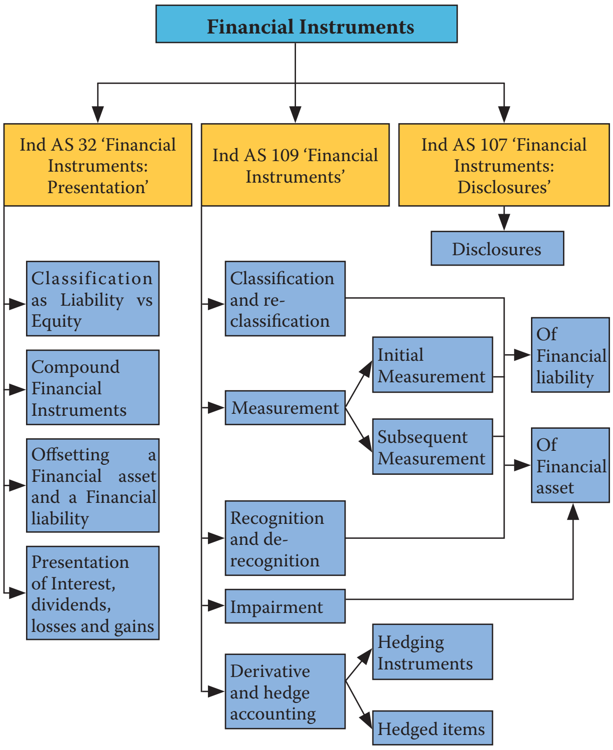
- No disclosures are specified in Ind AS 28
- Instead, Ind AS 112 '*Disclosure of Interests in Other Entities*' outlines the disclosures required for entities with joint control of, or significant influence over, an investee

MAJOR CHANGES IN IND AS 28 FROM IAS 28

Particulars	Ind AS 28	IAS 28
Capital Reserve / Negative Goodwill	Any excess of: (a)The entity's share of net fair value of JV's identifiable assets and liabilities OVER (b) The cost of investment is recognized directly in Equity as **Capital Reserve** in the period in which the investment is acquired	Any excess of: (a)The entity's share of net fair value of joint venture's identifiable assets and liabilities OVER (b) The cost of investment is included as **Income** – in the determination of the investor's share of the JV's share of profit/loss in the period in which the investment is acquired
Requirement of uniform accounting policies to be followed by associates and joint ventures	Ind AS 28 gives an exemption in case of an associate **where it is impracticable** to follow uniform accounting policies	To be adhered. There is no such exemption given under IAS 28.

FINANCIAL INSTRUMENTS

Overview of standards providing guidance on financial instruments



INDIAN ACCOUNTING STANDARD (IND AS) 32: FINANCIAL INSTRUMENTS: PRESENTATION

Objective of Ind AS 32 is to				
Establish principles for presenting financial instruments as liabilities or equity	Establish principles for offsetting financial assets and financial liabilities	Classify financial instruments, from the perspective of the issuer into -financial assets, -financial liabilities and -equity instruments	Classify related interest, dividends, losses and gains	Circumstances in which financial assets and financial liability should be offset

Note: Principles in Ind AS 32 complement the principles for recognising and measuring financial assets and financial liabilities in Ind AS 109 and for disclosing information about them in Ind AS 107.

Scope of Ind AS 32

- Applied by **all** entities to ***all types of financial instruments***
- **Exceptions:**
  - Interests in subsidiaries, associates or joint ventures that are accounted for in accordance with Ind AS 110, Ind AS 27, or Ind AS 28
    Note: Entities shall apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures
  - Employers' rights and obligations under 'Employee benefit plans' to which Ind AS 19 applies
  - Insurance contracts as defined in Ind AS 104
    Exception 1: Derivatives that are embedded in insurance contracts -if accounted separately by the issuer, as required by Ind AS 109.
    Exception 2: Financial guarantee contracts -if the issuer applies Ind AS 109 in recognising and measuring the contracts. However, issuer can elect applying Ind AS 104 in recognising and measuring them
  - Financial instruments within the scope of Ind AS 104 (because they contain a discretionary participation feature). However, exemption is limited to paragraphs 15– 32 and AG25–AG35 which relates to the distinction between financial liabilities and equity instruments.
    Note: Ind AS 32 applies to derivatives that are embedded in these instruments
  - Financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 applies,
    Exception 1: Contracts within scope of paras 8-10 of Ind AS 32
    Exception 2: Treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements to which paras 33, 34 of Ind AS 32 applies

Summary of the transaction outside the scope Financial Instruments:

S. No.	Particulars	Covered under Ind AS 109	Covered under Ind AS 32	Applicable Ind AS
1	Interest in subsidiaries (At Costs)	No	No	Ind AS 27
2	Interests in associates (At Costs)	No	No	Ind AS 27
3	Interest in joint ventures (At Costs)	No	No	Ind AS 27
4	Rights and obligations under leases	No	No	Ind AS 116
5	Employers' rights and obligations under employee benefit plans	No	No	Ind AS 19

S. No.	Particulars	Covered under Ind AS 109	Covered under Ind AS 32	Applicable Ind AS
6	Rights and obligations under an insurance contract	No	No	Ind AS 104
7	Forward contract arising in case of business combination	No	No	Ind AS 104
8	Loan commitment other than covered under Ind AS 109 and Ind AS 32	No	No	Ind AS 37
9	Shared based payments	No	No	Ind AS 102
10	Reimbursement right in respect of provision	No	No	Ind AS 37
11	Rights and obligations under revenue for contracts with customers	No	No	Ind AS 115
12	Interest in subsidiaries / Associates / Joint venture (At Fair Value)	Yes	Yes	Ind AS 109

Scope of 'Contract to Buy or Sell a Non-Financial Item'

Ind AS 32 is applicable when the contract (including written option) is settled

- Net in cash
- or By another financial instrument
- or By exchanging financial instruments

→ As if the contract was a financial instrument

Ind AS 32 is not applicable when

- When an entity irrevocably designates the contract as measured at fair value through profit or loss as per para 2.5 of Ind AS 109
- Contract is entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements

Even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements

Note: This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency which arise from not recognising that contract under Ind AS 32

Ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments.

- When the terms of the contract permit either party to settle it
  - net in cash or
  - another financial instrument or
  - by exchanging financial instruments
- When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts in the said manner (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse)
- When, for similar contracts, the entity has practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin
- When the non-financial item that is the subject of the contract is readily convertible to cash

Note: Such Contracts on which Ind AS 32/Ind AS 109 is applicable are considered to be derivatives while those contracts that are not covered under the scope of Ind AS 32 are considered as executory contracts.

What are Financial Instruments?

Any contract → That gives rise

- Contracts need not be in writing and may take a variety of forms
- An agreement between two or more parties that
  - has clear economic consequences and
  - is enforceable by law

Any assets or liabilities that are not contractual are not financial assets or financial liabilities. Example: Income taxes are a statutory obligation

- To one entity's → Financial asset
- To another entity's → Financial liability OR Equity instrument

What are Financial Assets?

- Cash
- Equity instrument of another entity
- A contractual right:
  - To receive cash or another financial asset from another entity
  - OR
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially *favourable* to the entity
- Contract (Derivative or Non-Derivative) settled with variable amount of entity's own equity instruments

The ability to exercise a contractual right or to satisfy a contractual obligation may be absolute or it may be contingent on occurrence of one or more future events, not wholly within the control of either party to the contractual arrangement

A contingent right and obligation meets the definition of financial asset and financial liability, even though such assets and liabilities are not always recognized in the financial statements. For eg.: A lender may be provided with a financial guarantee by a party ('guarantor') on behalf of borrower, entitling to recover the outstanding dues from the guarantor if the borrower were to default, etc.

Exception:
Entity's own equity instruments do not include
- puttable financial instruments classified as equity instruments
- instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments, or
- instruments that are contracts for the future receipt or delivery of the entity's own equity instruments

Important Points
- **Physical assets** (such as inventories, property, plant and equipment), **right-of-use assets** and **intangible assets** (such as patents and trademarks) are not financial assets.
- Assets (such as **prepaid expenses**) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
- **'Perpetual' debt instruments** (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

TEST YOUR KNOWLEDGE		
Particulars	**Whether Financial Asset (FA) or not?**	**Remarks**
Investment in bonds debentures	FA	Contractual right to receive cash
Loans and receivables	FA	Contractual right to receive cash
Deposits given	FA	Contractual right to receive cash
Trade & other receivables	FA	Contractual right to receive cash
Cash and cash equivalents	FA	Specifically covered in the definition
Bank balance	FA	Contractual right to receive cash
Investments in equity shares	FA	Equity instrument of another entity
Perpetual debt instruments Eg. perpetual bonds, debentures and capital notes.	FA	Such instruments provide the contractual right to receive interest for indefinite future or a right to return of principal under terms that make it very unlikely or very far in the future
Physical assets Eg. inventories, property, plant and equipment etc.	No	Control of such assets does not create a present right to receive cash or another financial asset
Right to use assets Eg. Lease vehicle etc.	No	Control of such assets does not create a present right to receive cash or another financial asset
Intangibles Eg. Patents, trademark etc.	No	Control of such assets does not create a present right to receive cash or another financial asset
Prepaid expenses Eg. Prepaid insurance, prepaid rent etc.	No	These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash
Advance given for goods and services	No	These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash

What are Financial Liabilities?

- A contractual obligation
  - To deliver cash or another financial asset to another entity
  - OR
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially *unfavourable* to the entity
- Contract (Derivative or Non-Derivative) settled with variable amount of entity's own equity instruments

Exception:

- Rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments
- The equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments if the exercise price is fixed in any currency
- Puttable financial instruments that are classified as equity instruments as per paras 16A and 16B
- Instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments as per para 16C and 16D, or
- Instruments that are contracts for the future receipt or delivery of the entity's own equity instruments

"**Note:** An instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D."

TEST YOUR KNOWLEDGE		
Particulars	**Whether Financial Liability (FL) or not?**	**Remarks**
Loans payable or bank loan	FL	Contractual obligation to pay cash / bank
Trade and other payables	FL	Contractual obligation to pay cash / bank
Bills payable / acceptance	FL	Contractual obligation to pay cash / bank
Deposits received	FL	Contractual obligation to pay cash / bank
Mandatory redeemable preferences shares	FL	Contractual obligation to pay cash / bank
Financial guarantee given	FL	Contractual obligation to pay cash, due to the occurrence of certain events

Equity Instrument

↓

Any contract that

↓

Evidences a residual interest in the assets of an entity after deducting **all** of its liabilities

↓

The instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met:

(a) The instrument includes **no contractual obligation:**

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

(ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially **unfavourable** to the issuer

(b) If the instrument will or may be settled in the **issuer's own equity instruments,** it is:

(i) A non-derivative that includes **no contractual obligation** for the issuer to deliver a variable number of its own equity instruments; or

(ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments

Fixed-for-fixed transaction!

Note: *A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument.*

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

No contractual obligation	❖ A key characteristic of equity instruments is that they carry **no contractual obligation throughout** for any payment or distribution towards the *holders* of such instruments. ❖ However, following type of instruments as an exception are 'equity' classified even if they contain an obligation to deliver cash or other financial asset, provided certain requisite criteria are met – 1. Puttable financial instruments that meet certain conditions 2. An instrument, or a component of an instrument, that contains an obligation for the issuing entity to deliver to the holder a pro rata share of the net assets of the issuing entity only on its liquidation

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

An issuer of non-puttable ordinary shares assumes a liability when:

- it formally acts to make a distribution and
- becomes legally obliged to the shareholders to do so

↓

This may be the case following the:

- Declaration of a dividend or
- When the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders

↓

Example: When the dividend is approved by shareholders in AGM, the Company has taken an obligation to distribute dividend to its shareholders and hence, it is a contractual obligation meeting the definition of financial liability

Examples of equity instruments include:

- Non-puttable ordinary shares, for example: equity shares issued by companies
- Some puttable instruments (if they meet requisite criteria and are not classified as financial liabilities)
- Some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (if they meet requisite criteria and are not classified as financial liabilities)
- Some types of preference shares (where repayment and distribution is at the discretion of the Issuer);
- Warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset.
- ❖ Other instruments convertible into fixed number of equity shares, etc.

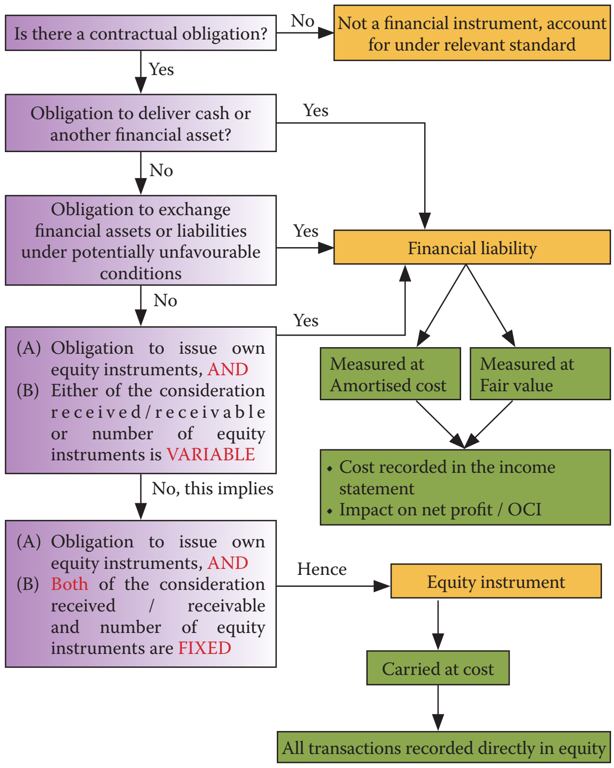
Important Points

- The classification of a financial instrument under Ind AS 32 is done from the perspective of the issuer and not from the perspective of the holder
- For some financial instruments, although their legal form may be equity, the substance of the arrangements may be that they are liabilities. Paragraphs 11 and 16 of Ind AS 32 provides guidance to distinguish a financial liability from an equity instrument
- A preference share, for example, may display either equity or liability characteristics depending on the substance of the rights attaching to it

Comparative Table For Classifying Financial Liabilities And Equity Instruments From The Perspective Of The Issuer

Financial liability (Ind AS 32.11)	Equity (Ind AS 32.16)
A financial instrument that fulfils <u>either of (A) or (B)</u> below:	A financial instrument that fulfils <u>both (A) and (B)</u> below:
Condition (A): An instrument that <u>**is a contractual obligation:**</u> i. to deliver cash or another financial asset to another entity; or ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity	**Condition (A):** An instrument that contains <u>**no contractual obligation:**</u> i. to deliver cash or another financial asset to another entity; or ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity
Condition (B): An instrument that will or may be settled in the entity's own equity instruments and is: i. A non-derivative <u>**for which the entity is or may be obliged**</u> to deliver a variable number of the entity's own equity instruments; or ii. A derivative that will or may be settled <u>**other than by**</u> the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments	**Condition (B):** An instrument that will or may be settled in the entity's own equity instruments and is: i. a non-derivative <u>**that includes no contractual obligation for the issuer**</u> to deliver a variable number of the entity's own equity instruments; or ii. a derivative that will or may be settled <u>**only by**</u> the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

The Flowchart Below Further Summarises The Distinction Between The Definitions Of A Financial Liability And Equity:



No Contractual Obligation to Deliver Cash or Another Financial Asset

A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of the issuer either to deliver cash or another financial asset to the holder or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer

There are very limited exceptions to this principle in the form of "puttable instruments" and "obligations arising on liquidation"

The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease

If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability

A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions

Settlement In The Entity's Own Equity Instruments

To recapitulate: A financial instrument is classified as a liability not just when there is an obligation to deliver cash or another financial asset, it is sometimes so classified even when the entity's obligation is to settle the instrument through delivery of its own equity instruments.

If an entity has a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation, such a contract is a financial liability.

Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (eg an interest rate, a commodity price or a financial instrument price)

The number of equity instruments to be delivered could vary as a result of entity's own share price.

A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument

The above requirements are summarised in the table below:

S.no. 2 in table is also called "fixed for fixed" test for equity classification

i.e. fixed amount of cash or other financial asset for fixed number of own equity instruments

S. No.	Consideration for financial instrument	Number of own equity instruments to be issued in settlement	Classification and rationale
1	Fixed	Variable	Financial liability – own equity instruments are being used as currency to settle an obligation for a fixed amount
2	Fixed	Fixed	Equity – issuer does not have an obligation to pay cash and holder is not exposed to any variability
3	Variable	Fixed	Financial liability – though issuer does not have an obligation to pay cash, but holder is exposed to variability
4	Variable	Variable	Financial liability – though issuer does not have an obligation to pay cash, but both parties are exposed to variability

Another point to note is a fine distinction highlighted in the definition of financial liability and equity, as mentioned in the paragraph "Definitions – financial liability and equity". Being mirror images of each other, for simplicity sake, let us look at condition (B) in the definition of "financial liability":

"An instrument that will or may be settled in the entity's own equity instruments and is:

i. a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments"

In short, the treatment can be explained as follows

- Conversion feature fails "fixed for fixed" test?
  - No → Equity instrument – consideration received is credited to equity
  - Yes → Conversion feature is derivative?
    - No → Can be subsequently measured at amortised cost
    - Yes → Subsequently measured at fair value with fair value changes recognised in profit or loss

Important Points

- Changes in the fair value of a contract arising from variations in market interest rates that do **not** affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument
- Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity
- Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity.
- Changes in the fair value of an equity instrument are not recognised in the financial statements

Contracts settled in own equity instruments but classified as 'financial liability' (where equity instrument is treated as currency):

Terms	Evaluation under Ind AS 32
Non derivative contract	• A contract that will be settled in a variable number of entity's own shares whose value equals a fixed amount is a **financial liability**, because the entity is under an obligation to pay a fixed amount that is settled through equity instruments (similar to settlement in currency) • Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, **is a financial asset or a financial liability**
Derivative contract	• A contract that will be settled in a variable number of the entity's own shares whose value equals an amount based on changes in an underlying variable (eg a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract

Preference Shares

In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attached to the share to determine whether it exhibits the fundamental characteristic of a ***financial liability or an equity instrument***

Redeemable Preference shares

- Redemption at a specified date → Classified as a financial liability
- Redemption at option of Holder → Classified as a financial liability
- Redemption at option of Issuer → Classified as equity instrument

Classified as a financial liability: The potential inability of an issuer to redeem a preference share when contractually required either because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation

Classified as equity instrument: An obligation may arise, when the issuer of the shares exercises its option, (usually by formally notifying the shareholders of an intention to redeem the shares), at which time this instrument shall be reclassified from 'equity' to 'financial liability'

Non-Redeemable Preference shares

When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer → The shares are equity instruments

Points to be noted:

- The contractual terms determine the nature of instrument.
- Any historical trend or ability of the Issuer does not affect the classification of an instrument as 'equity' or 'financial liability'.
- The classification of a preference share as an equity instrument or a financial liability is not affected by
  - (a) A history of making distributions
  - (b) An intention to make distributions in the future
  - (c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made
  - (d) The amount of the issuer's reserves
  - (e) An issuer's expectation of a profit or loss for a period or
  - (f) An ability or inability of the issuer to influence the amount of its profit or loss for the period

Classification / Evaluation of Preference Shares Based on Distribution on and of Preference Shares

Nature	Dividend Terms whether at the option of the issuer	Evaluation	Classification	Accounting
Mandatory Redeemable Preference Shares	Non - Discretionary	• Dividend – Liability • Redemption – Liability	Liability	Amortized costs
	Discretionary	• Dividend – Equity • Redemption – Liability	Compound FI	Split Accounting into liability and Equity component
• Non redeemable • Convertible	Non - Discretionary	• Dividend – Liability • Fixed to Fixed – Not met – Liability	Liability	Amortized costs
		• Dividend – Liability • Fixed to Fixed – Met – Equity	Compound FI	Split Accounting into liability and Equity component
	Discretionary	• Dividend – Equity • Fixed to Fixed – Not met – Liability	Compound FI	Split Accounting into liability and Equity component
		• Dividend – Equity • Fixed to Fixed – Met – Equity	Equity	• Fair value • No re-measurement

Puttable Instruments

It gives the holder the ***right*** ⭘ to put the instrument back to the issuer ⭘ for cash or another financial asset OR is automatically put back to the issuer

- on the occurrence of an uncertain future event OR
- the death or retirement of the instrument holder

phrase "put back to the issuer" refers to redemption of the instrument

A puttable financial instrument includes a **contractual obligation for the issuer** to repurchase or redeem that instrument for cash or another financial asset *on exercise of the put*

Note: If the holder has a right, but not an obligation to require the issuer to redeem the instrument, it is referred to as "put option

As per the principle, it shall be classified as financial liability. However, it would be classified as Equity, subject to fulfillment of certain conditions

Exception to the definition of a financial liability ie when **a puttable financial instrument** is classified as an **equity instrument** if it has **ALL** the following features:

1. It takes a pro rata share of the entity's net assets in the event of the entity's liquidation
2. It is subordinate to **all** other classes of instrument
   - That is, in its present form, it has no priority over other claims to the entity's assets **on liquidation** (entity will need to assume liquidation on date of classification)
3. All financial instruments in that class of instruments have identical features
   - For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class
4. Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, there are no other contractual obligations:
   - to deliver cash or another financial asset to another entity, or
   - to settle in variable number of entity's own equity instruments with another entity

   In other words, there are no other features of the instrument which could satisfy the definition of "financial liability"
5. Total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the:
   - profit or loss,
   - change in the recognised net assets or
   - change in the fair value of the recognised and unrecognised net assets

   of the entity over the life of the instrument

   Or say, if the cash flows are attributable to any factors other than the three listed above, ex., an index, the puttable instrument will fail the equity classification
6. The issuer must have no other financial instrument or contract that has:
   - total cash flows on same terms as point 5, with
   - the effect of substantially restricting or fixing the residual return to the puttable instrument holders

Carve Out in Ind AS 32 from IAS 32	
As per IFRS	**Carve out**
As per accounting treatment prescribed under IAS 32, equity conversion option in case of foreign currency denominated convertible bonds is considered a derivative liability which is embedded in the bond. Gains or losses arising on account of change in fair value of the derivative need to be recognised in the statement of profit and loss as per IAS 32.	In Ind AS 32, an exception has been included to the definition of 'financial liability' in paragraph 11 (b) (ii), whereby conversion option in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments is classified as an equity instrument if the exercise price is fixed in any currency.

Obligations Arising on Liquidation

Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation

The obligation arises because:

Liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity)

OR

Is uncertain to occur but is at the option of the instrument holder

As per the principle, it shall be classified as financial liability. However even then it would be classified as Equity, subject to fulfillment of certain conditions

Note: The conditions number 1-3 and 6 given for puttable financial instrument (to be classified as equity instruments) are also applicable in case of Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, for classification as an equity instruments

Reclassification of Puttable Instruments / Obligations Arising on Liquidation

Classification: As an *Equity instrument* is to be done, from the date when the instrument has **all** the features and meets the specified conditions

Re-Classification: Is to be done from the date, when the instrument ceases to have **all** the features or meet all the specified conditions

Accounting for reclassification:

Reclassification from	Reclassification to	Measurement	Recognition of difference in carrying amount and measurement of reclassified instrument
Financial liability	Equity	At the carrying value of the financial liability at the date of reclassification	-N.A.-
Equity	Financial liability	At fair value of the instrument at the date of reclassification	In equity

Contingent Settlement Provisions

A financial instrument may require an entity to deliver cash or another financial asset, or settle it in some other way that would require it to be classified as a financial liability, but only in the event of occurrence or non-occurrence of some uncertain future event

The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability)

However, there are some exceptions where it is classified as equity

Note:
The occurrence or non-occurrence of uncertain future events beyond the control of both the issuer and the holder of the instrument might include:
- A change in a stock market index
- A change in consumer price index
- A change in interest rate or taxation requirements, or the issuer's future revenues
- A change in net income or debt-to-equity ratio

Classification of Contingent Settlement Provisions into Liability or Equity

Is the contingent event within the control of the issuer?
- Yes → Equity classification
- No → Assess whether the part of the contingent settlement provision that indicates liability classification is genuine
  - No → Equity classification
  - Yes → Can the issuer be required to settle the obligation in cash or another financial asset only in the event of the liquidation of the issuer?
    - Yes → Equity classification
    - No → Does the instrument have all the features and meet all the conditions relating to the exceptions for puttable instruments and obligations arising on liquidation?
      - Yes → Equity classification
      - No → Financial liability classification

TEST YOUR KNOWLEDGE	
Contingent settlement event	**Within the issuer's control?**
Issue of an IPO prospectus prior to the conversion date	Yes
Successful completion of IPO	No
A change in accounting, taxation, or regulatory regime which is expected to adversely affect the financial position of the issuer	No
Issuer makes a distribution on ordinary shares	Yes. Dividends on ordinary shares are discretionary
Appointment of a receiver, administrator, entering a scheme of arrangement, or compromise agreement with creditors	No. Depends on the respective requirements in each jurisdiction
Suspension of listing of the issuer's shares from trading on the stock exchange for more than a certain number of days	No
Change in credit rating of the issuer	No

Compound Financial Instruments

- A compound financial instrument has a legal form of a single instrument, whereas the substance is that both liability and equity instrument exist
- A compound financial instrument is a non-derivative financial instrument that, from the issuer's perspective, contains ***both a liability and an equity component***
- The issuer of a non-derivative financial instrument should *evaluate the terms of the financial instrument* to determine whether it contains both a liability and an equity instrument
- Example: In convertible bond, a bond holder can either be paid cash at maturity or get fixed number of shares in exchange of bond at maturity. It is compound financial instrument as it contains 2 elements viz Liability and Equity

Convertible bond
- Liability component → Reason: Issuer has the obligation as per contractual arrangement to deliver cash or another financial asset
- Equity component → Reason: A **call option** granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity

Accounting Treatment of Compound Financial Statements in Issuer's Books

Issuer must perform the **'split accounting'** on initial recognition as follows:

↓

In compound financial instrument, identify the various components

↓

Ascertain the fair value of the compound financial instrument as a whole

↓

Ascertain the fair value of the liability component

Note: The fair value of the liability component is to be calculated with reference to fair value of a similar liability (with the same terms like interest rate, duration etc) that ***does not have any associated equity conversion feature***

↓

Ascertain the fair value of the equity component as:

Fair value of the compound financial instrument as a whole (less) the fair value of liability component

This step ensures no gain or loss on initial recognition

Treasury Shares

- Treasury shares are entity's own reacquired equity instruments, that are held by the entity
- Holdings of treasury shares may arise in a number of ways. For example:
  - In Consolidated financial statement:
    - Shares held by the employee benefit trust
    - Shares were purchased by another entity which subsequently became a subsidiary of the reporting entity, either through acquisition or changes in financial reporting requirements
  - The entity holds the shares as the result of a direct transaction, such as
    - a market purchase, or
    - a buyback of shares from shareholders as a whole, or
    - a particular group of shareholders.

Accounting Treatment of Treasury Shares

- Consideration paid or received for acquisition of Treasury shares shall be **adjusted in Equity**
  - Are own equity instruments acquired? → Debit amount paid directly to equity
  - Are own equity instruments sold? → Credit amount paid directly to equity
- **No gains / losses recognised** in profit or loss on:
  - Any purchase, sale, issue or cancellation of own equity instruments or
  - In respect of any changes in the value of treasury shares

- The amount of **treasury shares held is disclosed separately either in the balance sheet or in the notes,** in accordance with Ind AS 1.
- An entity provides disclosure in accordance with Ind AS 24, *Related Party Disclosures,* if the entity reacquires its own equity instruments from related parties

Interest, Dividends, Losses and Gains

The classification of an issued financial instrument as either a financial liability or an equity instrument determines recognition of interest, dividends, gains, and losses relating to that instrument in profit or loss or directly in equity.

- Dividends to holders of outstanding shares that are classified as equity - Directly to equity. Taxes will be recognised in Equity
- Dividends to holders of outstanding shares that are classified as financial liabilities - Interest expense in Profit and loss. Taxes will be recognised in Profit or loss
- Changes in the Fair Value of equity instruments of the entity – OCI / Profit or Loss.
- Changes in the Fair Value of own equity instruments of the entity – Not recognised.
- Costs incurred in issuing or acquiring own equity instruments are not expensed but accounted for as a deduction from equity. Such costs include regulatory fees, legal fees, advisory fees, and other transaction costs

Offsetting a Financial Asset and a Financial Liability

- A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:
  - Currently has a **legally enforceable right to set off** the recognised amounts
    - This means that the right of set off:
      a) Must not be contingent on a future event; and
      b) Must be legally enforceable in the normal course of business, in the event of default and in the event of insolvency or bankruptcy of the entity and all of the counterparties
  - **Intends** either to settle on a net basis, or to realise the asset and settle the liability simultaneously
    - If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion
- Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount is different from the derecognition of a financial asset or a financial liability
  - Although offsetting does not give rise to recognition of a gain or loss, the derecognition not only results in the removal of the previously recognised financial instrument from the statement of financial position but also may result in recognition of a gain or loss
- A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor
- The conditions set out above are generally not satisfied and offsetting is usually inappropriate when:
  - when one financial instrument in a 'synthetic instrument' is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting
  - Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties
  - Financial or other assets are pledged as collateral for non-recourse financial liabilities
  - Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement)
  - Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract

INDIAN ACCOUNTING STANDARD (IND AS) 33: EARNINGS PER SHARE

- Overview of Ind AS 33
  - Measurement
    - Basic EPS
      - Earnings
        - Effect of preference dividend
        - Effect of Cumulative and non-cumulative preference dividend
        - Early conversion of Preference shares at premium
        - Effect of discounts, premiums related to preference shares
        - Early conversion of Preference shares at premium
      - Shares
        - Weighted Average Number of Shares
        - Deciding the date for issue of shares
        - Change in the number of shares without change in value of capital
    - Diluted EPS
      - Earnings
      - Shares
        - Base for calculation
        - Calculation of weighted average to be done independently for every period
        - Shares of subsidiary, joint venture or associate
        - Dilutive potential ordinary shares
        - Antidilutive potential ordinary shares
        - Options, warrants and their equivalents
        - Employee stock options
        - Convertible instruments
        - Contingently issuable shares
        - Contingently issuable potential ordinary shares
        - Contracts that may be settled in ordinary shares or cash
        - Purchased options
        - Written put options
  - Presentation
  - Disclosure

Objective of Ind AS 33

To prescribe principles for

- Determination of earnings per share
- Presentation of earnings per share

To improve performance comparisons between

- Different entities in the same reporting period
- Different reporting periods for the same entity

Scope of Ind AS 33

- Apply to companies that have issued ordinary shares (equity shares in Indian context)
- Entity that discloses EPS shall calculate and disclose EPS in accordance with this Ind AS 33
- When an entity is required to present both consolidated financial statements and separate financial statements then
  - Disclosure required by this Standard shall be presented in both consolidated financial statements (CFS) and separate financial statements (SFS) separately
  - An entity shall present EPS in CFS based on the information given in CFS only. Similarly, EPS in SFS should be based on the information given in SFS only.

Important Points:

- Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated.
- An entity may have more than one class of ordinary shares.
- Ordinary shares of the same class have the same rights to receive dividends.

Measurement of basic earnings per share (Basic EPS)

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

Measurement of Earnings for Basic EPS

Profit or loss from continuing operations attributable to the parent entity is adjusted for:

- After-tax amounts of preference dividends*
- Differences arising on the settlement of preference shares
- Other similar effects of preference shares which are classified as equity
- Any item of income or expense which is otherwise required to be recognized in profit or loss in accordance with Ind AS is debited or credited to securities premium account/other reserves

*Treatment of after-tax amount of preference dividend in calculation of Basic EPS

Nature of preference shares

- Non-cumulative: Deduct after-tax amount of preference dividend of the period from Profit and Loss **only when declared**
- Cumulative: **Deduct** after-tax amount of preference dividend from Profit and Loss, **whether or not dividend is declared**

Other adjustments to Profit or loss attributable to the parent

- When preference shares are issued at discount or premium to provide for a low or high initial dividend respectively to compensate an entity for selling the preference shares at a discount or premium (referred as increasing rate preference shares)
  - Any original issue discount or premium on increasing rate preference shares is amortised to retained earnings using the effective interest method and **treated as a preference dividend**
- When preference shares are repurchased under an entity's tender offer to the holders
  - Return to the preference shareholders (charge to retained earnings) **deducted in calculating profit or loss** attributable to ordinary equity holders of the parent entity = Fair value of the consideration paid to the preference shareholders − Carrying amount of the preference shares
- In case of an early conversion of convertible preference shares
  - Return to the different shareholders **is deducted in calculating profit or loss** attributable to ordinary equity holders of the parent entity = Fair value of the ordinary shares or other consideration **paid at the time of conversion** − Fair value of the ordinary shares **issuable** under the original conversion terms

Note:

The amount of preference dividends for the period **does not** include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

Weighted average number of shares (For calculation of Basic EPS)

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

Weighted average number of equity shares:	
Ordinary shares outstanding at the beginning	xxxx
Less: Ordinary shares bought back multiplied by time-weighting factor*	xxxx
Add: Ordinary shares issued multiplied by time-weighting factor *	xxxx
Ordinary shares outstanding during the period	xxxx

*The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period.

Deciding the date for issue of shares

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

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

Important points:

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

Where,

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

Change in the weighted average number of shares (increase or reduction) without a corresponding change in value of capital

- Capitalization or bonus issue
- A share split
  - → The number of **ordinary shares outstanding is increased** without an increase in resources i.e. **without any additional consideration.**
  - → The date in that case will be considered from the **beginning of the earliest period presented**
- A bonus element in any other issue, for example, a bonus element in a rights issue to existing shareholders
  - → Refer Rights Issues
- A reverse share split (consolidation of shares)
  - → It **reduces** the number of ordinary shares outstanding **without a corresponding reduction in resources**
  - → However, when the overall effect is a share repurchase at fair value, the reduction in the number of ordinary shares outstanding is the result of a corresponding reduction in resources

Rights issues

The rights shares can either be offered at the current market price or at a price that is below the current market price. The notional capitalization issue reflects the bonus element inherent in the rights issue and is measured by the following fraction:

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

where,

Theoretical ex-rights fair value per share:

$$\frac{\text{Fair value of all outstanding shares before exercise of right + Total amount received from exercise of rights}}{\text{No. of shares outstanding after the exercise of the rights}}$$

Dilution	It is a **reduction in earnings per share** or an **increase in loss per share** resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.
Antidilution	It is an **increase in earnings per share** or a **reduction in loss per share** resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.
Potential ordinary share	It is a **financial instrument or other contract** that may entitle its holder to ordinary shares.
	Examples of potential ordinary shares are: (a) financial liabilities or equity instruments, including preference shares, that are convertible into ordinary shares (b) options and warrants (c) shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

The formula can be mathematically expressed as follows:

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

Measurement of Earnings for Diluted EPS:

Basic earnings are adjusted for after-tax effect of changes in Profit and Loss that result from conversion of all dilutive potential ordinary shares.

Measurement of Earnings for Diluted EPS

↓

Measurement of Earnings for Basic EPS, adjusted for, by the after-tax effect of:

- Add back any dividends or other items related to dilutive potential ordinary shares
- Add back any interest recognized in the period related to dilutive potential ordinary shares
- Add/Less any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.

Note:

The expenses associated with potential ordinary shares include transaction costs and discounts accounted for in accordance with the effective interest method

<u>Calculation of Shares for the purpose of calculating Diluted EPS</u>

Existing weighted average number of ordinary shares + Weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

Important points to be considered:

- Potential ordinary shares are weighted for the period they are outstanding
- All potential ordinary shares are assumed to be converted into ordinary shares at the beginning of the period
- If not in existence at the beginning of the period, potential ordinary shares are assumed to be converted into ordinary shares at the date of its issuance.
- Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations.
- Potential ordinary shares that are converted into ordinary shares during the period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; **from the date of conversion, the resulting ordinary shares are included in both basic and diluted earnings per share.**

Test for determining whether potential ordinary shares are Dilutive or Antidilutive

Will **EPS decrease** or **loss per share increase** due to conversion of potential ordinary shares

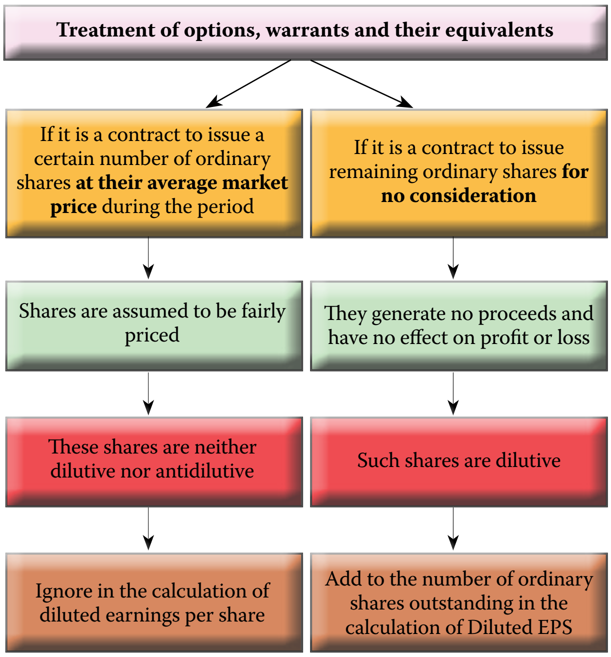
- Yes → Dilutive → Consider in Diluted EPS
- No → Antidilutive → Ignore

Note:

- If potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share
- Dilutive potential ordinary shares shall be determined independently for each period presented
- In determining whether potential ordinary shares are dilutive or antidilutive, each issue or series of potential ordinary shares is **considered separately** rather than in aggregate
- To maximise the dilution of basic earnings per share, **each issue or series of potential ordinary shares is considered in sequence from the most dilutive to the least dilutive**, i.e. dilutive potential ordinary shares with the lowest 'earnings per incremental share' are included in the diluted earnings per share calculation before those with a higher earnings per incremental share
- Options and warrants are generally included first because they do not affect the numerator of the calculation

Options, warrants and their equivalents

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



Note:

- Options and warrants have a dilutive effect only when the **average market price of ordinary shares** during the period **exceeds the exercise price of the options or warrants** (i.e. they are 'in the money').
- Previously reported earnings per share are **not retroactively adjusted** to reflect changes in prices of ordinary shares.
- Employee share options with fixed or determinable terms and non-vested ordinary shares are treated as options in the calculation of diluted earnings per share, even though they may be contingent on vesting. **They are treated as outstanding on the grant date**.
- Performance-based employee share options are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.

Contingently issuable shares

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

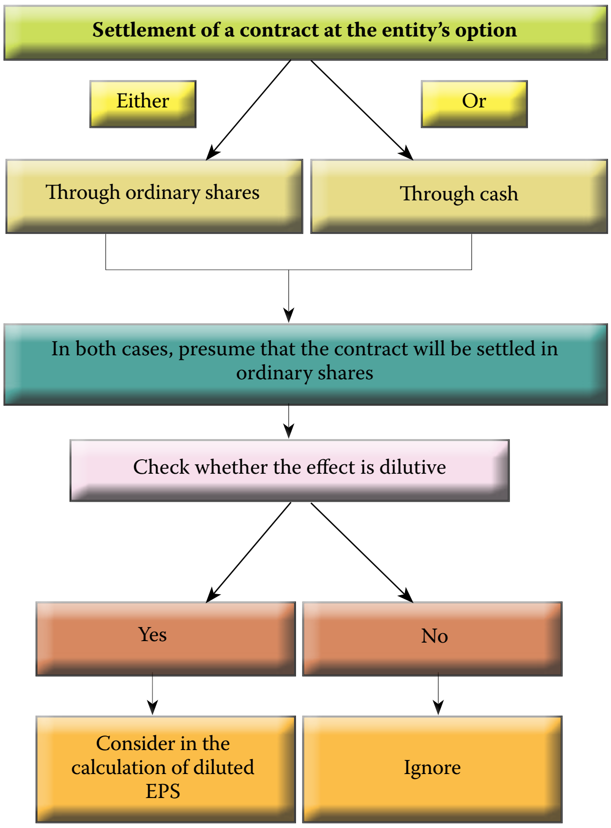
» A *contingent share agreement* is an agreement to issue shares that is dependent on the satisfaction of specified conditions.

» In the calculation of basic earnings per share, contingently issuable ordinary shares are treated as outstanding and included in the calculation of diluted earnings per share if the conditions are satisfied (i.e. the events have occurred).

» Contingently issuable shares are included from the beginning of the period (or from the date of the contingent share agreement, if later).

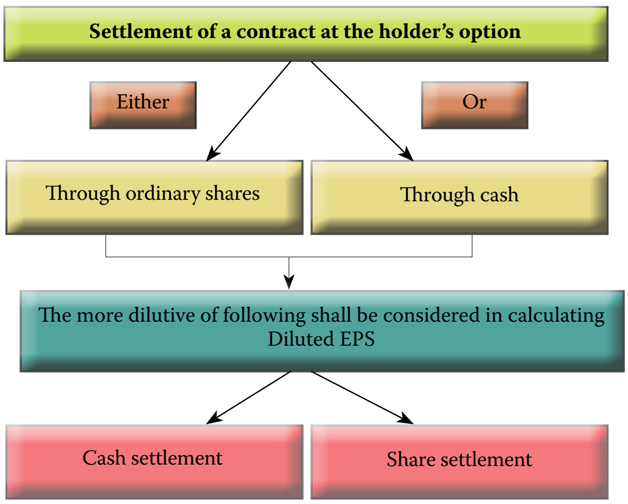
» If the conditions are not satisfied, the number of contingently issuable shares included in the diluted earnings per share calculation is based on the number of shares that would be issuable if the end of the period is the end of the contingency period

Contracts that may be settled in ordinary shares or cash



Note:

When an issued contract that may be settled in ordinary shares or cash at the entity's option may give rise to an asset or a liability, or a hybrid instrument with both an equity and a liability component under Ind AS 32, the entity should adjust the numerator (profit or loss attributable to ordinary equity holders) for any changes in the profit or loss that would have resulted during the period if the contract had been classified wholly as an equity instrument.



Purchased options

Contracts (i.e. options held by the entity on its own ordinary shares)

Purchased put options

Purchased call options

Not included in the calculation of Diluted EPS (because including them would be antidilutive)

Written put options

Contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive.

Incremental ordinary shares shall be included in the calculation of diluted earnings per share = Number of ordinary shares assumed to be issued − Number of ordinary shares received from satisfying the contract

Retrospective adjustments

If the number of ordinary or potential ordinary shares are outstanding

Increases as a result of a capitalisation, bonus issue or share split

Decreases as a result of a reverse share split

Calculation of basic and diluted earnings per share for all periods presented shall be **adjusted retrospectively.**

Note:

1. Basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.
2. An entity does not restate diluted earnings per share of any prior period presented for changes in the assumptions used in earnings per share calculations or for the conversion of potential ordinary shares into ordinary shares.

Presentation as per Ind AS 33

- Present in the statement of profit and loss basic and diluted earnings per share for profit or loss from continuing operations for each class of ordinary shares
- Earnings per share is presented for every period for which a statement of profit and loss is presented
- If diluted earnings per share is reported for at least one period, it shall be reported for all periods presented
- If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line in the statement of profit and loss.
- An entity that reports a discontinued operation shall disclose the basic and diluted amounts per share for the discontinued operation either in the statement of profit and loss or in the notes
- An entity shall present basic and diluted earnings per share, even if the amounts are negative (i.e. a loss per share)

Disclosure as per Ind AS 33

- Numerators - amounts used in calculating basic and diluted earnings per share and reconciliation of the amount used to profit or loss
- Denominators - weighted average number of ordinary shares used in calculating basic and diluted earnings per share and a reconciliation of these denominators to each other
- Instruments (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, but were not included since they are antidilutive for the period
- Description of ordinary share transactions or potential ordinary share transactions that occur after the reporting period and that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period

INDIAN ACCOUNTING STANDARD (IND AS) 34: INTERIM FINANCIAL REPORTING

Overview of Ind AS 34

- Objective
- Scope
- Definitions
- Content of an Interim Financial Report
  - Minimum components of an interim financial report
  - Form and content of interim financial statements
  - Significant events and transactions
  - Other disclosures
  - Disclosure of compliance with Ind AS
  - Periods for which interim financial statements are required to be presented
  - Materiality
- Disclosure in Annual Financial Statements
- Recognition and Measurement
  - Same accounting policies as annual
  - Revenues received seasonally, cyclically, or occasionally
  - Costs incurred unevenly during the financial year
  - Applying the recognition and measurement principles
  - Use of estimates
- Restatement of Previously Reported Interim Periods

Minimum components of an interim financial report

It shall include at a minimum

- a condensed balance sheet
- a condensed statement of profit and loss
- a condensed statement of changes in equity
- a condensed statement of cash flows
- selected explanatory notes

Important points to remember

1.	The interim financial report is intended to provide an update on the latest complete set of annual financial statements
2.	It focuses on new activities, events, and circumstances and does not duplicate information previously reported
3.	Ind AS 34 does not prohibit or discourage an entity from publishing a complete set of financial statements (as described in Ind AS 1) in its interim financial report
4.	Ind AS 34 does not prohibit or discourage an entity from including in condensed interim financial statements more than the minimum line items or selected explanatory notes
5.	Ind AS 34 requires to include all the disclosures required by this Standard as well as those required by other Ind AS

Form and content of interim financial statements

If in its interim financial report, an entity publishes

- A complete set of financial statements
  - Its form and content shall conform to the requirements of Ind AS 1 for a complete set of financial statements
- A set of condensed financial statements
  - It shall include, at a minimum,
    - Each of the headings and subtotals that were included in its most recent annual financial statements
    - The selected explanatory notes as required by this Standard
    - Additional line items or notes to avoid any misleading of report
- A statement presenting components of profit or loss
  - Entity shall present basic and diluted earnings per share for that period

Note:
1. *An interim financial report is prepared on a consolidated basis if the entity's most recent annual financial statements were consolidated statements.*
2. *If an entity's annual financial report includes the parent's separate financial statements in addition to consolidated financial statements, then Ind AS 34 does not restrict or mandate to include the parent's separate statements in the entity's interim financial report prepared on a consolidated basis.*

Significant events and transactions

Include in interim financial report

An explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.

Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report.

Do not include in interim financial report

Insignificant updates to the information that was reported in the notes in the most recent annual financial report because the user will have access to the most recent annual financial report carrying such information.

List of events and transactions for which disclosures would be required if they are significant:

(a) the write-down of inventories to net realisable value and the reversal of such a write-down;
(b) recognition of a loss from the impairment of financial assets, property, plant and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;
(c) the reversal of any provisions for the costs of restructuring;
(d) acquisitions and disposals of items of property, plant and equipment;
(e) commitments for the purchase of property, plant and equipment;
(f) litigation settlements;
(g) corrections of prior period errors;
(h) changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;
(i) any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period;
(j) related party transactions;
(k) transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments;
(l) changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and
(m) changes in contingent liabilities or contingent assets.

Note: The list is not exhaustive.

Other Disclosures

Shall be given (Refer the list in para 16A of Ind AS 34)

Either

In the interim financial statements

Or

Incorporated by cross-reference from the interim financial statements to some other statement (such as management commentary or risk report)

Statements should be available to users of the financial statements on the same terms as the interim financial statements and at the same time **otherwise the interim financial statements shall be considered as incomplete**

The information shall normally be **reported on a financial year-to-date basis.**

Periods for which interim financial statements are required to be presented

Interim reports shall include interim financial statements (condensed or complete) i.e.

Balance sheet
- as of the end of the **current interim period**
- a comparative balance sheet as of the end of the immediately **preceding financial year**

Statements of profit and loss
- for the **current interim period**
- cumulatively for the **current financial year to date**
- comparative statements of profit and loss for the **comparable interim periods (current and year-to-date) of the immediately preceding financial year**

Statement of changes in equity
- cumulatively for the **current financial year to date**
- comparative statement for the **comparable year-to-date period of the immediately preceding financial year**

Statement of cash flows
- cumulatively for the **current financial year to date**
- a comparative statement for the comparable **year-to-date period of the immediately preceding financial year**

Note: *For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period may be useful.*

Points to remember

Disclosure of compliance with Ind AS	If an entity's interim financial report is in compliance with this Standard, that fact shall be disclosed.
	An interim financial report shall be described as complying with Ind ASs when it complies with all of the requirements of Ind ASs.
Materiality	In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data.
	It shall be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.
Disclosure in annual financial statements	If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate shall be disclosed in a note to the annual financial statements for that financial year.
	An entity is not required to include additional interim period financial information in its annual financial statements.

Recognition and Measurement

Same accounting policies as annual	• Apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. • Measurements for interim reporting purposes shall be made on a year-to-date basis. • The amounts reported in prior interim periods are not retrospectively adjusted. However, that the nature and amount of any significant changes in estimates be disclosed.
Revenues received seasonally, cyclically, or occasionally	• Such revenues shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year. • Some entities consistently earn more revenues in certain interim periods of a financial year than in other interim periods. Such revenues are recognised when they occur.
Costs incurred unevenly during the financial year	Such costs shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.
Use of estimates	Preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.
Restatement of previously reported interim periods	A change in accounting policy, shall be reflected: (a) by retrospective application, with restatement of prior period financial data as far back as is practicable; or (b) if the cumulative amount of the adjustment relating to prior financial years is impracticable to determine, then under Ind AS 8 the new policy is applied prospectively from the earliest date practicable.
Interim Financial Reporting and Impairment	An entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill.

INDIAN ACCOUNTING STANDARD (IND AS) 36: IMPAIRMENT OF ASSETS

Objective
- ensuring that assets are carried at no more than their recoverable amount.
- when an impairment loss should be reversed

Scope:
Applies to all asset except arising from Ind AS 2, 12, 19, 41, 104, 105, 109 and 115

Requirement for impairment review when there are inidcations for impairment

Requirement for annual review
Intangible assets with an indefinite useful life or not yet available for use.
Goodwill acquired in business combination

Measurement of recoverable amount : Higher of fair value less costs of diposal and its value in use

Recognition and measurement of an Impairment loss

Reversal of Impairment losses

Scope of Ind AS 36

Applicable

All assets other than non-applicable assets (as listed below)

- It includes Financial assets classified as
  - Subsidiaries, as per Ind AS 110
  - Associates, as per Ind AS 28
  - Joint ventures, as per Ind AS 111
- Assets that are carried at revalued amount *

Not applicable

- Inventories (Ind AS 2)
- Contract assets (Ind AS 115)
- Deferred tax assets (Ind AS 12)
- Assets arising from employees benefits (Ind AS 19)
- Biological Assets measured at fair value less cost to sell (Ind AS 41)
- Deferred acquisition costs and intangible assets arising from insurance contracts (Ind AS 104)
- Non-current assets (or disposal groups) classified as held for sale (Ind AS 105)
- Financial Assets (within the scope of Ind AS 109)

*Note: If the disposal costs are not negligible, then the revalued asset will be impaired if its value in use is less than its revalued amount.

Important definitions:

Cash-generating unit	• It is the smallest identifiable group of assets • This group of asset generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets
Corporate assets	They are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.
Costs of disposal	Costs of disposal are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.
Value in use	Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Impairment Loss = Carrying Amount − Recoverable Amount

Assessment of impairment shall be done annually of following assets irrespective of whether there is any indication of impairment:

- Intangible asset with an indefinite useful life
- Intangible asset not yet available for use
- Goodwill acquired in a business combination

Note:

1. The concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated.
2. If previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount and no significant event had occurred which will change the difference, there is no need for annual assessment of impairment.
3. If indication of impairment exists than remaining useful life, the depreciation (amortisation) method or the residual value for the asset should be reviewed and adjusted, even if no impairment loss is recognised for the asset.

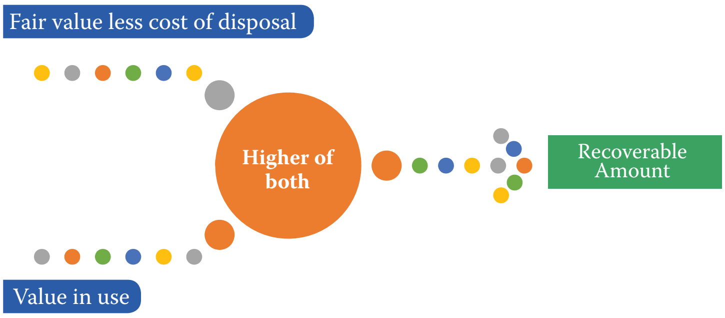
Indicators for impairment

External sources of information
- Significant decline in market value (more than normal decline)
- Significant changes in technology, market, economic or legal environment with adverse effect on entity
- Increase in market interest rates or rate of returns
- Carrying amount of net assets of entity is more than its market capitalisation

Internal sources of information
- Obsolescence or physical damage of an asset
- Significant changes in use or expected use of an asset with adverse effect on entity
- Internal reporting indicating worse economic performance of asset than expected

Dividend from a subsidiary, joint venture or associate
- Carrying amount of investment (in separate financial statements) > Carrying amounts of investee's net assets (including associated goodwill) in the consolidated financial statements
- Dividend > Total Comprehensive Income of investee

Measurement of Recoverable Amount



Circumstances in which it is not necessary to calculate both an asset's fair value less costs of disposal and its value in use

1. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
2. When fair value less costs of disposal would not be possible to be measured due to various reasons, the entity may use the asset's value in use as its recoverable amount.
3. In case of an asset held for disposal, the asset's fair value less costs of disposal may be used as its recoverable amount.

Value in Use

Value in Use = Sum of Year wise estimated future cash flows × Applicable discount rate

Year wise estimated future cash flows

Includes:
- Projections of cash inflows from the continuing use of the asset
- Projections of cash outflows, which are necessarily incurred to generate the cash inflows from continuing use of the asset and can be directly attributed to the asset
- Net cash flows, to be received/paid for the disposal of the asset at the end of its useful life

Excludes:
- Future restructuring to which an entity is not yet committed
- Improving or enhancing the asset's performance
- Cash inflows or outflows from financing activities
- Income tax receipts or payments

Applicable discount rate

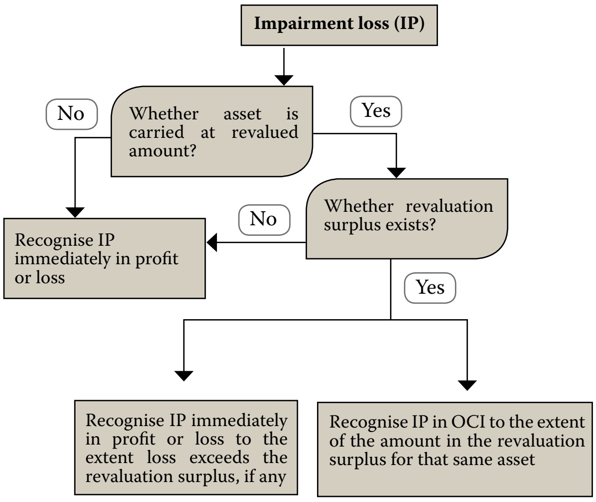
It should be a pre-tax rate (rates) that reflect(s) current market assessments of
- Time value of money
- Risks specific to the asset for which the future cash flow estimates have not been adjusted

When an asset-specific rate is not directly available from the market, the entity uses surrogates to estimate the discount rates
- Entity's weighted average cost of capital
- Entity's incremental borrowing rate
- Other market borrowing rates

Note:

Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation.

Recognising and Measuring an Impairment Loss other than Goodwill

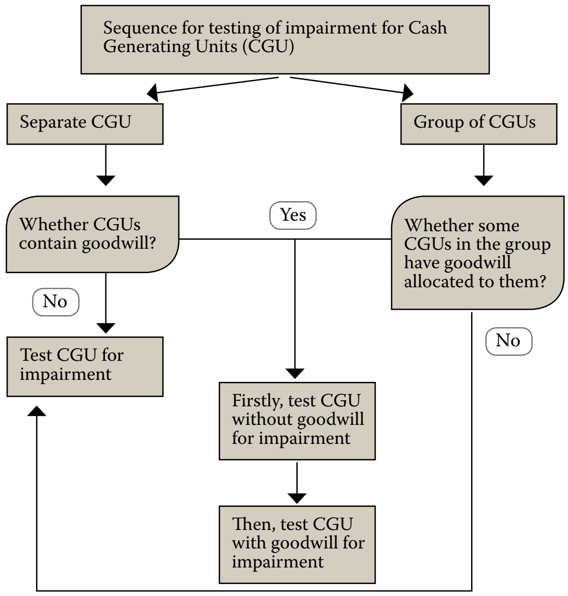


Note:

1. Any impairment loss of a revalued asset (increased earlier) shall be treated as a revaluation decrease as per other standard.
2. When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability, if required.
3. After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.
4. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined in accordance with Ind AS 12 by comparing the revised carrying amount of the asset with its tax base.

Recognition and Measurement of an Impairment Loss for a Cash-generating Unit and Goodwill

S.No.	Particular	Guidance under Ind AS 36
A.	Identification of cash generating units	❖ Firstly, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity is required to determine the recoverable amount of the cash-generating unit to which the asset belongs (ie. the asset's cash-generating unit). ❖ The recoverable amount of an individual asset cannot be determined if: a) the asset's value in use cannot be estimated to be close to its fair value less costs of disposal; and b) the asset does not generate cash inflows that are largely independent of those from other assets. ❖ In such cases, value in use and recoverable amount, can be determined only for the asset's cash-generating unit. ❖ If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows. ❖ If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. ❖ Cash-generating units shall be identified consistently from period to period for the same asset or types of assets.
B.	Allocation of assets and liabilities to CGUs	❖ The carrying amount of a cash-generating unit: (a) includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit's value in use; and (b) does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability. ❖ Subtract the carrying amount of the liability to determine both the cash-generating unit's value in use and its carrying amount to perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount.
C.	Allocating goodwill to cash-generating units	❖ For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units. ❖ The above allocation shall be irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. ❖ Goodwill does not generate cash flows independently of other assets or groups of assets and, therefore, it will always be tested for impairment as part of a CGU or a group of CGUs. ❖ If goodwill has been allocated to a cash-generating unit and the entity disposes of an operation within that unit, the goodwill associated with the operation disposed of shall be: a) included in the carrying amount of the operation when determining the gain or loss on disposal; and b) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.
D.	Timing of impairment tests	❖ Impairment test for a cash-generating unit to which goodwill has been allocated shall be performed annually. ❖ If some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current annual period.



Allocating corporate assets to cash-generating units for impairment

Whether a portion of the carrying amount of a corporate asset can be allocated on a reasonable and consistent basis to that unit?

Yes:

Whether CV of the CGU* > RV of the CGU?
* CV includes the portion of the CV of the corporate asset allocated to it

- Yes → Impairment loss is allocated in the following order
  - **Order 1** Reduce the CV of any goodwill allocated to CGU (group of units)
  - **Order 2** Reduce CV of other assets of the unit (group of units) pro rata on the basis of the CV of each asset in the unit (group of units)
- No → No impairment loss

No:

Step 1: Compare CV of the CGU* with RV of the CGU
* CV excludes corporate asset

Step 2: Identify the smallest group of CGU that includes the CGU under review and to which a portion of the CV of the corporate asset can be allocated on a reasonable and consistent basis

Step 3: Compare CV of that Smallest group of CGU* with RV of group of units
* CV includes the portion of the CV of the corporate asset allocated to that smallest group of CGU

In allocating an impairment loss to individual assets within a CGU, the carrying amount of an individual asset shall not be reduced below the highest of:

- Fair value less costs to sell
- Value in use
- zero

Reversing an Impairment Loss (IP)

General

- Impairment loss is reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount
- Carrying amount of the asset is increased to its recoverable amount.
- Impairment loss is not reversed just because of the passage of time, even if the recoverable amount of the asset becomes higher than its carrying amount.

Individual asset

Cash-generating unit

- Reversal shall be allocated to the assets of the unit (except for goodwill) on pro rata with the carrying amount of those assets.
- Increases in carrying amounts shall be treated as reversals of impairment losses for individual assets.
- In allocating a reversal of an impairment loss for a CGU, the carrying amount of an asset shall not be increased above the lower of:
  - a) Its recoverable amount; and
  - b) The carrying amount (net of amortisation or depreciation) determines had no impairment loss been recognised for the asset in prior periods.
- The reversal of the impairment loss that would otherwise have been allocated to the asset is allocated pro rata to the other assets of the unit, except for goodwill

Goodwill

- Not permitted

Asset without revaluation

On reversal, the increased carrying amount of an asset (other than goodwill) due to reversal of an impairment loss shall not exceed the carrying amount (net of amortisation/ depreciation) had no impairment loss been recognised for the asset in prior years.

- A reversal of an impairment loss (other than goodwill) is recognised immediately in profit or loss unless the asset is carried at revalued amount
- Any increase in excess of this amount would be a revaluation accounted for under appropriate Standard

Asset with revaluation in the earlier years

- A reversal of an impairment loss on a revalued asset is recognised in OCI and increases the revaluation surplus for that asset.
- To the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.
- After reversal, the depreciation / amortisation charge for the asset is adjusted in future periods on a systematic basis over its remaining useful life.

For disclosure requirements of Ind AS 36 refer the study material.

INDIAN ACCOUNTING STANDARD (IND AS) 37: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Overview of Ind AS 37

- Recognition
  - Provision
    - Present obligation
    - Past event
    - Probable outflow of resources embodying economic benefits
    - Reliable estimate of the obligation
  - Contingency
    - Contingent liability
    - Contingent Asset
- Measurement
  - Best estimate
  - Risk and uncertainties
  - Present value
  - Future events
  - Expected disposal of assets
- Reimbursements
- Change and use of provisions
- Application of the recognition and measurement rules
  - Future operating losses
  - Onerous contracts
  - Restructuring
- Disclosure
  - Provision
  - Contingent liability
  - Contingent asset

Objective of Ind AS 37

- To ensure that appropriate recognition criteria and measurement bases are applied
- To ensure that sufficient information is disclosed in the notes to understand nature, timing & amount

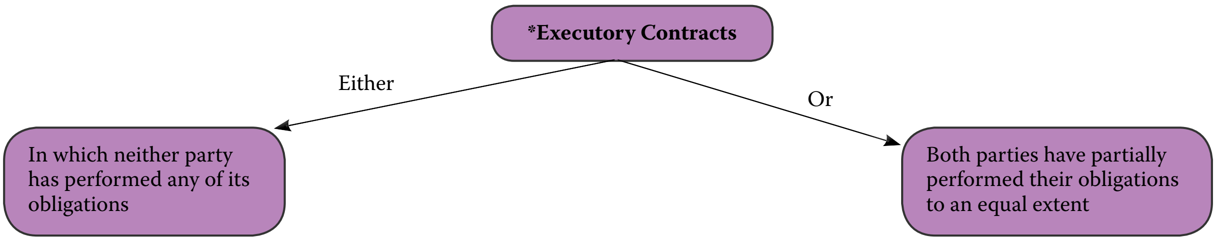
→ For provisions, contingent liabilities and contingent assets

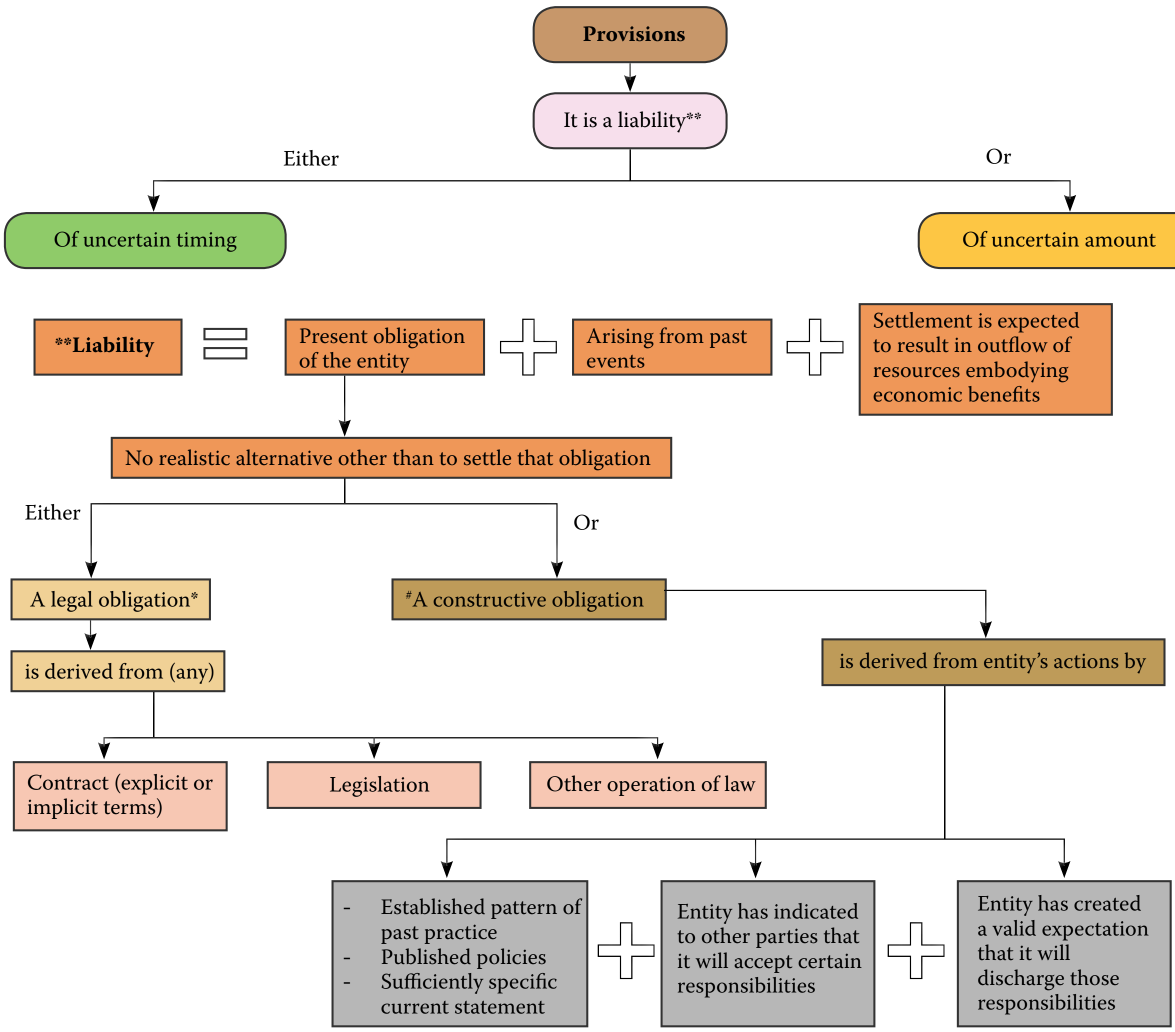
Ind AS 37 does not apply to

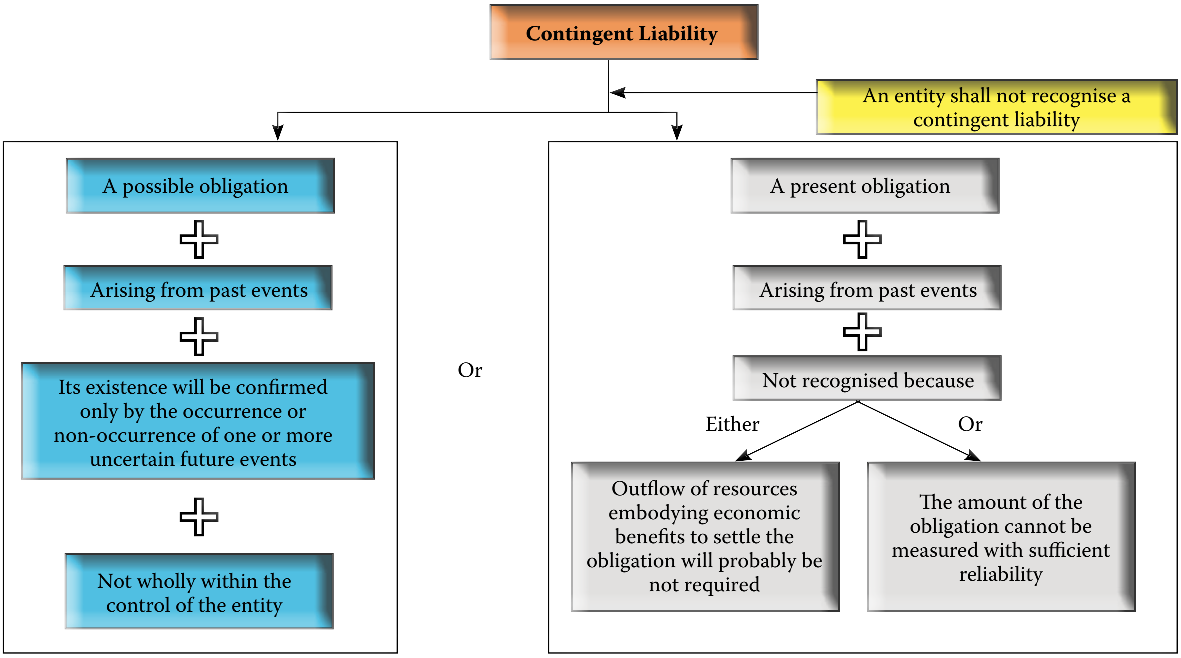
- Financial instruments (including guarantees) within the scope of Ind AS 109
- Those covered by another Ind AS
  - Ind AS 115 'Revenue from Contracts with Customers'
  - Ind AS 12 'Income Taxes'
  - Ind AS 116 'Leases'
    - Except lease that becomes onerous before the commencement date of the lease as per Ind AS 116
    - Except short-term leases and leases for which the underlying asset is of low value and that have become onerous
  - Ind AS 19 'Employee Benefits'
  - Ind AS 104 'Insurance Contracts'
  - Contingent Consideration of an acquirer in a business combination (Ind AS 103)
- Executory Contracts*
  - Except those are onerous in nature

Notes:

- Items such as depreciation, impairment of assets and doubtful debts are adjustments to the carrying amounts of assets and are not dealt with in this Standard.
- Ind AS 37 neither prohibits nor requires capitalisation of the costs recognised when a provision is made.
- This Standard applies to provisions for restructurings (including discontinued operations).

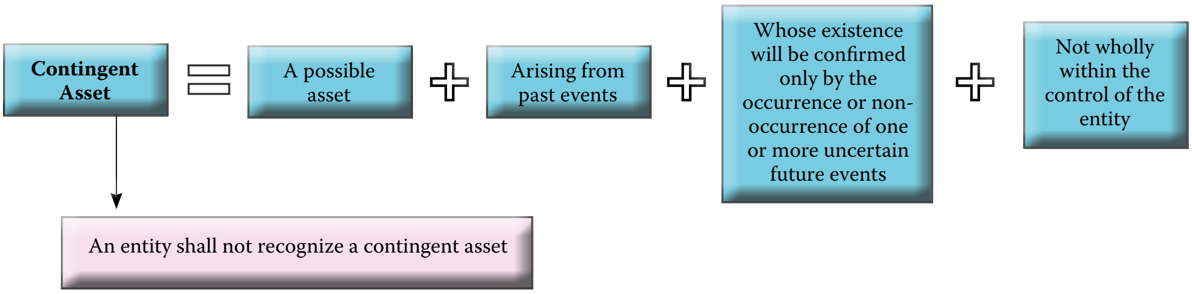

*Executory Contracts
Either
Or
In which neither party has performed any of its obligations
Both parties have partially performed their obligations to an equal extent


Provisions
It is a liability**
Either
Or
Of uncertain timing
Of uncertain amount
**Liability
Present obligation of the entity
Arising from past events
Settlement is expected to result in outflow of resources embodying economic benefits
No realistic alternative other than to settle that obligation
Either
Or
A legal obligation#
#A constructive obligation
is derived from (any)
is derived from entity's actions by
Contract (explicit or implicit terms)
Legislation
Other operation of law
- Established pattern of past practice
- Published policies
- Sufficiently specific current statement
Entity has indicated to other parties that it will accept certain responsibilities
Entity has created a valid expectation that it will discharge those responsibilities



Notes:

1. The term 'contingent liability' is used for liabilities that do not meet the recognition criteria.
2. Where it is not probable that a present obligation exists, an entity discloses a contingent liability. Probable means 'more likely than not'.
3. If the possibility of an outflow of resources embodying economic benefits is remote, contingent liability is not disclosed.
4. Where an entity is jointly and severally liable for an obligation, the part of the obligation that is **expected to be met by other parties is treated as a contingent liability.** The **entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable,** except in the extremely rare circumstances where no reliable estimate can be made.
5. Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable, a provision is recognised in the period in which the change in probability occurs.

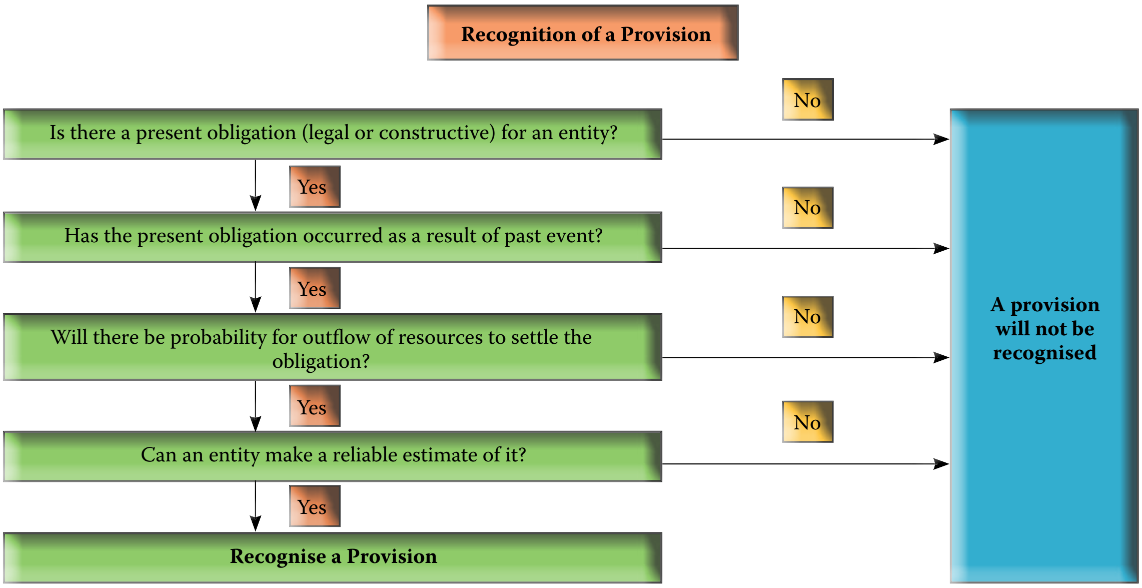


Notes:

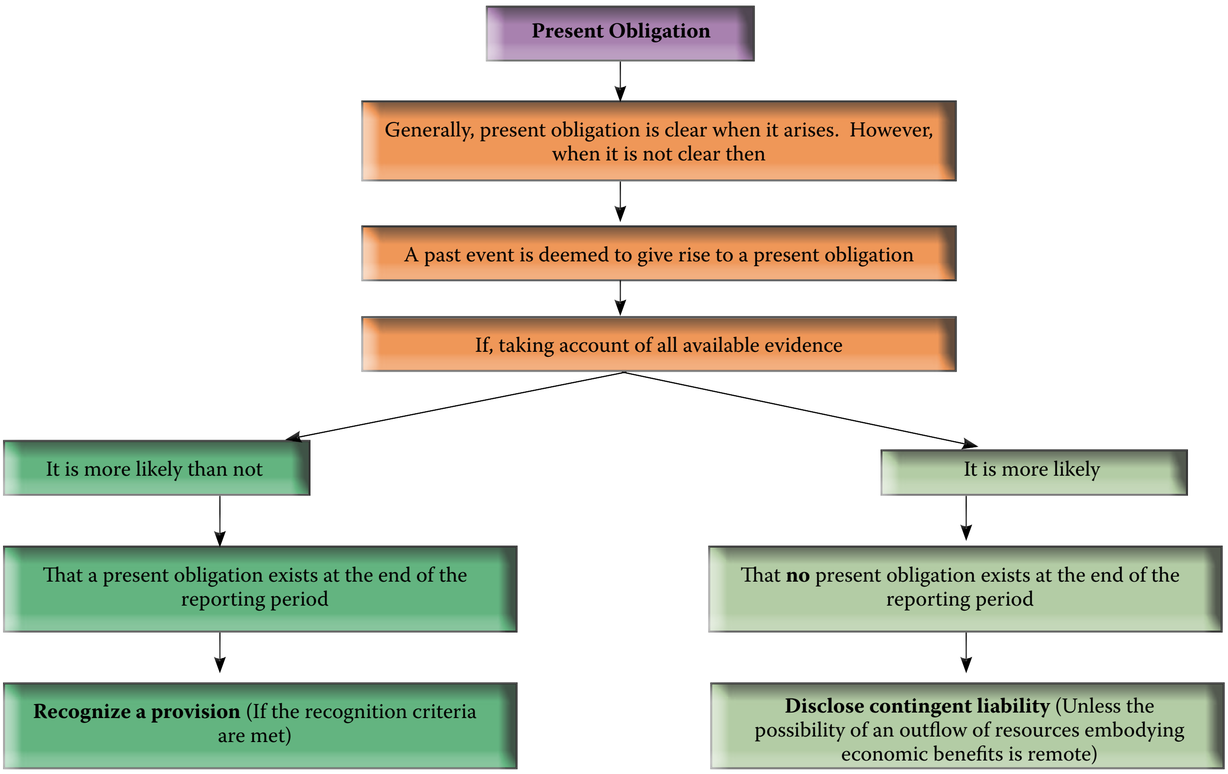
1. Contingent assets are not recognised in financial statements since it may never be realised.
2. When the realisation of income is **virtually certain**, then the related asset is recognised.
3. Contingent asset is disclosed where an inflow of economic benefits is probable.
4. Contingent assets are assessed continually. If it has become virtually certain, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Differences between Provisions & Other Liabilities

S. No	Provisions	Other liabilities (Trade payables or accruals)
1	In provisions, there is uncertainty about the timing or amount of the future expenditure required in settlement	• Trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier. Hence uncertainty is generally much less than for provisions • Accruals are similar to trade payables. However, it may also include amounts due to employees
2	Provisions are reported separately	Accruals are often reported as part of trade and other payables



Notes:
1. If these conditions are not met, no provision should be recognised.
2. Where there are a number of similar obligations (eg product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.
3. Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable, then the provision shall be reversed.
4. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost.



Notes:
- **No** provision is recognised for costs that need to be incurred to operate in the future.
- Only those liabilities are recognised in an entity's balance sheet which exist at the end of the reporting period.

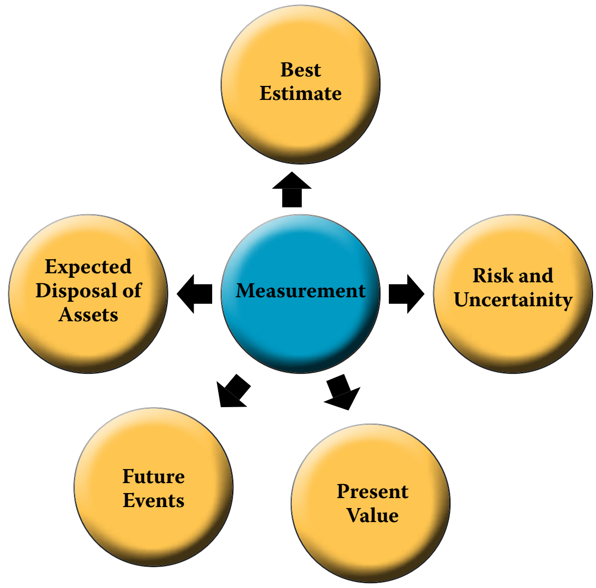
Obligations arising from past events

↓

Existing independently of an entity's future actions

- Yes → Recognize Provision (If the recognition criteria are met)
  - ↓ To the extent that the entity is obliged to rectify damage already caused
  - ↓ Examples:
    - Penalties or clean-up costs for unlawful environmental damage
    - Decommissioning costs of an oil installation or a nuclear power station
- No → Don't recognize Provision
  - ↓ Because the entity can avoid the future expenditure by its future actions
  - ↓ Example:
    - Fitting smoke filters in a certain type of factory

MEASUREMENT



Best estimate in measurement of provision amount

↓

Provision should be the best estimate of expenditure required to settle the present obligation (At the end of the reporting period)

↓

Provision should be measured before tax

Measurement of estimates of outcome & financial effect considers

- Management's judgement
  - ↓ Supplemented by:
    - Experience of similar transactions
    - Reports from independent experts
- If Provision involves items of large population (Ex. customer refunds, warranties, etc.)
  - ↓ Weight all possible outcomes by their associated probabilities (expected value)
- In continuous range of possible outcomes
  - ↓ When each point in that range is as likely as any other
  - ↓ Then mid-point of the range is used
- In case of measurement of single obligation
  - ↓ Individual most likely outcome may be the best estimate (Consider other possible outcomes too)
- If other possible outcomes are either mostly higher or mostly lower than the most likely outcome
  - ↓ Higher or lower amount will be the best estimate

Risks and Uncertainties in measurement of provision amount

- Risk is variability of outcome
  - It should be considered in reaching the best estimate of an amount of provision
- Risk adjustment = Expected excess amount to be paid
  - Consider present value of outflows due to uncertainty
- Risk adjustment may increase the amount at which a liability is measured
  - **Caution:** Income or assets are not overstated and expenses or liabilities are not understated
- Risk adjustment can be accounted for in number of ways as:
  - **Adding in:** Expected present value of future outflows
  - **Adjusting:** Estimates of future outflows
  - **Adjusting:** Discount rate
- Disclosure of the uncertainties surrounding the amount of the expenditure should be made

Present Value in measurement of provision amount

- Whether the effect of the time value of money is material?
  - Yes → Consider present value of expenditures expected to settle the obligation as provision amount
  - No → Ignore present value
- The discount rate should be a pre-tax rate
  - Discount rate should not reflect risks for which future cash flow estimates have been adjusted
- The expected present value of outflows are calculated as follows:
  - Each outcome is discounted to its present value
  - The present value of outcomes are weighted by their associated probabilities
- Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time.
- This increase is recognised as borrowing cost

Future events in measurement of provision amount

- Should be reflected where there is sufficient objective evidence that they will occur
- Effect of possible new legislation is taken into consideration when sufficient objective evidence exists that legislation is virtually certain to be enacted
  - Evidence is required both of:
    - what legislation will demand
    - whether it is virtually certain to be enacted and implemented in due course

Expected disposal of assets in measurement of provision amount → Gains on the expected disposal of assets are not taken into account in measuring a provision → Recognise gains on expected disposals of assets at the time specified by the Standard dealing with the assets concerned

Reimbursements			
Situation	**The entity has no obligation for the part of the expenditure to be reimbursed by the other party**	**Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party and it is virtually certain that reimbursement will be received if the entity settles the provision**	**Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party but the reimbursement is NOT virtually certain**
Recognition	The entity has no liability for the amount to be reimbursed. Hence no provision will be made	• The reimbursement is recognised as a separate asset in the balance sheet • In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement • The amount recognised for the expected reimbursement shall not exceed the liability	The expected reimbursement is not recognised as an asset
Disclosure	No disclosure is required	The reimbursement is disclosed together with the amount recognised for the reimbursement	The expected reimbursement is disclosed

Future operating losses

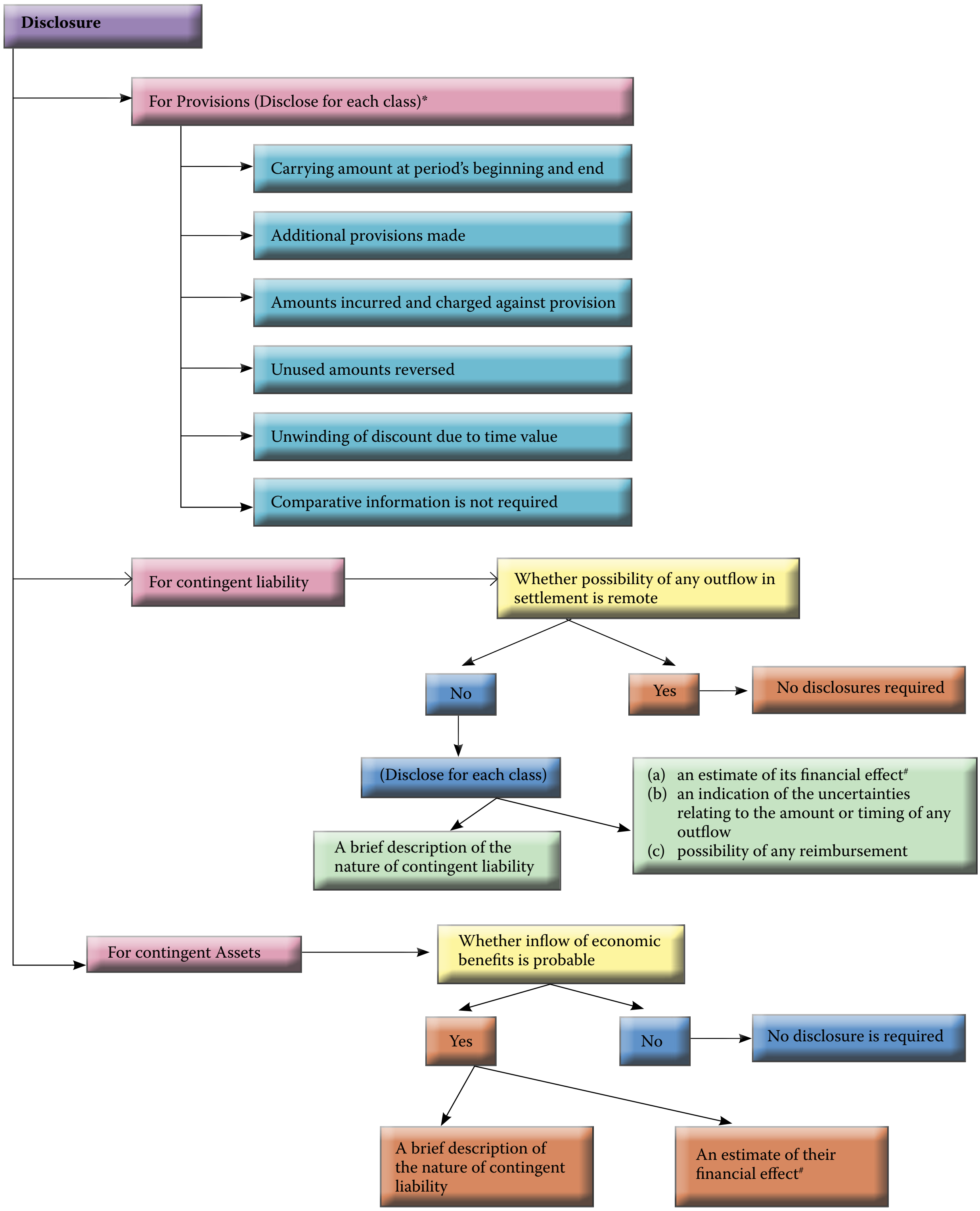
- Provisions shall not be recognised for future operating losses
  - ↓ As they do not meet the definition of a liability and the general recognition criteria set out for provisions
- An expectation of future operating losses is an indication that certain assets of the operation may be impaired
  - ↓ An entity tests these assets for impairment under Ind AS 36, Impairment of Assets

Onerous contract = Unavoidable costs of meeting the obligations under the contract > Economic benefits expected to be received under the contract

- Present obligation is to be recognised and measured as a provision
- Executory contracts that are not onerous fall outside the scope of Ind AS 37
- Make provision amount for the lower of
  - Unavoidable costs of fulfilling the contract
  - Penalty / Compensation for not meeting the obligations from the contract
- **Recognize any impairment loss** as per Ind AS 36 on assets dedicated to onerous contract **before making a separate provision** for an onerous contract

Restructuring

- In general, restructuring is a plan of management to change the scope of business or manner of conducting business
- Examples of events that may fall under the definition of restructuring:
  - sale or termination of a line of business;
  - closure of business locations or relocation of business activities;
  - changes in management structure; and
  - fundamental reorganizations that have a material effect on the nature and focus of the entity's operations
- Provision for restructuring costs is recognized only when the general recognition criteria set out for provisions are met
- An obligation to restructure arises only if entity has
  - Detailed formal plan for restructuring
    - Identifying at least:
      - (i) the business or part of a business concerned;
      - (ii) the principal locations affected;
      - (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;
      - (iv) the expenditures that will be undertaken; and
      - (v) when the plan will be implemented.
  - Raised valid expectation in those affected that it will carry out restructuring (through implementation or announcement of main features of restructuring)
- No obligation arises for the sale of an operation until there is a binding sale agreement
- When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under Ind AS 36
- Restructuring provision includes only direct expenditures arising from the restructuring, which are both
  - Necessarily demanded by restructuring
  - Not associated with the ongoing activities of entity
- Restructuring provision does not include costs of:
  - Retraining or relocating continuing staff;
  - Marketing; or
  - Investment in new systems and distribution networks.



* Disclose the following for each class of provision:

a) Nature of obligation and expected timing of any resulting outflows

b) Uncertainties about the amount or timing of those outflows

c) Any expected reimbursement

Provisions or contingent liabilities may be aggregated to form a class, but consider whether the nature of items is sufficiently similar for a single statement

\# If required information is not disclosed since not practicable to do so, that fact shall be stated

INDIAN ACCOUNTING STANDARD (IND AS) 38: INTANGIBLE ASSETS

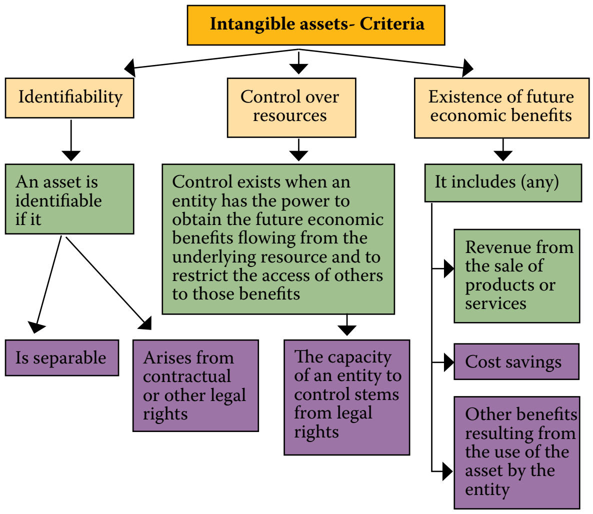
Scope of Ind AS 38

Applicability

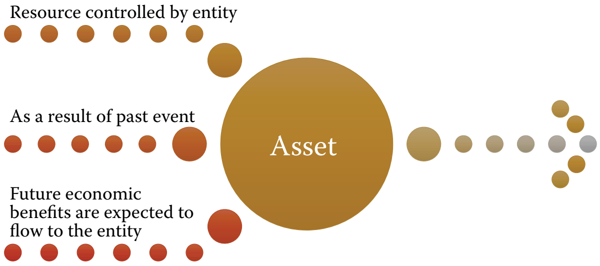
- Intangible assets other than included in the list of non-applicability
- Expenditure on advertising, training, start-up, research and development activities
- Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights
- Other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

Non-Applicablility

- Financial assets (Ind AS 32)
- Recognition and measurement of exploration and evaluation assets (Ind AS 106)
- Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources
- Intangible assets held by an entity for sale in the ordinary course of business (Ind AS 2)
- Deferred tax assets (Ind AS 12)
- Leases of intangible assets (Ind AS 116)
- Assets arising from employee benefits (Ind AS 19)
- Goodwill acquired in a business combination (Ind AS 103)
- Deferred acquisition costs and intangible assets, arising from an insurer's contractual rights under insurance contracts (Ind AS 104)
- Non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) (Ind AS 105)
- Assets arising from contracts with customers (Ind AS 115)
- Amortisation of the intangible assets arising from service concession arrangements in respect of toll roads



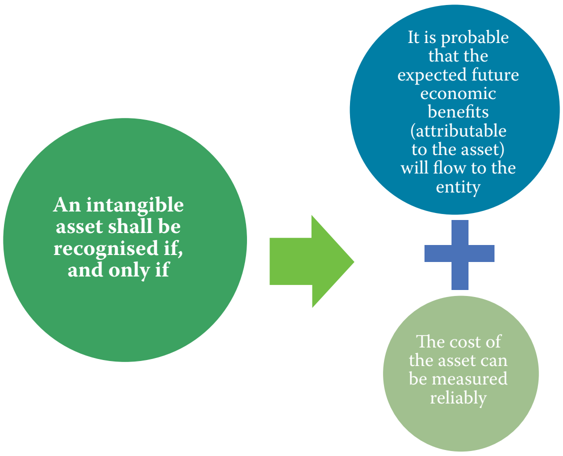
Definition of Asset



Definition of Intangible Asset

Intangible Assets		
Identifiable	Non-monetary asset	Without physical substance

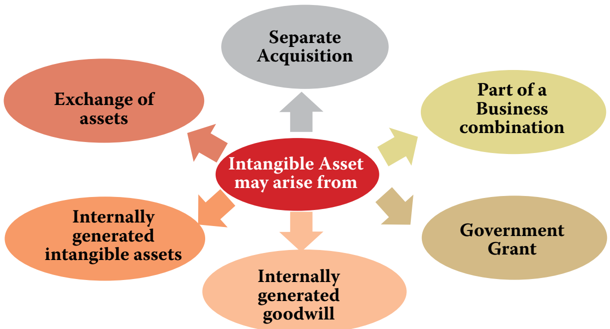
Recognition of Intangible Assets – General Principles



Note: Probability of future economic benefits will exist if the entity expects there to be an inflow of economic benefits, though there is uncertainty about the timing or the amount of the inflow.

Measurement of Intangible Asset

Intangible assets may be acquired or can be self generated. The below diagram reflect the method and mode by which Intangible assets may arise:



A. Recognition and Measurement for intangible assets acquired separately	
Recognition for intangible assets acquired separately	• The probability recognition criterion is always considered to be satisfied for separately acquired intangible assets. • The cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

Measurement of Cost for Intangible Assets Acquired Separately

Cost of Separately Acquired Intangible Asset

- Purchase price including import duties and non - refundable purchase taxes
- Directly attributable Cost of preparing the asset for its intended use. (Cost of Employee Benefits, Professional and Legal Fees Cost of Testing)
  - **Includes**
    - Costs of employee benefits
    - Professional fees arising directly from bringing the asset to its working condition
    - Costs of testing
  - **Excludes**
    - Costs of introducing a new product or service
    - Costs of conducting business in a new location or with a new class of customer
    - Administration and other general overhead costs.

Note:

1. Costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset.
2. Incidental operations not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised immediately in profit or loss.
3. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit if not capitalised as per Ind AS 23.

B. Acquisition as part of a business combination	
Recognition criteria for intangible assets acquired as part of a business combination	• The probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. • The reliable measurement criterion is always considered to be satisfied for intangible assets acquired in business combinations. • The acquirer may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives.
Measuring fair value	• If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date.
C. Acquisition by way of a government grant	
Recognition	If an intangible asset is acquired free of charge, or for nominal consideration, by way of a government grant, an entity recognises both the intangible asset and the grant initially at fair value as per Ind AS 20.

D. Exchanges of assets	
Measurement	• One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. • If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident. (Refer chart on "Exchange of Assets" given in Ind AS 16)
E. Internally generated goodwill	
Recognition	• Internally generated goodwill shall not be recognised as an asset. • Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the entity that can be measured reliably at cost.

Internally generated Intangible Asset

Recognition of Internally generated intangible assets

- **Research phase**
  - Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding
  - No intangible asset arising from research phase shall be recognised
- **Development phase**
  - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved asset
  - An intangible asset arising from development phase shall be recognised if, and only if, an entity can demonstrate all of the following:
    - The technical feasibility of completing the intangible asset so that it will be available for use or sale
    - Its intention to complete the intangible asset and use or sell it.
    - Its ability to use or sell the intangible asset
    - How the intangible asset will generate probable future economic benefits
    - The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
    - Its ability to measure reliably the expenditure attributable to the intangible asset during its development

Note:

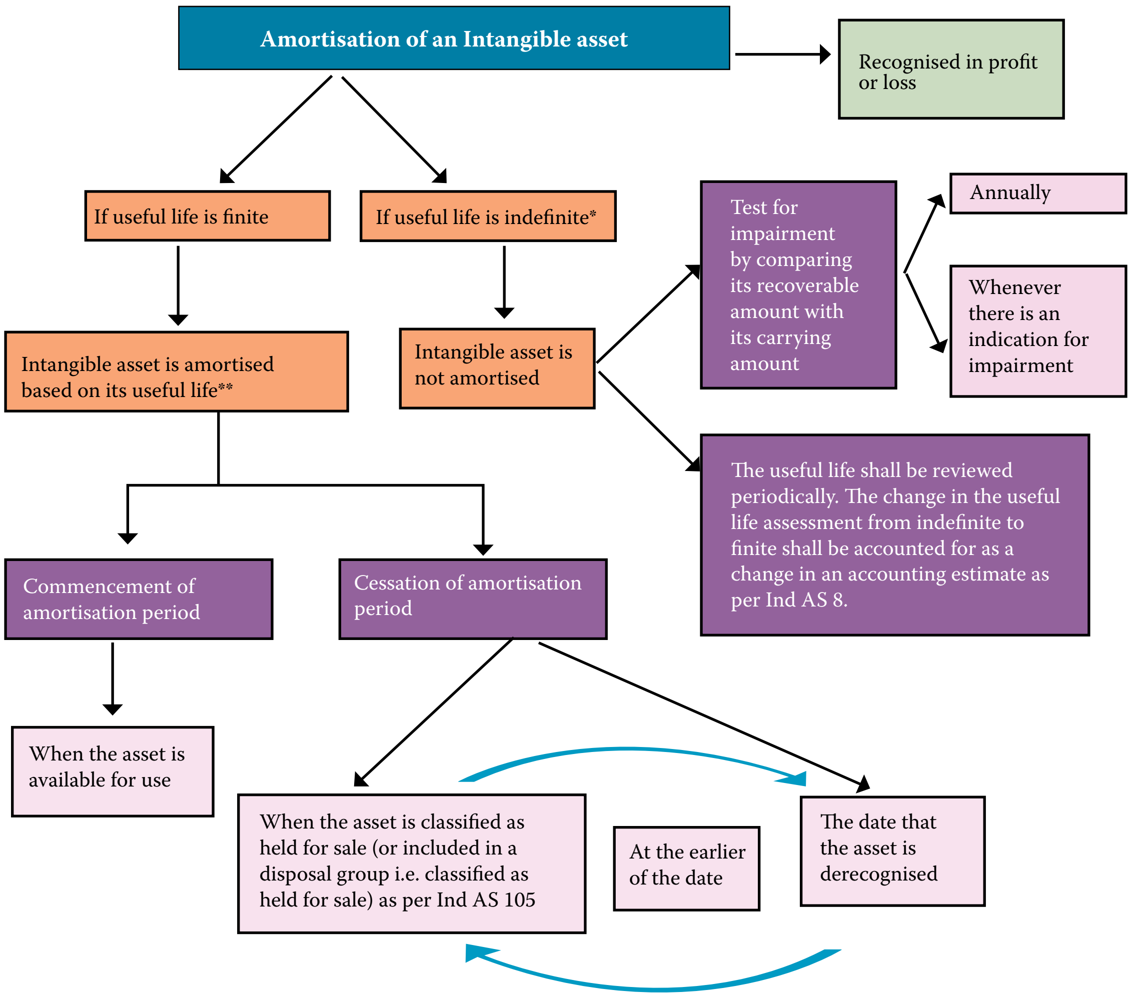
1. If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.
2. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.
3. The cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
4. Standard prohibits reinstatement of expenditure previously recognised as an expense.

Measurement after Recognition and Revaluation

Refer the charts for 'Measurement after recognition', 'Frequency of revaluation', 'Treatment on application of revaluation model' and 'Treatment of revaluation gain or loss' given in Ind AS 16. Same charts hold goods for Ind AS 38 also.

Additional important points to be remembered in case of revaluation of intangible asset

- ❖ If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset,
  - the asset shall be carried at its cost less any accumulated amortisation and impairment losses.
- ❖ If the fair value of a revalued intangible asset can no longer be measured by reference to an active market,
  - the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.
- ❖ The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired.



Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, if the asset has not been fully depreciated or has not been classified as held for sale (or included in a disposal group that is classified as held for sale) as per Ind AS 105.

**The term 'indefinite' does not mean 'infinite'.*
***Useful life is equivalent to the length of, or number of production or similar units.*

Useful Life of an Intangible Asset

Useful life of an intangible asset

Factors considered in determining the useful life of an intangible asset

- Expected usage of the asset by the entity
- Typical product life cycles for the asset and public information on estimates of useful lives of similar assets
- Technical, technological, commercial or other types of obsolescence
- Stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset
- Expected actions by competitors
- Level of maintenance expenditure required
- Period of control over the asset and legal or similar limits on the use of the asset
- Dependent on the useful life of other assets of the entity

If intangible asset arises from contractual or other legal rights

The useful life **shall not exceed** the period of the contractual or other legal rights

The useful life may be shorter depending on the period over which the entity expects to use the asset

Whether the contractual or other legal rights can be renewed?

Yes: Useful life of the intangible asset shall include the renewal period(s) if renewal is without significant cost

No: Useful life of the intangible asset shall not include the renewal period(s)

If an intangible asset is a reacquired right arisen due to a business combination

Its useful life is the remaining contractual period of the contract in which the right was granted and **shall not include** renewal periods

Factors influencing the useful life

Economic factors

Economic factors determine the period over which future economic benefits will be received by the entity

Legal factors

Legal factors may restrict the period over which the entity controls access to these benefits

The useful life is the shorter of the periods determined by these factors

Amortisation Method

Amortisation Method

- Straight-line method
- Diminishing balance method
- Units of production method

Applied consistently from period to period

Method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset

Residual Value is assumed to be zero unless there is

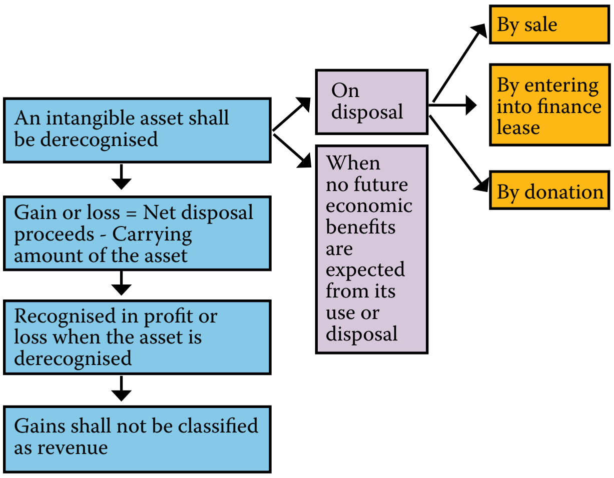
Commitment by a third party to purchase at end of useful life i.e. have a guaranteed residual value or

There is an active market

Note:

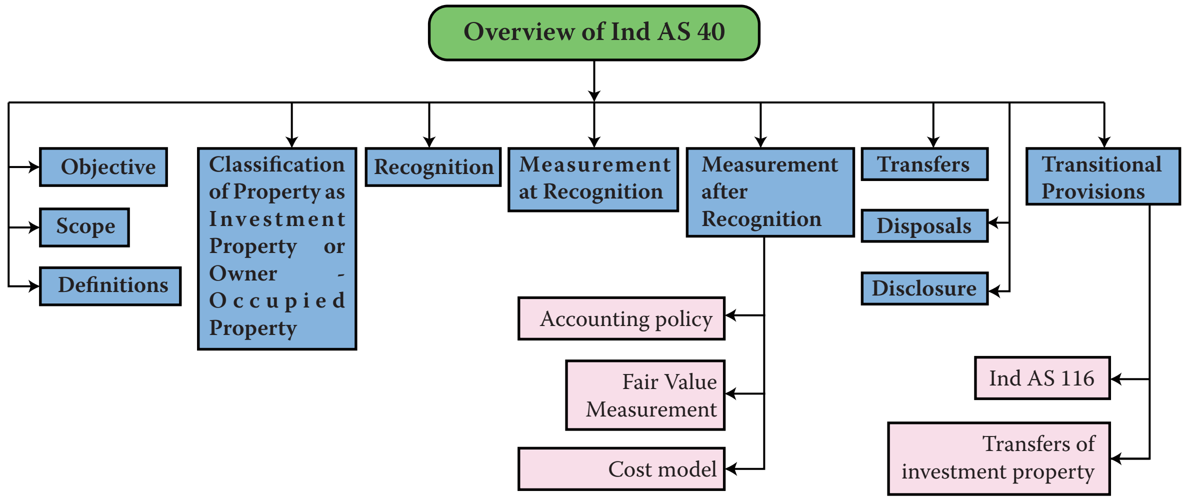
Particular	Details
Residual value other than zero	It implies that an entity expects to dispose of the intangible asset before the end of its economic life
Review of residual value	The residual value is reviewed at least at each financial year-end
Change in the asset's residual value	A change in the asset's residual value is accounted for as a change in an accounting estimate as per Ind AS 8
Increase in residual value to an amount equal to or greater than the asset's carrying amount	In such a situation, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount
Review of amortisation period and amortisation method	Reviewed at least at each financial year-end
Change in expected useful life	Amortisation period shall be changed
Change in the expected pattern of consumption of the future economic benefits	Amortisation method shall be changed to reflect the changed pattern
Accounting for changes in amortisation period/method	Such changes shall be accounted for as changes in accounting estimates in accordance with Ind AS 8

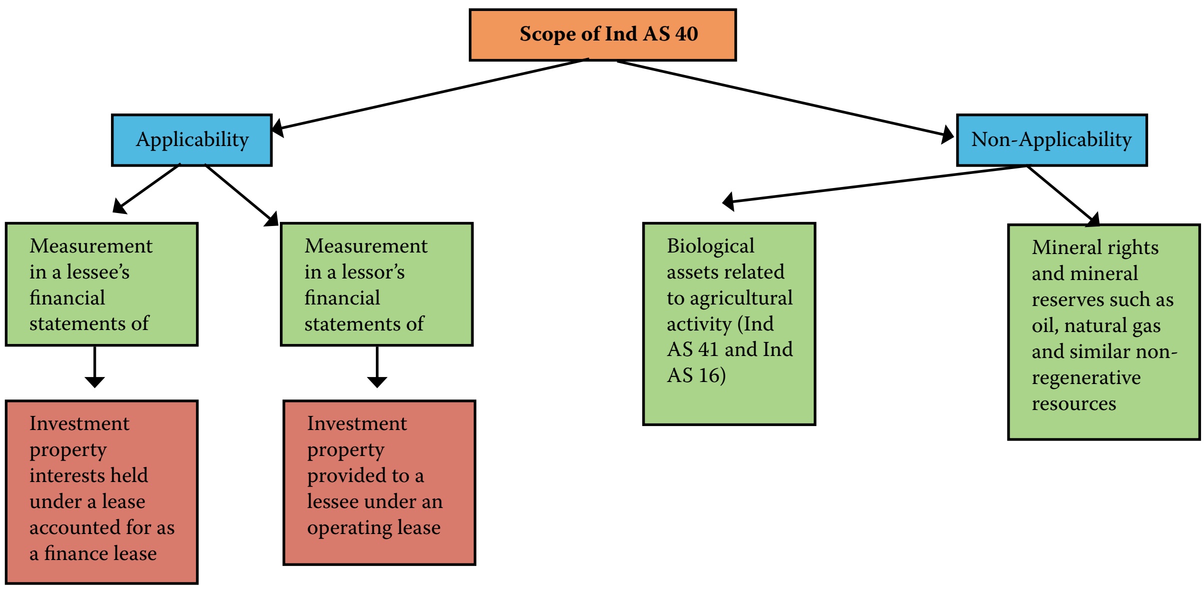
Retirements and Disposals of Intangible Assets



For disclosure requirements of Ind AS 38 refer the study material.

INDIAN ACCOUNTING STANDARD (IND AS) 40: INVESTMENT PROPERTY





Investment Property

Includes
- Land
- Building—or part of a building
- Both Land and Building

Held (by the owner or by the lessee as a right-of-use asset)

To earn rentals or for capital appreciation or both

Excludes
- Property used in the production or supply of goods or services or for administrative purposes
- Property held for sale in the ordinary course of business
- Owner-occupied property. Ind AS 16 applies to it
- Property occupied by employees. Ind AS 16 applies to it
- Owner-occupied property awaiting disposal. Ind AS 16 applies to it
- Owner-occupied property held by a lessee as a right-of-use asset

Examples of Investment Property

- Land held for long-term capital appreciation
- Land held for a currently undetermined future use
- A building owned by the entity (or a right-of-use asset relating to a building held by the entity) 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

Note:
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.

Property Held for More Than One Purpose

Dual Purpose – Able to split
- Owner Occupied → Ind AS 16
- Rental Income → Ind AS 40

Dual Purpose – Unable to split
- Owner Occupied
- Rental Income

→ Ind AS 40

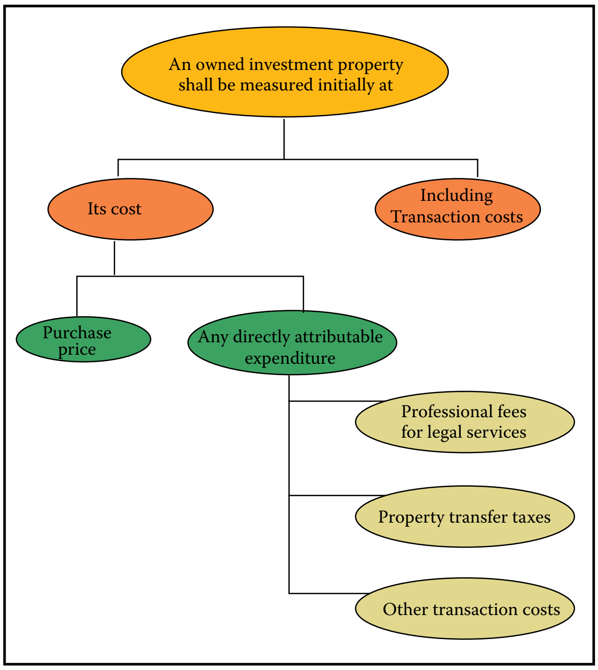
Investment property shall be recognised as an asset when, and only when
- It is probable that the future economic benefits that are associated with the investment property will flow to the entity
- The cost of the investment property can be measured reliably

Costs include
• costs incurred initially to acquire an owned investment property and
• costs incurred subsequently to add to, replace part of, or service a property

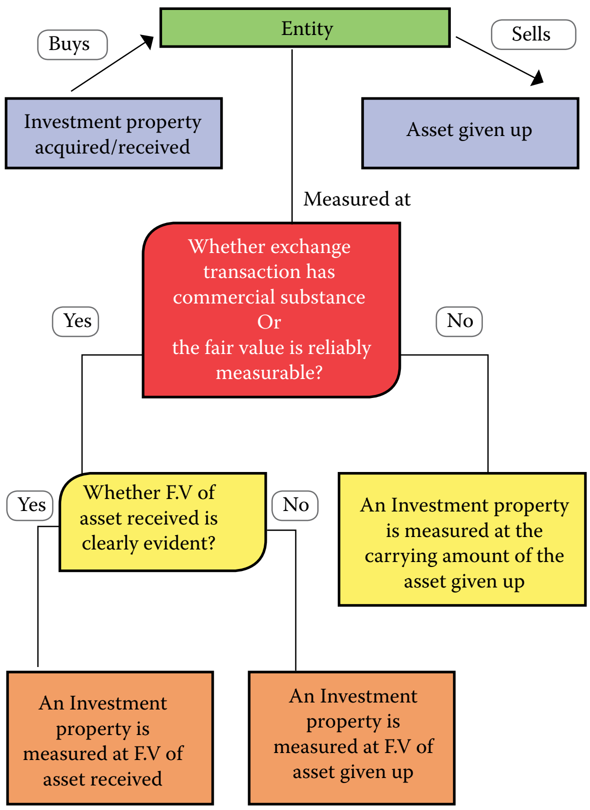
•Recognise in the carrying amount the cost of replacing part of an existing investment property when it is incurred.
•The carrying amount of replaced part is derecognised

Note: An investment property held by a lessee as a right-of-use asset shall be recognised and measured initially at its cost as per Ind AS 116

Measurement at Recognition



Exchange for Non-monetary Assets



Important Notes

S. No.	Particular	Detail
1.	Cost of an investment property does not include	(a) Start-up costs (unless necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management), (b) Operating losses incurred before the investment property achieves the planned level of occupancy, or (c) Abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.
2.	Deferred payment	• Cost of an investment property is its cash price equivalent. • The difference between this amount and the total payments is recognised as interest expense over the period of credit.

Measurement after Recognition

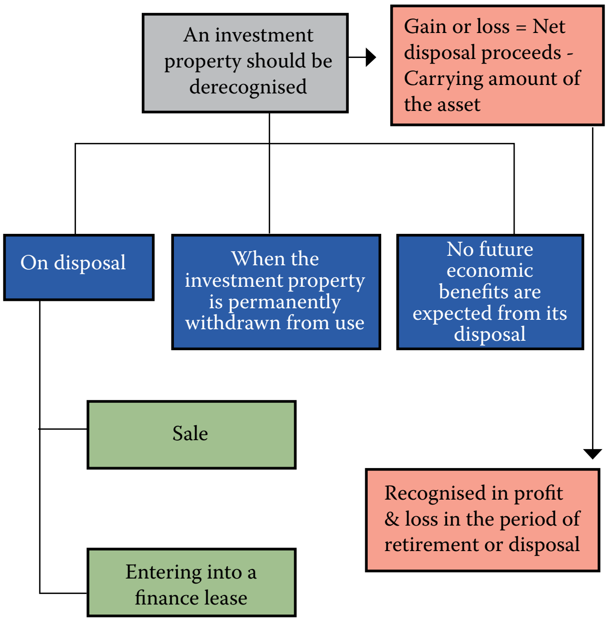
Note:

1. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with Ind AS 105.
2. Investment properties held by a lessee as a right-of-use asset and is not held for sale is measured as per Ind AS 116.
3. All other investment properties are measured as per Ind AS 16, under cost model.

Transfers

1) Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:
   a) Commencement of owner-occupation, for a transfer from investment property to owner-occupied property;
      Ind AS 40 → Ind AS 16
   b) Commencement of development with a view to sale, for a transfer from investment property to inventories;
      Ind AS 40 → Ind AS 2
   c) End of owner-occupation, for a transfer from owner-occupied property to investment property; or
      Ind AS 16 → Ind AS 40
   d) Commencement of an operating lease to another party, for a transfer from inventories to investment property.
      Ind AS 2 → Ind AS 40
2) 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.

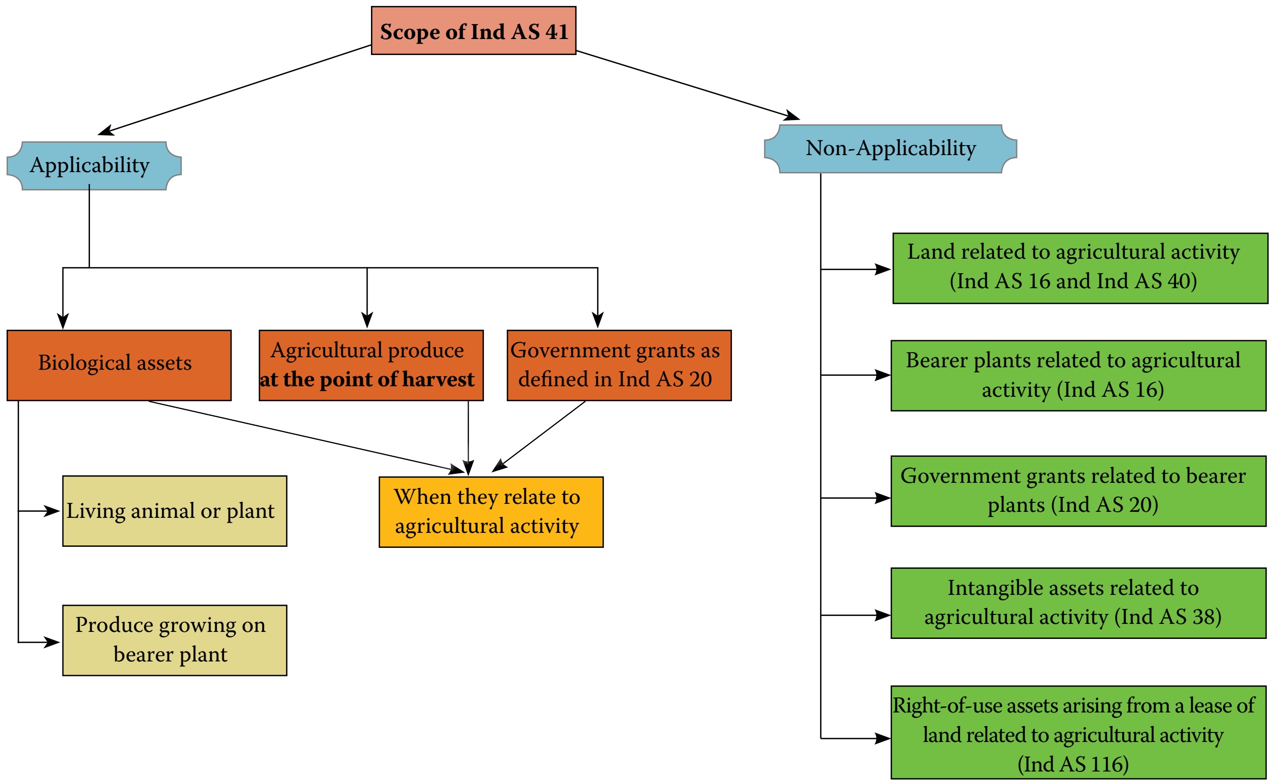
Disposals



S. No.	Particular	Detail
1.	Date of disposal for investment property	• The date is when the recipient obtains control of the investment property sold for determining when a performance obligation is satisfied. • Ind AS 116 applies to a disposal effected by entering into a finance lease and to a sale and leaseback
2.	Measurement of consideration receivable on disposal	• The consideration receivable on disposal of an investment property is recognised initially **at fair value** • If payment for an investment property is deferred, the consideration received is recognised initially at the **cash price equivalent.** • The **difference** between the nominal amount of the consideration and the cash price equivalent **is recognised as interest revenue**
3.	Compensation	• Compensation from third parties for investment property that was impaired, lost or given up **shall be recognised in profit or loss when the compensation becomes receivable.**

For disclosure requirements of Ind AS 40 refer the study material.

INDIAN ACCOUNTING STANDARD (IND AS) 41: AGRICULTURE



Note:

1. This Standard is **applied to agricultural produce**, which is the harvested produce of the entity's biological assets, **at the point of harvest.** Thereafter, Ind AS 2 or another applicable Ind AS is applied. Hence, Ind AS 41 **does not deal with** the processing of agricultural produce **after harvest.**
2. Ind AS 41 **does not apply to** Bearer plants **but applies to the produce on those bearer plants.**

   The following are **NOT** bearer plants:

   (a) Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);

   (b) Plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and

   (c) Annual crops (for example, maize and wheat).
3. Bearer plants no longer used to bear produce are still considered as bearer plant even when they might be cut down and sold as scrap.

The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a timber plantation	Felled Trees	Logs, lumber
Dairy Cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Cotton plants	Harvested cotton	Thread, clothing
Sugarcane	Harvested cane	Sugar
Tobacco plants	Picked leaves	Cured tobacco
Tea bushes	Picked leaves	Tea
Grape vines	Picked grapes	Wine
Fruit trees	Picked fruit	Processed fruit
Rubber trees	Harvested latex	Rubber products

Note:

Some plants, for example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are within the scope of Ind AS 16. However, the produce growing on bearer plants, for example, tea leaves, grapes, oil palm fruit and latex, is within the scope of Ind AS 41.

Agricultural activity is the management by an entity of
- biological transformation
- harvest of biological assets

for sale or for conversion
- into agricultural produce
- into additional biological assets

Features
- **Capability to change -** Living animals/plants are capable of biological transformation
- **Management of change -** Management facilitates biological transformation by enhancing, or at least stabilising, conditions necessary for the process to take place (for example, nutrient levels, moisture, temperature, fertility, and light)
- **Measurement of change -** The **change in quality** (for example, genetic merit, density, ripeness, fat cover, protein content, and fibre strength) **or quantity** (for example, progeny, weight, cubic metres, fibre length or diameter, and number of buds) **brought about by biological transformation or harvest is measured and monitored** as a routine management function

Note: Harvesting from unmanaged sources (such as ocean fishing and deforestation) is **not** agricultural activity.

Biological Transformation

is a processes of (causing qualitative or quantitative changes in a biological asset)

- Growth: An increase n quantity or mprovement in quality of an animal or plant
- Degeneration: A decrease in the quantity or deterioration in quality of an animal or plant
- Production: Of agricultural produce such as latex, tea leaf, wool, and mik
- Procreation: Creation of additional living animals or plants

Bearer plant	It is a living plant that: (a) is used in the production or supply of agricultural produce; (b) is expected to bear produce for more than one period; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales
Harvest	It is the detachment of produce from a biological asset or the cessation of a biological asset's life processes

Biological Assets

Recognition (when and only when)
- the entity controls the asset as a result of past events
- it is probable that future economic benefits associated with the asset will flow to the entity
- the fair value or cost of the asset can be measured reliably

Measurement
- initial recognition
- at the end of each reporting period

at its fair value less costs to sell

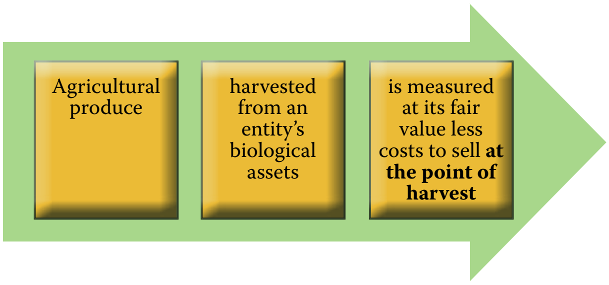
Exception

This presumption **can be rebutted only on initial recognition for a biological asset** when
a. quoted market prices are not available and
b. alternative fair value measurements determined are clearly unreliable.

In such a case, it shall be **measured at its cost less any accumulated depreciation and any accumulated impairment losses.**

<u>**Note:**</u> Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell.

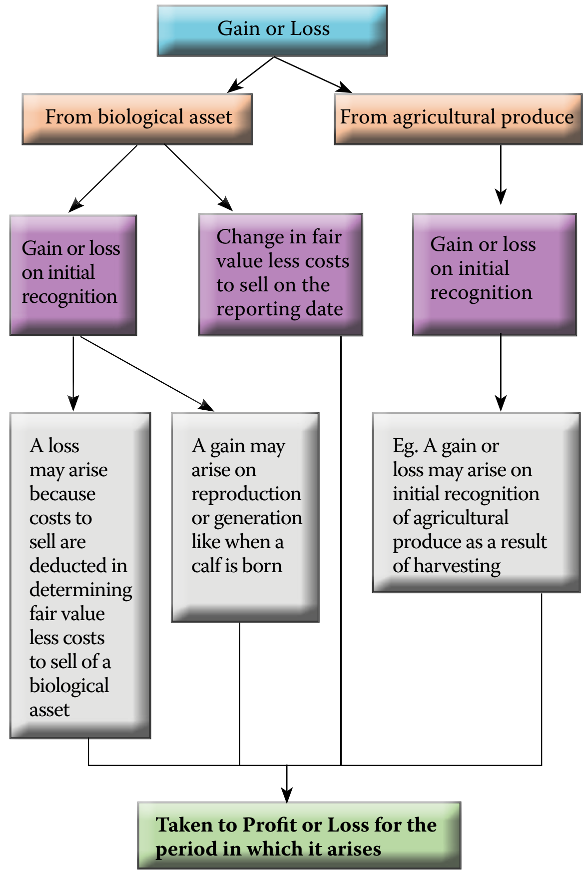
Note:
Once a **non-current** biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) as per Ind AS 105, it is presumed that fair value can be measured reliably.

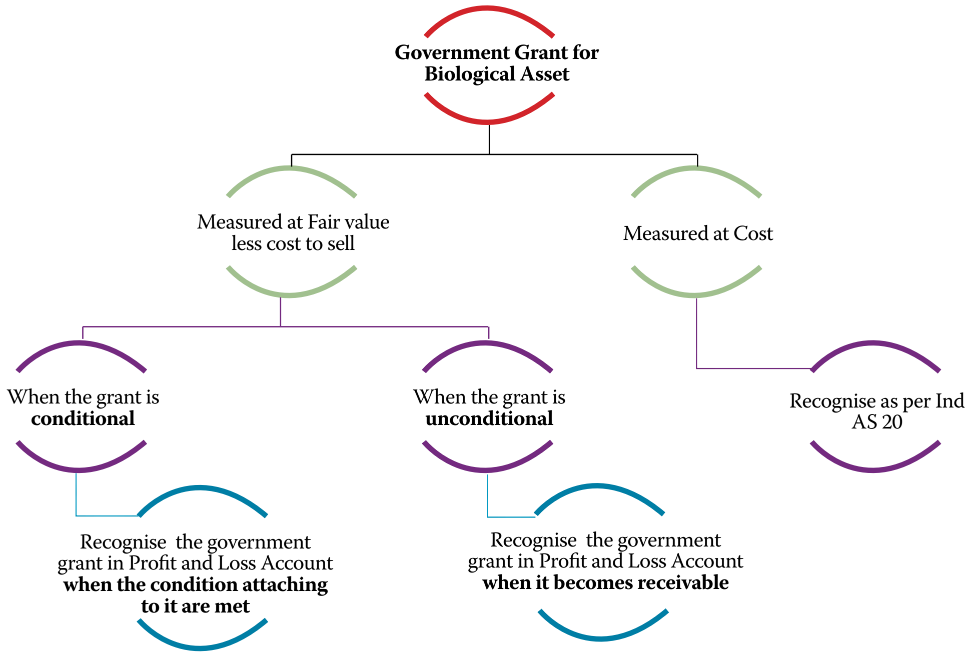


Important points:

1. Entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Generally, contract prices are not relevant in measuring the fair value.
2. The fair value of a biological asset or agricultural produce is **not** adjusted because of the existence of a contract.
3. There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to measure the fair value of the biological assets.

   (For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.)
4. An entity **once measured a biological asset** at its fair value less costs to sell **has to continue** to measure the biological asset at its fair value less costs to sell **until disposal**.
5. Ind AS 41 assumes that the fair value of agricultural produce at the point of harvest can always be measured reliably.





For disclosure, refer paragraphs 40-57 of bare text of Ind AS 41.

INDIAN ACCOUNTING STANDARD (IND AS) 101: FIRST TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS

Objective

Ind AS 101 ensures that an entity's first Ind AS financial statements and first Ind AS interim financial statements contain high quality financial information that:

Transparent	• Financial Statements are transparent and comparable over all periods presented
Serves as Starting point	• Financial Statements provide a suitable starting point for accounting under Ind AS
Cost v/s benefit	• Financial Statements can be generated at a cost that does not exceed the benefits to users

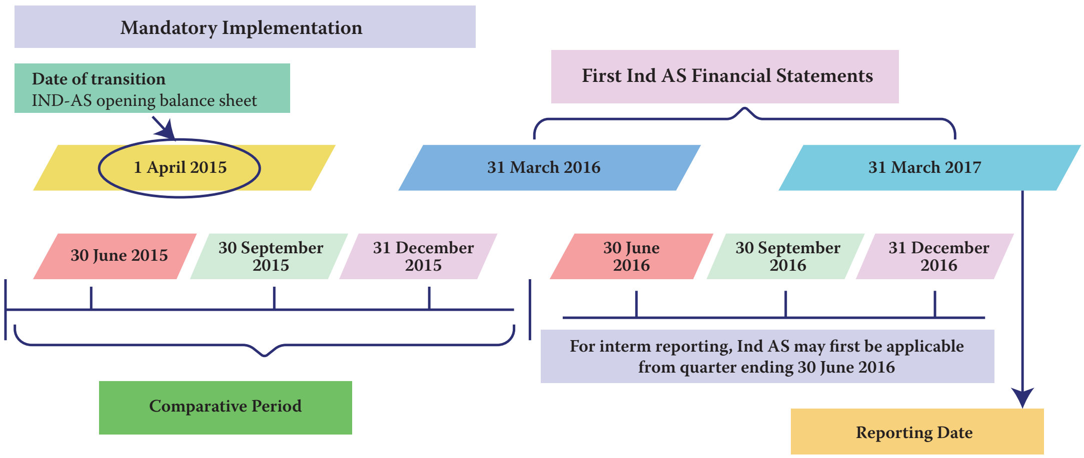
Scope

In Scope	• First Ind AS annual financial statements • Interim financial statement covered under period of First Ind AS financial statements
Out of Scope	• Changes in accounting policy made by an entity already applying Ind AS • Such changes to be accounted under Ind AS 8 or transitional period under other Ind AS • Interim financial statement covered under period of First Ind AS financial statements

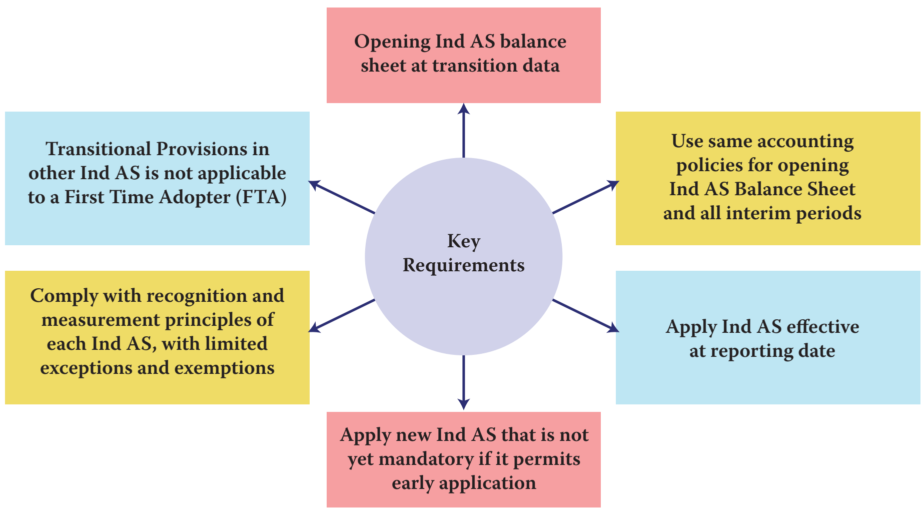
Key Definitions

First Time Adopter	An entity that presents its first Ind AS Financial Statements
First Ind AS financial statements	The first annual financial statement in which an entity adopts Ind AS by an explicit and unreserved statement of compliance with Ind AS
Previous GAAP	The basis of accounting that a first-time adopter used for its statutory reporting requirements in India immediately before adopting Ind AS For instance - Companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements
Deemed Cost	· An amount used as a **surrogate for cost or depreciated cost** at a given date · Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost

Timelines



Selection and Application of Accounting Policies



Except where Ind AS 101 contains an **exception or an exemption**, an entity must:

Step 1	Step 2	Step 3	Step 4
• **Recognise** all assets and liabilities required to be recognised by Ind AS • E.g. Share based transactions with non-employees	• **De-recognise** all assets and liabilities not permitted by Ind AS • E.g. Proposed dividend	• **Reclassify** all items in accordance with Ind AS • E.g. Redeemable preference shares	• **Measure** all recognized assets and liabilities in accordance with Ind AS • E.g. Discounting of long term provisions

The restatement is booked through retained earnings (or, if appropriate, another category of equity) except for certain adjustments (acquired intangibles, impairment which is adjusted against goodwill)

Exemptions and Exceptions

To facilitate the implementation of Ind AS, this standard provides some **relief from retrospective application** of Ind AS which can be broadly divided in two categories:

- **Optional Exemptions:** FTAs* can choose to adopt one or more of the exemptions available under Ind AS 101
- **Mandatory Exceptions:** FTAs* are prohibited from applying certain provisions of Ind AS retrospectively
- **No relief:** from any presentation and disclosure requirements of other Ind AS

*First Time Adopters

20 - Optional Exemptions

Fixed Assets related	Business combination and group accounts	Financial Instruments related	Others
Deemed cost of PPE/ Investment property and certain intangible asset	Business combination	Compound financial instrument	Severe hyperinflation
Decommissioning liabilities included in PPE	Investment in subsidiaries / associates/joint venture	Fair Value measurement of financial asset and financial liability	Non-current assets held for sale and discontinuing operations
Leases	Assets and liabilities of subsidiaries / associates/ joint venture	Designation of previously recognized financial instruments	Share-based payment transactions
Service Concession agreements	Cumulative translation difference	Extinguishing financial liabilities with equity	Insurance contracts
Stripping costs in the production phase	Joint arrangements	Designation of contracts to buy or sell non financial item	Revenue from contract with others

Property,Plant and Equipment related exemptions

Deemed cost
Fair value or revaluation or previous GAAP's carrying value

FTA may adopt any of the options as deemed cost at transition date:

Fair value	Previous GAAP's revaluation amount	Previous GAAP's carrying value
Use fair value of assets at transition date	If revalued amount at the date of revaluation was broadly comparable to: • Fair value or • Cost or depreciated cost in accordance with Ind AS	Recognize assets at carrying value of previous GAAP after making necessary adjustments

For Fair value and Previous GAAP's revaluation amount:
- This option may be elected **asset by asset**
- Applicable to intangible assets only if active market exists

For Previous GAAP's carrying value:
- If selected, becomes applicable to all assets

Deemed cost- Previous GAAP's carrying value

If entity avails option of considering previous GAAP's carrying value as deemed cost, then:

- Necessary adjustments to be made for decommissioning liabilities
- No further transitional adjustment is required to determine deemed cost in the opening balance sheet that other Ind AS might require
- Applicable to PPE, investment property and intangible assets

Decommissioning, Restoration and Similar Liabilities

- Appendix A to Ind AS 16 requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted carrying amount of the asset is then depreciated prospectively over its remaining useful life.

A FTA may not apply above requirements for changes in such liabilities that occurred before transition date. If a FTA uses this exemption, it shall:

- Measure the decommissioning liability at transition date as per Ind AS 37
- Capitalize discounted liability back to the date the obligation arose (using the best estimate of historical risk-adjusted discount rates)
- Calculate accumulated depreciation on that amount at transition date (calculated by applying current estimated life and entity's depreciation policy for the asset under Ind AS)

Note :
If an entity opts for fair value measurement of PPE, it would need to determine whether the fair value of the assets is inclusive or exclusive of the decommissioning obligation in order to make the necessary adjustment to remove any potential overstatement

Leases

If an arrangement existing at the date of transition to Ind AS contains a lease on the basis of facts and circumstances existing on the date of transition, then

- measure a lease liability at the present value of the remaining lease payments discounted using the lessee's incremental borrowing rate at the date of transition to Ind AS;
- measure a right-of-use asset on a **lease-by-lease basis** either at:
  - its carrying amount as if Ind **AS 116 had been applied since the commencement date of the lease,** but **discounted using the lessee's incremental borrowing rate at the date of transition** to Ind AS; or
  - an amount **equal to the lease liability**, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet immediately before the date of transition to Ind AS.
- apply Ind AS 36 to right-of-use assets

Leases

A first-time adopter that is a lessee may do one or more of the following at the date of transition to Ind AS, applied on a lease-by lease basis:

- apply a **single discount rate to a portfolio of leases** with reasonably similar characteristics.
- **elect not to apply the above requirements given in (a) to (c)** to leases for which the lease term ends within 12 months of the date of transition to Ind AS and instead, account for these leases as if they were **short-term leases.**
- **elect not to apply the above requirements given in (a) to (c)** to leases for which the underlying asset is of **low value** and instead, account for these leases as per Ind AS 116.
- **exclude initial direct costs** from the measurement of the right-of-use asset at the date of transition to Ind AS
- **use hindsight,** such as in **determining the lease term** if the contract contains options to extend or terminate the lease.

Service Concession Arrangements

- Financial assets or Intangible assets are accounted for as per Appendix D to Ind AS 115 Service Concession Arrangements
- An entity may apply provisions of Appendix D of Ind AS 115 i.e. Service Concession arrangements **from the date of transition rather than retrospectively.**

Recap of Appendix D of Ind AS 115: An entity (the operator) may enter into an arrangement with another entity (the grantor) to provide services that give the public access to major economic and social facilities. The grantor may be a public or private sector entity, including a governmental body. Examples of service concession arrangements involve water treatment and supply facilities, car parks, tunnels, bridges, airports, and telecommunication networks. The common characteristic of all service concession arrangements is that the operator receives a right as well as incurs an obligation to provide public services.

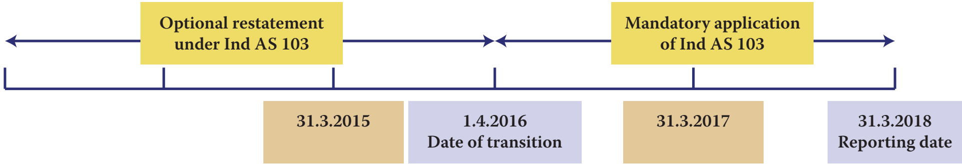
Stripping Costs in the Production Phase of a Surface Mine

- An entity may apply Appendix B of Ind AS 16 i.e. Stripping cost in the production phase of a surface mine **from the date of transition i.e. retrospective application is not required.**

Recap of Appendix B of Ind AS 16: In surface mining operations, entities may find it necessary to remove mine waste materials ('overburden') to gain access to mineral ore deposits. This waste removal activity is known as 'stripping'. After initial recognition, the stripping activity asset shall be carried at either its cost or its revalued amount less depreciation or amortisation and less impairment losses, in the same way as the existing asset of which it is a part.

Business Combination

First-time adopter can choose not to restate business combinations (in accordance with Ind AS 103) that have occurred before transition date



However, if an entity chooses to restate one business combination under Ind AS 103 prior to transition date, it will need to restate all the business combinations which occur after such restatement, for its opening Ind AS balance sheet.

Business combination exemption is applicable only if past transactions qualify as business as per Ind AS 103

Business Combination - Recognition of Assets and Liabilities

If FTA avails this exemption, should recognize assets and liabilities acquired or assumed in past business combination in the below explained steps:

1. Maintain previous GAAP classification except for Ind AS requirements to classify assets & liabilities into Financial / Non- Financial
2. Derecognize assets and liabilities recognized under previous GAAP but do not qualify for recognition under Ind AS e.g. intangible asset which does not meet Ind AS 38 criteria
3. Recognize all assets and liabilities not recognized under Previous GAAP but qualify for recognition under Ind AS e.g. intangible assets which meets Ind AS 38 criteria
4. Mandatorily test for impairment of goodwill recognized under previous GAAP on transition date regardless of whether any indicators are there or not
5. Re-measure such assets & liabilities on transition date if appropriate. Correct any errors in previous GAAP accounting / estimates discovered on transition date

Business Combination - Recognition/De-recognition of Assets and Liabilities

Recognition of assets and liabilities

- Adjust against retained earning
- Recognition of an intangible asset that was previously subsumed within goodwill should be adjusted either by decreasing goodwill or increasing capital reserve

De-recognition of assets and liabilities

- Adjust against retained earning
- Derecognition of intangible asset should be adjusted either by increasing goodwill or decreasing capital reserve

Business Combination - Measurement of Assets and Liabilities

Measurement of assets and liabilities acquired or assumed under past business combination at transition date

If, were recognized under previous GAAP

Measures at fair value with resulting change in carrying amount to be adjusted in retained earning and not against goodwill or capital reserve

Measures at previous GAAP's carrying value immediately after date of business combination less depreciation / amortization from that date till transition date

If, were NOT recognized under previous GAAP

Assets and liabilities not previously recognized **should be recognized** in acquirer's consolidation balance sheet on the basis that Ind AS would require in the Balance Sheet of the acquiree

Business Combination - Previously Unconsolidated Subsidiary

In accordance with its previous GAAP, the First Time Adopters (FTA) may not have consolidated a subsidiary acquired in a past business combination. For example because:

- Parent did not regard it as a subsidiary as per previous GAAP or
- Parent did not prepare consolidated financial statements

Recognize assets and liabilities at the amount Ind AS would require in the subsidiary's balance sheet

Deemed cost of goodwill =

- Parent's interest in adjusted carrying amount at transition date

  Less
- Cost of investment in parent's separate financial statements

Business Combination - Goodwill/ Capital Reserve

Goodwill/ capital reserve must be recognized at previous GAAP's carrying amount after making only adjustments permitted at transition date in opening Ind AS Balance Sheet

Adjustments permitted

- Recognition or derecognition of intangible assets acquired in business combinations
- Test goodwill for impairment on the basis of condition on transition date
- Recognition of any impairment loss in retained earnings
- No other adjustments must be made

Examples of adjustment not permitted

- In-process research and development acquired in business combination (unless meet the recognition criteria under Ind AS 38)

Business Combination - Goodwill/ Capital Reserve

If the first-time adopter had recognised goodwill in accordance with previous GAAP as a deduction from equity, then

- Need not recognize such goodwill in opening Ind AS balance sheet
- Need not reclassify goodwill to P & L on disposal or on impairment of investment in subsidiary
- Adjustment due to subsequent resolution of a contingency affecting PC* shall be recognized in retained earnings

PC* = Purchase Consideration

Business Combination - Deferred Tax and Minority Interest

Measurement of deferred tax → Book base for deferred tax calculation is the amount of assets and liabilities as per opening Ind AS balance sheet (after considering Ind AS 101 adjustments)

Measurement of minority interests → Minority interest related to subsidiaries should be calculated after all assets acquired, liabilities assumed and deferred taxation has been adjusted under Ind AS 101

Application of exemptions for past business combination is also applicable to →

- investments in associates
- interests in joint ventures
- interests in joint operations in which activity of the joint operation constitutes a business under Ind AS 103

Joint Venture- Transition from Proportionate Consolidation to the Equity Method

Recognize investments → Recognize inidital investment in joint venture as at transition date to Ind AS

Measure investments →

- Measure at the aggregate carrying amount of assets and liabilites that the entity has previously proportionately consolidated including goodwill
- Allocate goodwill, if any on the basis of relative carrying value of joint venture
- Such cost will be regarded as deemed cost at transiton date

Impairement testing →

- Test of impairment in accordance with Ind AS 36 at the date of transition regardless of existence of impairment indication
- Any resulting impairment shall be recognised as an adjustment to retained earnings at the date of transition to Ind AS

Investment in Subsidiaries, Joint Ventures and Associates

Ind AS 27 requires while preparing Separate Financial Statements, investments in subsidiaries, joint ventures and associates to be recorded either at cost or in accordance with Ind AS 109

If measured at cost by a first-time adopter, the investment to be measured at the following amounts in separate opening Ind AS Balance Sheet:

- Cost as per Ind AS 27 or;
- Deemed cost i.e.
  - Fair value at the entity's date of transition to Ind AS or;
  - Previous GAAP carrying amount at transition date

Assets and Liabilities of Subsidiaries, Associates and Joint Ventures – MCA made it Redundant

The exemption was applicable when the subsidiary company has adopted Ind AS after parent, the subsidiary shall measure its assets and liabilities at either

- The carrying amounts that would be included in parent's CFS or;
- The carrying amounts based on the subsidiary's transition date

However, as MCA requires that if Ind AS is applicable to an entity, then its subsidiaries, associates and JVs are also required to prepare their financial statements in Ind AS simultaneously, **hence this exemption has become redundant.**

Cumulative Translation Differences

Recap of Ind AS 21: It requires to recognise and accumulate FCTR through OCI and reclassify to P/L on disposal of foreign operation

A first-time adopter may elect to:

- set its cumulative translation differences for all foreign operations as zero at transition date; and
- exclude these translation differences that arose before the transition date from subsequent disposal gain or loss calculations of any foreign operation

Exemption has to be adopted for **all net investment in foreign operations collectively**

Retrospective application of translation difference would be costly or impracticable	Subsequent disposal of foreign operation, calculation of gain / loss include only translation difference post transition data

Financial Instrument – Compound Financial Instrument

Compound financial instrument under Ind AS 32 to be recognized as at inception

- Equity Component
- Liability Component

A FTA need not separate the compound financial instrument if liability component is not outstanding at transition date

Fair Value Measurement of Financial Assets or Financial Liabilities at Initial Recognition

- Ind AS 109 requires to initially recognize financial assets and liabilities at fair value. If the fair value differs from transaction price, the difference is recognized as gain or loss.

- An entity may apply these requirements of initial recognition prospectively to transactions entered on or after the date of transition i.e. no need to apply Ind AS 109 for such transactions entered into before transition date.

Financial Instrument – Designation of Previously Recognized Financial Instruments

FTA may designate following financial instruments on the basis of facts and circumstances existing on transition date

Financial Liabilities	Financial Assets	Investment is equity instruments
• Designate a financial liability to be measured at FVTPL or amortized cost on meeting criteria under Ind AS 109	• Designate financial asset to be measured at FVTPL under Ind AS 109	• Designate such instruments at FVTOCI under Ind AS 109. Such instruments should not be • held for trading or as contingent consideration under Ind AS 103

Extinguishing Financial Liabilities with Equity Instruments

An entity may apply Appendix D of Ind AS 109 i.e. Extinguishing financial liabilities with Equity Instruments from the date of transition.

Recap of Appendix D of Ind AS 109:

- When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.
- If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished.
- The difference between the carrying amount of the financial liability extinguished, and the consideration paid, shall be recognised in profit or loss.

Designation of Contracts to Buy or Sell a Non-financial Item

- Ind AS 109 permits some contracts to buy or sell non financial items to be designated at inception as measured at FVTPL.
- Therefore, this exemption provides the option to designate such contracts (i.e. contracts to buy or sell a non-financial item), if existed at transition date, to be measured at FVTPL on the date of transition, instead of doing that retrospectively from the initial date of that contract, provided entity designates all similar contracts.

Other Exemptions- Severe Hyperinflation

- If an entity has a functional currency which is currency of hyperinflationary economy, it shall determine whether it was subject to severe hyperinflation before the date of transition
- Measure assets and liabilities at fair value as at the date of transition

Other Exemptions- Non-current Assets Held for Sale and Discontinued Operations

An entity may apply the requirements of Ind AS 105 at the date of transition to Ind AS and recognise the difference between

→ the carrying amount as per previous GAAP and;

→ lower of carrying value and fair value less cost to sell

in retained earnings.

Other Exemptions- Insurance contracts

- An entity may apply Ind AS 104 for annual periods beginning on or before transition date.
- If they elect to do so they shall disclose the fact in the financial statements

Other Exemptions- Revenue from Contracts with Customers

- An entity is required to restate only those contracts as per Ind AS 115 which are not completed till the transition date
- This implies that the revenue contracts which are already completed are not required to be restated as per Ind AS 115.

Other Exemptions- Long Term Foreign Currency Monetary Items

A FTA may continue the policy adopted in accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements as per the previous GAAP for the period ending immediately before the beginning of the first Ind AS financial reporting period **i.e. Accounting policy as per para 46 / 46A of AS 11 can be continued if and only if it has been availed in IGAAP.**

This exemption cannot be used for foreign currency monetary items arising in future.

Exemption from Application of Ind AS 102 "Share-based Payment Transaction" on Transition Date

Retrospective Application

- A FTA is encouraged, but not required, to apply Ind AS 102 to equity instruments vested and to liabilities that were settled before the transition date to Ind AS.
- If FTA elects to apply Ind AS 102, **it may do so only if** entity has disclosed publicly the fair value of those equity instruments

Modification of Terms and Conditions

- On availing the exemption from restropective application, any modification before transition date need not be treated as required under Ind AS 102.

Disclosure: For all grants of equity instruments to which Ind AS 102 has not been applied, FTA shall disclose the information required by Ind AS 102

Mandatory Exceptions - to Retrospective Application of Other Ind AS

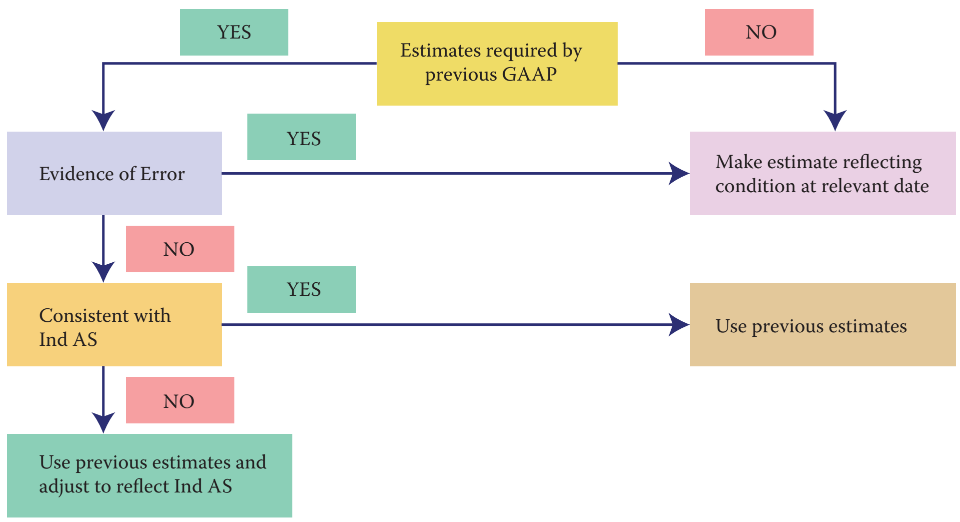
Ind AS 101 prohibits retrospective application of some aspects of other Ind AS relating to:

1. Estimates
2. De-recognition of financial assets and financial liabilities;
3. Hedge accounting
4. Classification and measurement of financial assets
5. Impairment of financial assets
6. Embedded derivatives
7. Some aspects of accounting for non-controlling interests
8. Government loans

Estimates

- Estimates made in accordance with Ind AS at the transition date shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), except where there is an error
- Information in respect of any estimate received after the transition date to be treated as non-adjusting event, except where there is an error
- New estimates required for Ind AS transition to be reflective of conditions at the transition date
- The requirement applies both to estimates made in respect of the date of transition and to those in respect of the end of any comparative period.

Estimates



De-recognition of Financial Assets and Financial Liabilities

Prospective application

De-recognition criteria under Ind AS 109 to be applied to transactions occurring on or after transition date

Classification and Measurement of Financial Assets

An entity shall classify and measure its financial assets either

- at amortized cost or;
- at FVTOCI or;
- at FVTPL

by assessing its contractual cash flow characteristics only on the basis of facts and circumstances **existing at the date of transition**

Impairment of Financial Assets

Approximate Credit Risk	No undue cost or effort	If unable
• An entity shall determine the approximate credit risk at the date that financial instruments were initially recognized and compare that to the credit risk at the date of transition to Ind AS	• Based on reasonable and supportable information that is available without undue cost or effort • i.e. no need to do an exhaustive search for such information at transition date to determine if there is significant increase in credit risk since initial recognition date	• If an entity is unable to make this determination without undue cost or effort, it shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized

Embedded Derivatives

Entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative either on the basis of conditions that existed on the date of:

→ it **first became party** to the contract; or

→ when reassessment is required under Ind AS 109 i.e. **significant modification** of the contract

whichever is later

Hedge Accounting

- All derivatives to be measured at fair value at the date of transition to Ind AS
- All deferred gains and losses arising on derivatives under previous GAAP to be eliminated at the date of transition to Ind AS
- The opening Ind AS balance sheet must not reflect a hedging relationship that does not qualify for hedge accounting under Ind AS 109
- If, before the date of transition to Ind AS, an entity had designated a transaction as a hedge, but the hedge does not meet the conditions for hedge accounting in Ind AS 109, then entity **shall** discontinue hedge accounting
- Transaction entered into before the date of transition to Ind AS **shall not** be retrospectively designated as hedges

Non-controlling Interest

Mentioned requirements of Ind AS 110 to be applied **prospectively** from transition date:

- Attribute total comprehensive income to owners of parent and NCI, even if NCI results to have a deficit balance
- Accounting for changes in parent's ownership interest in subsidiary that do not result in loss of control to be accounted as equity transaction
- Accounting for loss of control over a subsidiary as required in Ind AS 110 and Ind AS 105
- If FTA adopts Ind AS 103 retrospectively, it shall also apply Ind AS 110 retrospectively

Government Loans

- If under its previous GAAP, below market interest rate govt. loans were not recognised as govt. grant, then it shall use its previous GAAP carrying amount of the loan at the date of transition
- Ind AS 109 is applied to such loans after the date of transition
- Now, classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32
- Alternatively, an entity may apply the requirements in Ind AS 109 and Ind AS 20 **retrospectively** to any government loan originated before the transition date, provided that the information needed to do so had been obtained at the time of initial accounting of that loan

Disclosure Requirements

First set of Ind AS Financial Statements contains

- 3 Balance Sheets & 2 Statements of Profit/Loss
- 2 Statements of Changes in Equity
- 2 Statements of cash flows
- Related notes, including comparative information

Disclosure Requirements – Explanation of Transition to Ind AS

FTA to explain how transition to Ind AS affected its balance sheet, Statement of Profit and Loss and cash flows

Reconcile equity under Ind AS	**With equity under previous GAAP at** • Transition date • The end of latest period presented under previous GAAP in the most recent Financial Statements
Reconcile total comprehensive income under Ind AS	**With total comprehensive income /profit & loss at** • The end of latest period presented under previous GAAP in the most recent Financial Statements
Other disclosure/ explanations	• Explain material adjustment to cash flow • Disclosures as required under Ind AS 36 for recognition or reversal of impairment done in opening Ind AS balance sheet

How Reconciliations to be presented in First Ind AS Financial Statements?

Entity A's date of transition to Ind AS is 1st April, 2015 and the end of it first Ind AS reporting period is 31st March, 2017. Entity A should present the following primary financial statements and reconciliations in its first Ind AS financial statements:

	1/04/2015	31/03/2016	31/03/2017
Balance Sheet	✓	✓	✓
Reconciliation of equity	✓	✓	
For the period ending			
Statement of profit or loss		✓	✓
Statement of cash flows		✓	✓
Statement of changes in equity		✓	✓
Reconciliation of total comprehensive income / profit & loss		✓	
Explanation of material adjustments to the statement of cash flows		✓	

INDIAN ACCOUNTING STANDARD (IND AS) 102: SHARE BASED PAYMENT

Overview of Ind AS 102: Share-based Payment

- Recognition
- Types of Share-based Payment Transactions
  - Equity Settled Share-based Payment Transaction
    - Transactions in which services are received
    - Transactions measured by reference to the fair value of the equity instruments granted
      - Determining the fair value of equity instruments granted
        - If the fair value of the equity instruments cannot be estimated reliably
      - Treatment of a reload feature
      - Treatment of conditions
    - Modifications including cancellations and settlements
  - Cash Settled Share-based Payment Transaction
    - Treatment of conditions
      - Vesting
      - Non-vesting
  - Share-based Payment Transaction with Cash Alternative
    - Share-based payment transactions which provide the counterparty with a choice of settlement
    - Share-based payment transactions which provide the entity with a choice of settlement
- Share-based Payment Transactions among group entities
- Disclosure

Objective

To specify financial reporting for an entity when it undertakes a *share-based payment transaction*

Requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including associated expenses

Entity receives or acquires goods or services in a SBPA* + Payment is based on price or value of shares = Share based payment Arrangement (SBPA)

*Share-based Payment Arrangement

Share-based payment is made to whom?

- To Employees
- To Other parties

Scope

Applicable to

- **All** share-based payment transactions, irrespective of specific identification by the entity of goods or services received, including:
  - Equity-settled share-based payment transactions
  - Cash-settled share-based payment transactions
  - Settlement of transaction in cash (or other assets) or equity instruments- either the entity or the supplier have a choice

  Goods includes inventories, consumables, PPE, intangible assets and other non-financial assets
- Settlement of a share-based payment transaction by another group entity (or a shareholder of any group entity) on behalf of the entity of the same group receiving or acquiring the goods or services
- Equity instruments granted to employees of the acquiree in their capacity as employees in return for continued service

Not applicable to

- Transaction clearly identified for a purpose other than payment for goods or services
- Transaction with the holder of equity instruments of the entity
- Transactions covered by other Ind AS
  - Transactions in which the entity acquires goods as part of the net assets acquired in a business combination or businesses under common control
  - Contribution of a business as a joint venture as per Ind AS 111
  - Cancellation, replacement or other modification of share-based payment arrangements because of a business combination or other equity restructuring
  - Transactions in which the entity receives or acquires goods or services under a contract as financial instrument (Ind AS 32 and 109)

Share-based Payment Transaction (SBPT)

Entity

- Receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement

  Example: A Ltd. issues share options to its employees / issues shares to a supplier of PPE
- Incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services

  Example: H Ltd. issues share options to employees of S Ltd. issues shares to a S Ltd.'s supplier of PPE

Share-based Payment Arrangement (SBPA)

An agreement between

Party 1

- the entity; or
- another group entity; or
- any shareholder of any group* entity

Party 2

another party
(e.g.: an employee or a supplier of PPE)

entitles the other party to receive

Cash or other assets of the entity for amounts based on the price (or value) of equity instruments (including shares or share options**) of the entity/another group entity

Or

Equity instruments (including shares or share options) of the entity/another group entity

Provided the specified vesting conditions, if any, are met

Note:

*As per Ind AS 110, a group means 'a parent and its subsidiaries' from the perspective of the reporting entity's ultimate parent.

**Share option is a contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

Term	Definition	Points to remember
Exercise period	The period during which options can be exercised and shares can be purchased.	An employee who leaves the company during exercise period will still be entitled to the options.
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.	This Standard uses the term 'fair value' in a way that differs in some respects from the definition of fair value in Ind AS 113. Therefore, when applying Ind AS 102 an entity measures fair value in accordance with this Standard, not Ind AS 113.
Intrinsic value	The difference between the fair value of the shares and the price required to pay for those shares. For eg: A share option with an exercise price of ₹15, on a share with a fair value of ₹20, has an intrinsic value of ₹5.	Intrinsic value is not permitted for accounting of SBP.
Vest	To become an entitlement.	Under SBPA, a counterparty's right to receive cash / other assets / equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.
Vesting period	The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.	
Vesting condition	It determines whether the entity receives the services that entitle the counterparty to receive cash / other assets/ equity instruments of the entity, under SBPA.	Under SBPA, a counterparty's right to receive vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

Conditions

Vesting condition

Explanation:
Conditions determining whether the entity is entitled to receive the services that entitle the counterparty to receive cash / other assets/ equity instruments of the entity, under SBPA

Non-vesting conditions

Conditions not satisfying the service or performance conditions

Type of vesting conditions

Service condition

- It 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.
- It does not require a performance target to be met

Performance condition

It requires

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

(b) specified performance target(s) to be met while the counterparty is rendering the service required in (a) above

In other words;
Performance condition = Service condition + Performance targets

Types of Performance conditions

Market-related condition

In it, the exercise price, vesting or exercisability of an equity instrument depends upon the market price of equity instruments of
- the entity; or
- another entity in the same group

Non-market-related condition

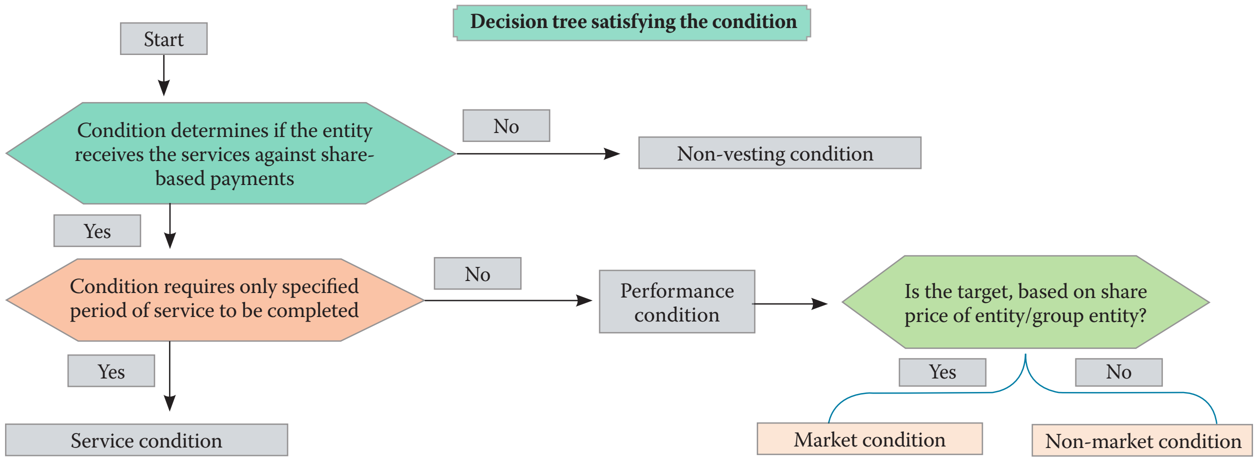
- It is not market driven but linked with some internal performance / operations or activities of the entity
- It does not have any impact on market price of the shares of the entity issuing such SBP

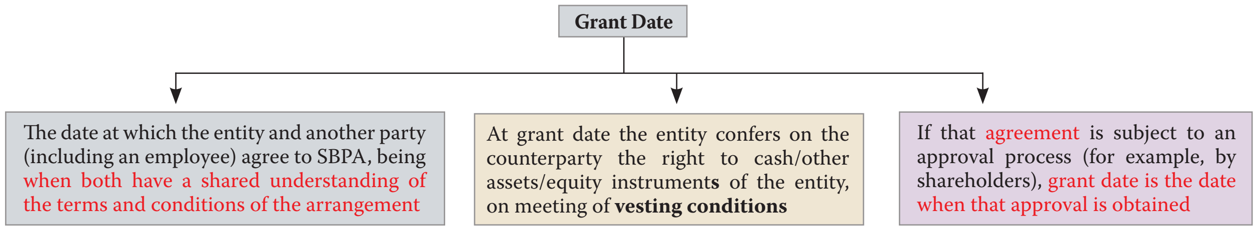
Service Condition Vs Performance Condition

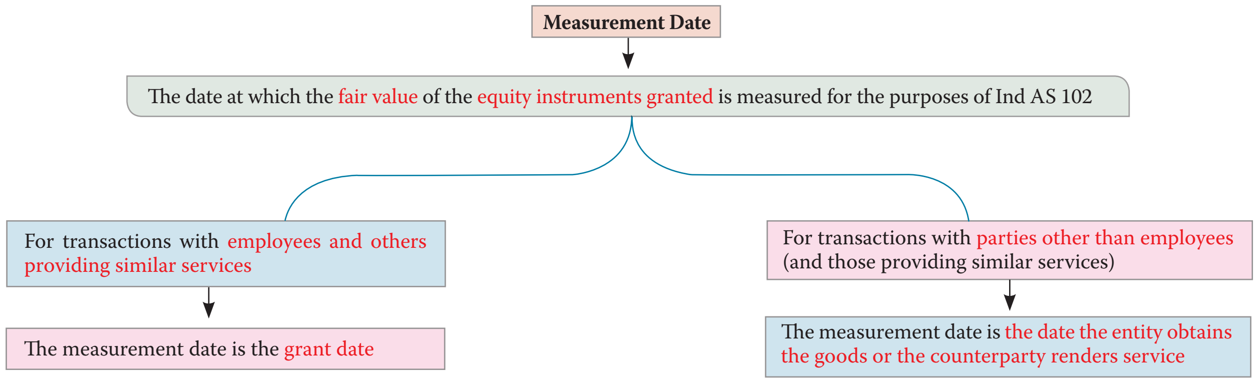
S. No.	Aspects	Service Condition	Performance Condition
1.	Condition	Counterparty should complete a specified period of service, during which services are provided to the entity	(a) Complete a specified period of service, and (b) Achieve specified performance targets during that period
2.	Performance target	Only service to be completed, no performance target	Achievement of performance target is a must in this condition
3.	Nature	Service condition is explicit	Service requirement could be explicit or implicit
4.	Period	Service period is specified, e.g., a requirement to be employed for 3 years	Target should be achieved within the service period. Period of achieving performance targets may start before (but not substantially before) the commencement of the service period.

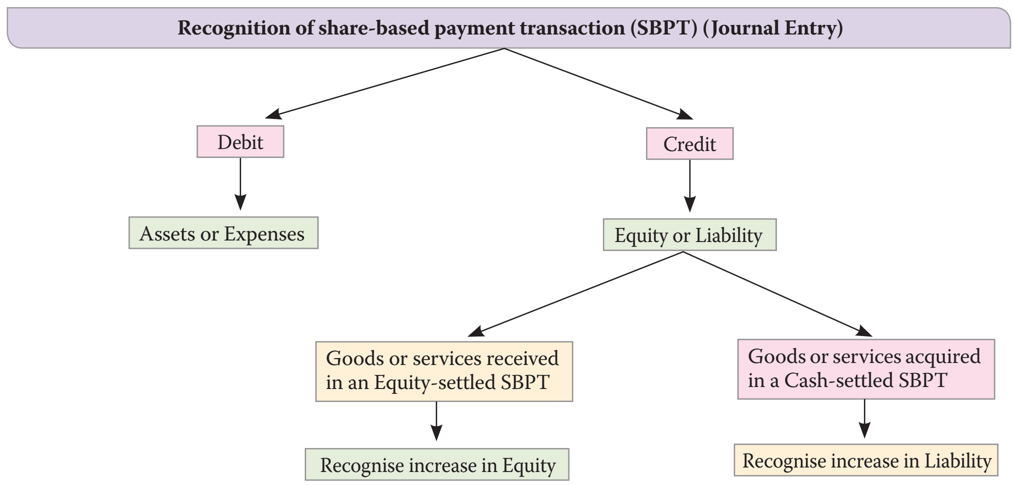
Market-related condition Vs Non-market related condition

S. No.	Aspects	Market-related Condition	Non-market related Condition
1.	Basis of performance target	Target is based on the price (or value) of the equity instruments of the entity/another group entity (including shares and share options)	Target is based on the entity's own operations (or activities) or the operations or activities of another entity in the same group
2.	Examples	(a) increase in share price by 10% (b) increase in shareholders' returns by 15% (c) increase in parent's share price from 500 to 850	(a) 8% decrease in employee turnover of this entity (or subsidiary/parent) (b) 20% increase in parent entity's revenue (c) 11.5% increase in parent's market share


Decision tree satisfying the condition
Start
Condition determines if the entity receives the services against share-based payments
No
Non-vesting condition
Yes
Condition requires only specified period of service to be completed
No
Performance condition
Is the target, based on share price of entity/group entity?
Yes
No
Market condition
Non-market condition
Yes
Service condition


Grant Date
The date at which the entity and another party (including an employee) agree to SBPA, being when both have a shared understanding of the terms and conditions of the arrangement
At grant date the entity confers on the counterparty the right to cash/other assets/equity instruments of the entity, on meeting of vesting conditions
If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained


Measurement Date
The date at which the fair value of the equity instruments granted is measured for the purposes of Ind AS 102
For transactions with employees and others providing similar services
The measurement date is the 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


Recognition of share-based payment transaction (SBPT) (Journal Entry)
Debit
Credit
Assets or Expenses
Equity or Liability
Goods or services received in an Equity-settled SBPT
Goods or services acquired in a Cash-settled SBPT
Recognise increase in Equity
Recognise increase in Liability

Recognition of share-based payment transaction (SBPT)

Provides goods or services

Counterparty

Entity

Recognise expense or asset as applicable

- Services consumed immediately
- Goods used or consumed immediately
- Goods consumed over a period of time or, in case of inventories sold at a later date
- Acquiring goods as part of the Research Phase of a project to develop a new product

Settles in Cash or Equity: Recognise liability or equity accordingly

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Types of Share-based Payment Transactions (SBPTs)

Equity Settled Share-based Payment Transaction

In this, 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

Cash Settled Share-based Payment Transaction

In it, the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity / another group entity

Share-based Payment Transaction with Cash Alternative

- Share-based payment transactions which provide the counterparty with a choice of settlement
- Share-based payment transactions which provide the entity with a choice of settlement

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Treatment of Equity-settled SBPTs - Basic Principles in Measurement

Rule 1: Directly, at the fair value of the goods or services received → If fair value of goods or services cannot be estimated reliably, then use Rule 2

Rule 2: Indirectly, by reference to the fair value of the equity instruments granted → If fair value of the equity instruments granted cannot be estimated reliably, then use Rule 3

Rule 3: Initial measurement at intrinsic value, adjusted for changes at the end of each reporting period → Mentioned only in para 24(a) of Ind AS 102

Treatment of Equity-settled SBPTs

Measurement based on with whom the transaction has been done

Transaction with

- Employees and others providing similar services
  - Measurement principle: By reference to the fair value of the equity instruments granted
  - Measurement date: Fair value as on grant date
  - Recognition date: The date on which goods or services has been received
- Parties other than employees (and those providing similar services)
  - Measurement principle: At fair value of goods and services received if it can be estimated reliably*
  - Measurement date: Fair value as on date on which the entity obtains the goods or the counterparty renders the service
  - Recognition date: The date on which goods or services has been received

*rebuttable presumption

Treatment of Equity-settled SBPTs

Transactions in which services are received and equity instruments granted

If vest immediately, then

The counterparty is not required to complete a specified period of service for entitlement of equity instruments

In other words, it is presumed that services rendered by the counterparty as consideration for the equity instruments have been received

→ On grant date the entity shall recognise the services received in full, with a corresponding increase in equity

If do not vest immediately, then

Services to be rendered by the counterparty will be received in the future, during the *vesting period*

→ The entity shall account for those services during the vesting period, with a corresponding increase in equity

→ Vesting period may be based upon

Service condition only
For e.g., Remaining in employment for 3 years

→ Entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period

Performance condition, i.e.,
- achievement of performance condition; and
- the length of the vesting period varies depending on satisfaction of performance condition

→ Entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period

→ Estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition

If the performance condition is a *market condition*

→ The estimate of the length of the expected vesting period
- shall be consistent with the assumptions used in estimating the fair value of the options granted, and
- shall not be subsequently revised

If the performance condition is *not a market condition*

→ The entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates

Transactions measured by reference to the fair value of the equity instruments granted

Determining the fair value of equity instruments granted

Scenario

If market prices are available

If market prices are not available

The entity shall

If market prices are available: Measure the fair value of equity instruments granted at the measurement date, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted

If market prices are not available: Estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties

Treatment of Equity-settled SBPTs

Treatment of a reload feature

	Definition	Treatment
Reload feature	It provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price	It shall not be taken into account when estimating the fair value of options granted at the measurement date
Reload option	It is a new share option granted when a share is used to satisfy the exercise price of a previous share option	It shall be accounted for as a new option grant, if and when a reload option is subsequently granted

Accounting of Equity-settled SBPTs

- Initially, at the measurement date, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest.
- Subsequently at every reporting date during vesting period, it shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.
- On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested.

Journal Entries

At the measurement date		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Recognition of proportionate amount of expected equity instruments to be vested based on the vesting period)		
Subsequently, at every reporting date during vesting period		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Recognition, till reporting date, of proportionate amount of expected equity instruments to be vested based on the vesting period *less* proportionate amount already recognised in the previous year)		
On vesting date		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Final value of equity instruments vested)		
Share based payment reserve (equity) Dr. To Share Capital (Re-allocation of equity by issuing of shares)		

Note:
- The entity shall not subsequently reverse the amount recognised for services received from an employee if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised.
- However, this requirement does not preclude the entity from recognising a transfer within equity, i.e., a transfer from one component of equity to another.

Treatment of Equity-settled SBPTs

Modifications to the Terms and Conditions of the Plan

Basic Principle = Recognise services received measured at grant date fair value of equity instruments granted + Recognise effects of modification that increase the total fair value of SBPA or are otherwise beneficial to the employee

Treatment of Equity-settled SBPTs

Types of Modification to SBPA

Beneficial to employee

A. Increase in fair value of equity instruments granted
B. Increase in number of equity instruments granted
C. Modification of vesting conditions to the benefit of the employees

→ Account prospectively

Not beneficial to employee

A. Decrease in fair value of equity instruments granted- ignore
B. Decrease in number of equity instruments granted- treat as cancellation of that portion of the Grant
C. Modification of vesting conditions to the detriment of the employees - ignore

Treatment of Equity-settled SBPTs

Cancellation/Settlement of the Grant

Aspects of Cancellation/Settlement

Cancellation/Settlement

1. Account as an acceleration of vesting; and
2. Recognise immediately the amount that would be recognised for services received over the remainder of the vesting period

Payment to employee

1. Payment on cancellation/ settlement is treated as repurchase of equity interest, i.e., deduction from equity
2. If payment > fair value of the equity instruments granted, then excess shall be expensed
3. If SBPA includes liability components, then remeasure the liability at fair value on cancellation / settlement and then account for as an extinguishment of the liability

Choice as to compliance

Repurchase of vested equity instruments

1. Payment of employee shall be accounted as deduction from equity
2. If payment > fair value of the equity instruments purchased, then excess shall be expensed

Note: Not applicable to forfeiture due to vesting conditions not satisfied

Treatment of Cash-settled SBPTs

Measurement and Recognition

Measurement

Initial Measurement

The entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability

Re-measurement

Until the liability is settled, the entity shall
- remeasure the fair value of the liability at the end of each reporting period and at the date of settlement
- recognise any changes in fair value in profit or loss for the period

Note:
- These SBPTs result in a liability, as they represent an obligation to pay cash
- Same as equity settled SBPTs
  - ❑ Expenditure to be spread over the vesting period if SARs vest over period of service
  - ❑ Recognised immediately if no criteria for vesting period
  - ❑ Treatment of vesting conditions

Accounting of Cash-settled SBPTs

Journal Entries

At the measurement date			
Employee benefits expenses To Share based payment liability (Recognition of SBP liability at fair value)	Dr.		
Subsequently, at every reporting date during vesting period			
Employee benefits expenses To Share based payment liability (Recognition of increase in fair value of SBP liability on remeasurement at the reporting date)	Dr.		
Or			
Share based payment liability To Employee benefits expenses (Recognition of decrease in fair value of SBP liability on remeasurement at the reporting date)	Dr.		
On vesting date			
Employee benefits expenses To Share based payment liability (Recognition of decrease in fair value of SBP liability on remeasurement at the reporting date)	Dr.		
Share based payment liability To Cash/Bank (Settlement of SBP liability)	Dr.		

Treatment of Cash-settled SBPTs

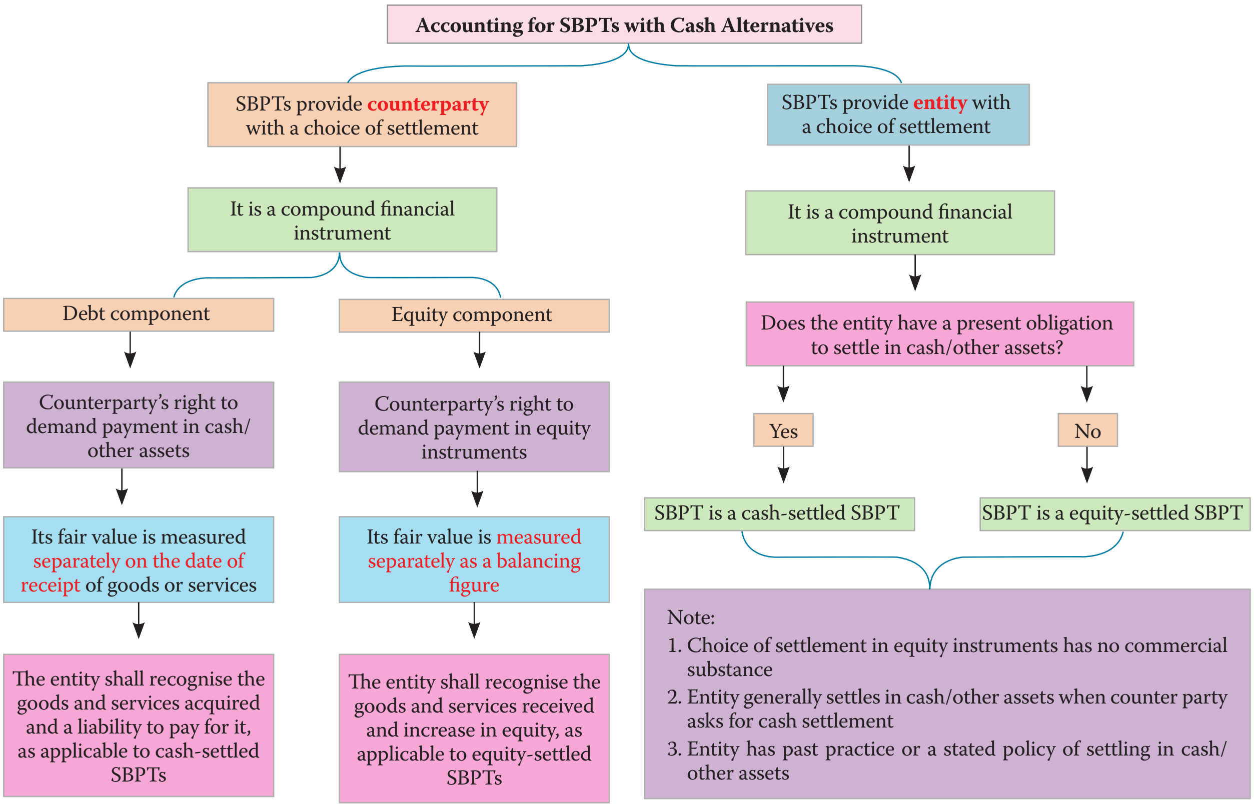
Change in Classification of SBPT from Cash-settled to Equity-settled

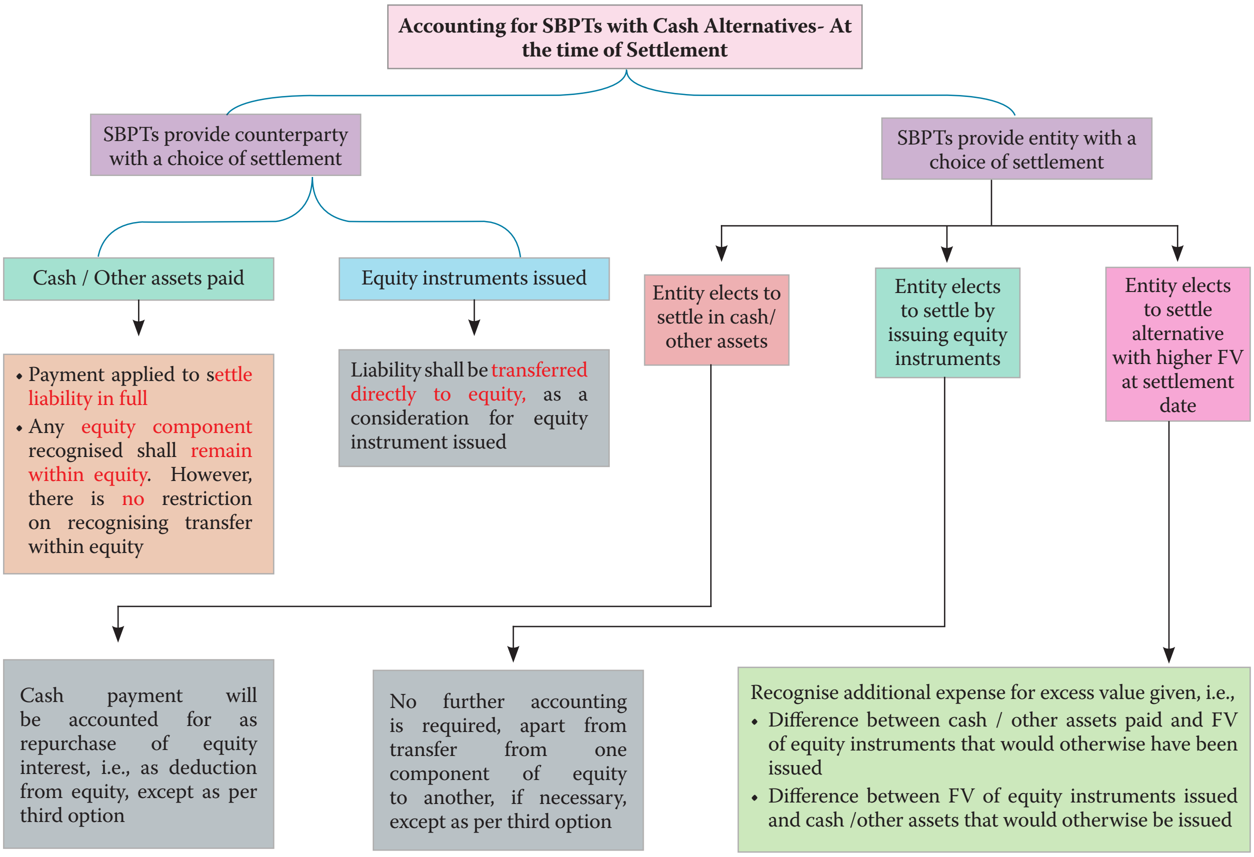
Equity-settled SBPT is measured by reference to fair value of equity instruments granted at the modification date

Liability for cash-settled SBPT as at the modification date is de-recognised

Difference between carrying amount of de-recognised liability and amount of recognised equity on modification date, is recognised immediately in Profit and Loss

Note: Such a transaction is accounted for, from the date of modification


Accounting for SBPTs with Cash Alternatives
SBPTs provide counterparty with a choice of settlement
It is a compound financial instrument
Debt component
Counterparty's right to demand payment in cash/ other assets
Its fair value is measured separately on the date of receipt of goods or services
The entity shall recognise the goods and services acquired and a liability to pay for it, as applicable to cash-settled SBPTs
Equity component
Counterparty's right to demand payment in equity instruments
Its fair value is measured separately as a balancing figure
The entity shall recognise the goods and services received and increase in equity, as applicable to equity-settled SBPTs
SBPTs provide entity with a choice of settlement
It is a compound financial instrument
Does the entity have a present obligation to settle in cash/other assets?
Yes
SBPT is a cash-settled SBPT
No
SBPT is a equity-settled SBPT
Note:
1. Choice of settlement in equity instruments has no commercial substance
2. Entity generally settles in cash/other assets when counter party asks for cash settlement
3. Entity has past practice or a stated policy of settling in cash/ other assets


Accounting for SBPTs with Cash Alternatives- At the time of Settlement
SBPTs provide counterparty with a choice of settlement
Cash / Other assets paid
• Payment applied to settle liability in full
• Any equity component recognised shall remain within equity. However, there is no restriction on recognising transfer within equity
Equity instruments issued
Liability shall be transferred directly to equity, as a consideration for equity instrument issued
SBPTs provide entity with a choice of settlement
Entity elects to settle in cash/ other assets
Entity elects to settle by issuing equity instruments
Entity elects to settle alternative with higher FV at settlement date
Cash payment will be accounted for as repurchase of equity interest, i.e., as deduction from equity, except as per third option
No further accounting is required, apart from transfer from one component of equity to another, if necessary, except as per third option
Recognise additional expense for excess value given, i.e.,
• Difference between cash / other assets paid and FV of equity instruments that would otherwise have been issued
• Difference between FV of equity instruments issued and cash /other assets that would otherwise be issued

Does Counterparty Get My Equity Instruments?

- Yes → Equity-settled expenses
- No → Does counterparty get equity instruments of another entity in the same group?
  - Yes → Do I have to provide those instruments (i.e., am I the settler?)
    - Yes → Cash-settled expenses
    - No → Equity-settled expenses
  - No → Does counterparty get cash (or other assets) based on the value of either my equity instruments or equity instruments of another group entity?
    - Yes → Do I have to settle the obligation?
      - Yes → Cash-settled expenses
      - No → Equity-settled expenses
    - No → Not in the scope of Ind AS 102

Accounting for SBPTs among Group Entities

H Ltd. would treat as an equity-settled SBPT only if it is settled in H Ltd.'s own equity instruments. Otherwise, the transaction shall be recognised as a cash-settled SBPT

Substance over form

Ind AS 102 is applicable to the recipient of goods/services; in this case, to S Ltd. – to be treated as cash-settled/equity-settled

Companies of the same group

Listed Parent Co. H Ltd.

Unlisted Subsidiary Co. S Ltd.

H Ltd. issues its equity shares

Employees of S Ltd.

Provides services

Accounting for SBPTs among Group Entities

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Companies of the same group

Listed Subsidiary Co. S Ltd.

Unlisted Parent Co. H Ltd.

S Ltd. issues its equity shares

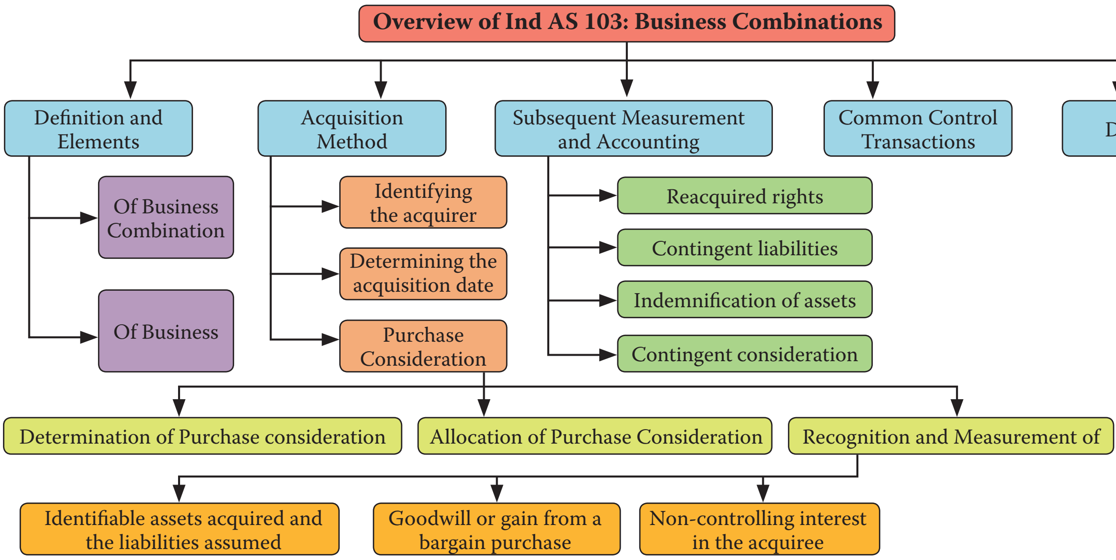
Employees of H Ltd.

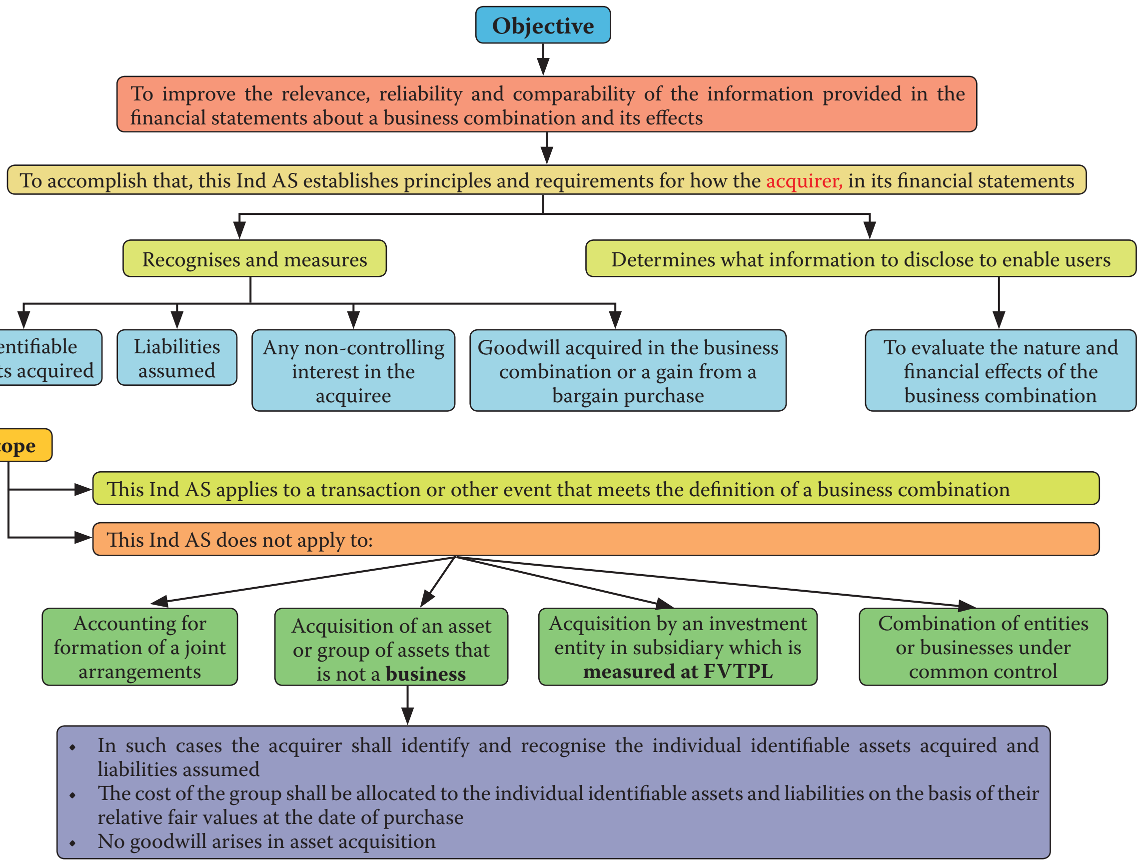
Provides services

Disclosures

- Type and scope of agreement in force
- Terms and conditions of each type pf share-based payment plans
- Number of weighted average price of share options outstanding with movement
- Average share price of exercised options
- Range of exercise prices and weighted average of remaining contractual life of options outstanding
- Valuation method used to estimate fair value of awards
- Impact on P&L and Balance Sheet

INDIAN ACCOUNTING STANDARD (IND AS) 103: BUSINESS COMBINATIONS





An entity shall account for each business combination by applying the ACQUISITION METHOD

STEPS FOR ACCOUNTING OF BUSINESS COMBINATION (ACQUISITION METHOD)

1. identify a business combination
2. identify the acquirer
3. determine acquisition date
4. recognise/measure identifiable assets acquired/liabilities assumed
5. recognise/measure any non-controlling interest
6. identify and measure consideration transferred
7. determine goodwill or gain on a bargain purchase

Identifying a Business Combination

Is there a transaction or event in which acquirer obtains **control*** over a **business****?

- Yes → It is a Business Combination
- No → It is an Asset Acquisition

Control* →
- Power over the investee
- Exposure, or rights to variable returns
- Ability to use its power over the investee to affect the amount of investor returns

Business** →
- Integrated set of activities and assets
- Capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities

A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer

(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners

(c) all of the combining entities or its owners transfer their net assets or equity interest, to a newly formed entity

(d) a group of former owners of one of the combining entities obtains control of the combined entity.

An acquirer might obtain control of an acquiree in a variety of ways, for example:

(a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business)

(b) by incurring liabilities

(c) by issuing equity interests

(d) by providing more than one type of consideration

(e) without transferring consideration, including by contract alone

Business Elements
(It generally consists of:)

Inputs
(economic resource that creates, or has the ability to create, outputs)

+

Process
(Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs.)

+

Output
(The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners)

Inputs and processes are mandatorily required:
- Inputs (e.g. employees, non current assets)
- Processes (e.g. strategic/ operation management)

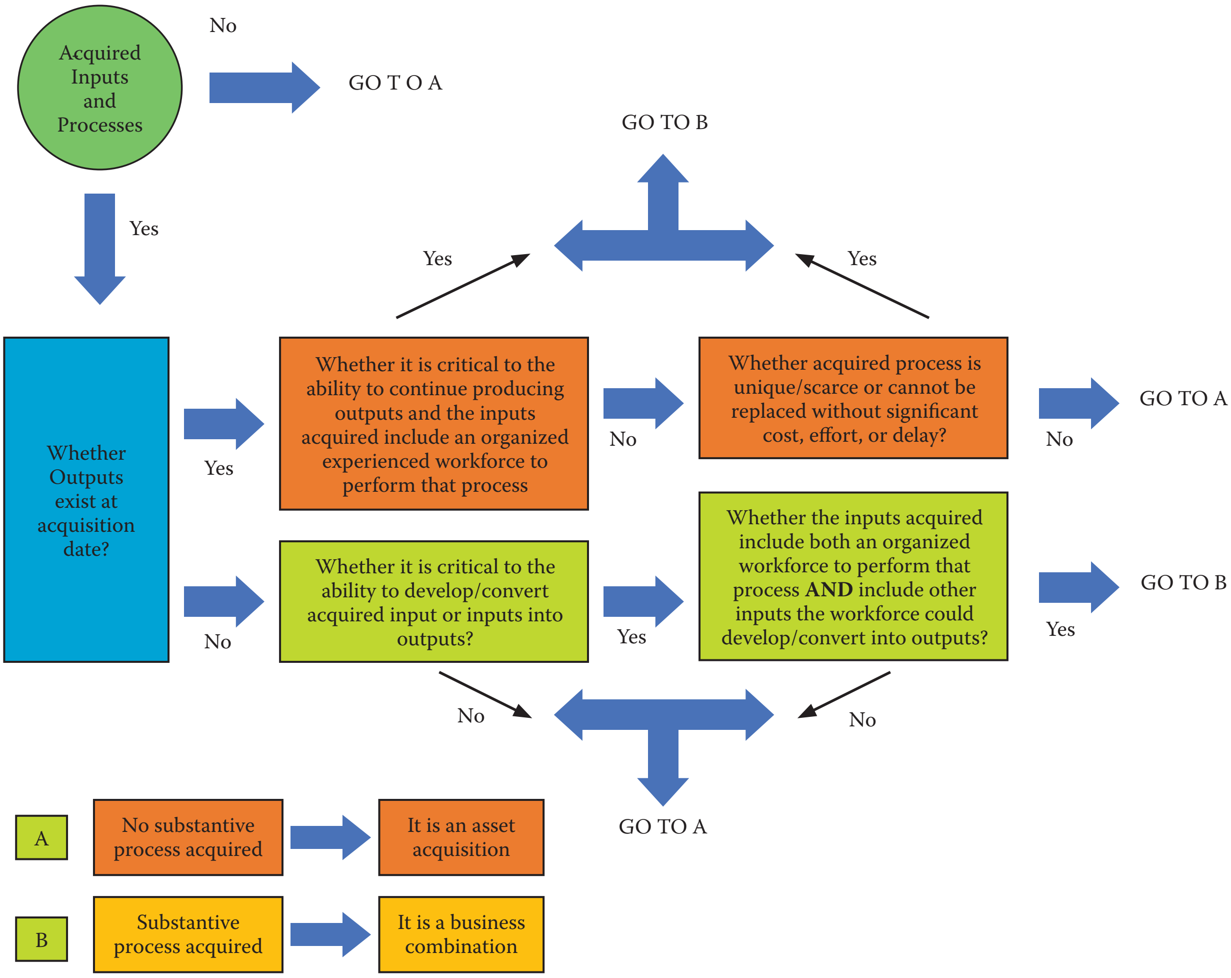
Outputs are not mandatorily required for a set of activities and assets to qualify as a business.
- Development stage activities without outputs may still be businesses

Goodwill :
There is a presumption that if goodwill exists, the acquisition is a business.
But
A business need not necessarily have goodwill

Meaning of a Business
A business need not include all the inputs or processes that the seller used in operating that business
If a market participant is capable of utilising the acquired set of activities and assets to produce outputs by integrating the acquired set with its own inputs and processes, the acquired set might constitute a business
If the elements that are missing from an acquired set are not present with a market participant but easily replaced/replicated, the acquired set might still be a business
The acquired set of activities and assets must have at least some inputs and processes in order to be considered a business

Definition of a Business: Development Stageof a set of Activities and Assets
Is the transferred set of activities and assets a business?
Factors include but are not limited to whether the set: • Has begun its planned principal activities • Has employees, intellectual property and other inputs and processes that could be applied to those inputs • Is pursuing a plan to produce outputs • Will be able to obtain access to customers that will purchase the outputs
Determination should be based on whether the integrated set is capable of being conducted and managed as a business by a **market participant** *(rather than the specific acquirer)*

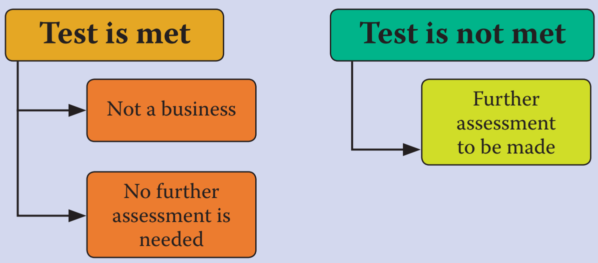
Further Assessment to Determine Whether Transaction is Business or not:



Concentration Test

An optional test (the concentration test) has been introduced in Ind AS 103 to permit a simplified assessment of whether an acquired set of activities and assets is not a business.

On the basis of the above test, following will be the consequences:



- Optional test is to identify concentration of fair value
- An entity may make such an election separately for each transaction or other event
- The concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets

Differences in Accounting for Business Combination Vs. Asset Acquisition

Impact on	Business combination	Asset acquisition
Intangible assets	Intangible assets are recognised at fair value, if they are separately identifiable	Intangible assets acquired as part of a group of assets would be recognised and measured based on an allocation of the overall cost of the transaction with reference to their relative fair values
Goodwill	Goodwill (or gain on bargain purchase) may arise	No goodwill is recognized
Initial measurement of assets acquired and liabilities assumed	Fair value	Allocated cost (on a relative fair value basis)
Directly attributable transaction costs	Expensed	Capitalised
Deferred tax on initial recognition	Recognised	Not recognized
Contingent liabilities assumed	To be recognised if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss	Not recognised, subject to Ind AS 37
Disclosures	More extensive	Less disclosures required

Identifying the Acquirer

- All business combination within the scope of Ind AS 103 are accounted under the acquisition method (also known as purchase method)
- For each business combination and in order to apply the purchase method, one of the combining entities shall be identified as the acquirer

The guidance in Ind AS 110 shall be used to identify the acquirer

As per Ind AS 110, an investor controls an investee if and only if the investor has all the following:

Power over the investee + Exposure, or rights, to variable returns from its involvement with the investee + The ability to use its power over the investee to affect the amount of the investor's returns = Control over the Investee

Note: The above definition is very wide and control assessment does not depend only on voting rights instead it depends on other factors as well, which are discussed in detail in Ind AS 110

If applying the guidance in Ind-AS 110 does not clearly indicate the acquirer, the following factors are considered in making the determination :

- Acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities
- Acquirer is usually the entity that issues its equity interests [**Note:** However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree]
  - Acquirer normally has the largest portion of the voting rights in the combined entity (consider the existence of any unused or special voting arrangements and options, warrants or convertible securities)
  - Existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest
  - Acquirer will have ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity
  - The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity
  - The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities
- The entity whose size is significantly greater than that of the other combining entity or entities

Date of Acquisition

The date on which the acquirer obtains control of the acquiree (as identified by the acquirer)

In general, the **date of obtaining the control** is the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree

However, the acquirer might obtain control on a date that is either earlier or later than the closing date

Classification

The acquirer classifies and designates assets and liabilities *at acquisition date* based on:
– acquirer's economic conditions
– contractual terms of the assets/liabilities
– acquirer's operating or accounting policies
– other pertinent conditions existing at the acquisition date

Exception to the classification:
- classification of a lease contract in which acquiree is the lessor as either an operating lease or a finance lease in accordance with Ind AS 116, Leases
- Classification of a contract as an insurance contract in accordance with Ind AS 104, Insurance Contracts

The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (and not on the acquisition date)

Recognition and Measurement Principle

At the acquisition date, the acquirer shall **recognise**, separately from goodwill:
- the identifiable assets acquired
- the liabilities assumed and
- any non-controlling interest in the acquiree

Exceptions to recognition principle: contingent liabilities, deferred taxes, employee benefits, assets indemnifications, leases in which acquiree is the lessee

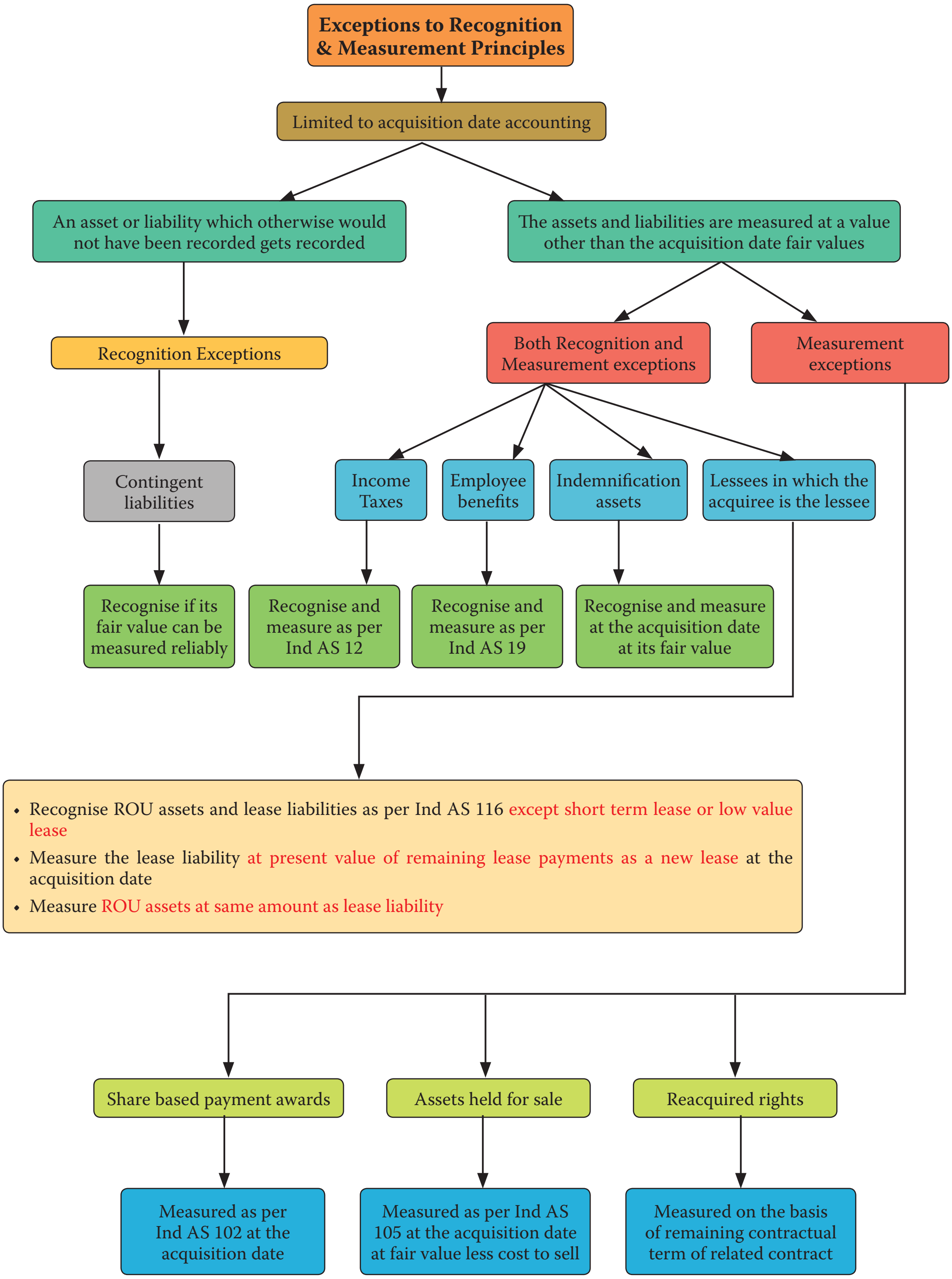
The acquirer shall **measure** the identifiable assets acquired and the liabilities assumed at their **acquisition-date fair values**

Exceptions to measurement principle: deferred taxes, employee benefits, assets indemnifications, leases in which acquiree is the lessee, reacquired rights, share-based payments, assets held for sale

For recognition of identifiable assets acquired/ liabilities assumed as part of the acquisition method, these assets/ liabilities
- must meet the definitions of assets and liabilities in the Framework issued by ICAI at the acquisition date
- must be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction

The acquirer shall determine which assets acquired or liabilities assumed, if any, are the result of separate transactions, they are to be accounted for in accordance with their nature and the applicable Ind AS

The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements


Exceptions to Recognition & Measurement Principles
Limited to acquisition date accounting
An asset or liability which otherwise would not have been recorded gets recorded
The assets and liabilities are measured at a value other than the acquisition date fair values
Recognition Exceptions
Both Recognition and Measurement exceptions
Measurement exceptions
Contingent liabilities
Income Taxes
Employee benefits
Indemnification assets
Lessees in which the acquiree is the lessee
Recognise if its fair value can be measured reliably
Recognise and measure as per Ind AS 12
Recognise and measure as per Ind AS 19
Recognise and measure at the acquisition date at its fair value
• Recognise ROU assets and lease liabilities as per Ind AS 116 except short term lease or low value lease
• Measure the lease liability at present value of remaining lease payments as a new lease at the acquisition date
• Measure ROU assets at same amount as lease liability
Share based payment awards
Assets held for sale
Reacquired rights
Measured as per Ind AS 102 at the acquisition date
Measured as per Ind AS 105 at the acquisition date at fair value less cost to sell
Measured on the basis of remaining contractual term of related contract

Recognising Particular Assets Acquired and Liabilities Assumed

- **For recognition purposes** → **Intangible assets** → The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination
  - → An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion
- **Reacquired rights** → An acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets
  - → A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill
- **Assembled workforce and other items that are not identifiable** → The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable or not qualifies as assets as of the acquisition date
- **For measurement purposes** → **Operating leases in which the acquiree is the lessee** → The acquirer shall recognise assets or liabilities related to an operating lease in which the acquiree is the lessor
  - → The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with the market terms

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Recognising and Measuring Goodwill or Gain from Bargain Purchase

Goodwill = Consideration transferred + Non Controlling Interests (NCI) + Acquisition date fair value of acquirer's previously held equity interest − Fair value of net identifiable assets at the acquisition date

Non Controlling Interests (NCI):

- At Fair value
- OR
- At Proportionate share in the recognized amounts of acquiree's identifiable net assets

- NCI is equity in a subsidiary not attributable, directly or indirectly to a parent
- Measurement option for NCI is done at acquisition date
- Choice is made for each business combination (not a policy choice)

Note:
"Bargain Purchase" is accounted when sum total of fair value of net assets and NCI exceeds consideration transferred

↓

In case of bargain purchase, the acquirer should reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed

↓

- If reassessment confirms bargain purchase, any gain is recognized in equity as capital reserve (routed through OCI) on the acquisition date.
- However, if there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain (bargain purchase) should be recognised directly in equity as capital reserve.

To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquiree in place of the acquisition-date fair value of the consideration transferred

Note:
Acquisition related costs charged to P&L except, debt securities issue cost–incorporated in effective interest rate (Ind AS 109) and Equity issue cost recognized in equity (Ind AS 32).

Consideration Transferred

- Consideration transferred is the sum of the acquisition-date fair values of:
  - Assets transferred by the acquirer
  - +
  - Liabilities incurred by the acquirer to former owners of the acquiree
  - +
  - Equity interests issued by the acquirer

Note: Any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with Ind AS 102 rather than at fair value.

- It also includes acquisition date fair value of contingent consideration
- **Examples of potential forms of consideration** include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.
- If the carrying amount of transferred assets / liabilities differ from fair value, AND

Whether they remain within the combined entity after business combination? (for example the assets or liabilities were transferred to the acquiree rather than to its former owners)

Yes

- Measure those assets and liabilities at their carrying amounts immediately before the acquisition date
- Gain or Loss is not recognized in Profit or Loss (when acquirer controls the assets or liabilities both before and after the combination)

No

- Remeasure the transferred assets or liabilities to their fair values as of the acquisition date
- Gain or Loss is recognized in Profit or Loss

Acquisition-Related Costs

Definition	Acquisition-related costs are costs that the acquirer incurs to effect a business combination
Examples	Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities
Accounting treatment	The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received
Exception	The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109

Contingent Consideration

It is the obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met

- Initial recognition at fair value
  - For changes occurred during the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date
  - Equity
    - Not re-measured
      - Subsequent settlement is accounted for within equity
  - Other contingent consideration
    - Within the scope of Ind AS 109
      - Measured at fair value at each reporting date
      - Changes in fair value is recognised in profit or loss
    - Not within the scope of Ind AS 109
      - Measured at fair value at each reporting date
      - Changes in fair value is recognised in profit or loss

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A Business Combination Achieved in Stages

- An acquirer may obtain the control of an acquiree in stages, by successive purchases of shares (commonly referred to as a 'step acquisition')
- When a party to a joint arrangement obtains control of a business that is a joint operation and had rights to the assets and obligations for the liabilities relating to that joint operation immediately before the acquisition date, the transaction is a business combination achieved in stages
  - The acquirer shall remeasure its entire previously held interest in the joint operation as follows:
- If the acquirer holds a non-controlling equity investment in the acquiree immediately before obtaining control:
  - Remeasure investment to fair value as at the date of gaining control
  - Recognise any gain or loss on remeasurement in profit or loss or OCI, as appropriate
    - In prior periods, whether the acquirer had recognised changes in the value of the equity interest in OCI?
      - Yes: Amount that was recognised in OCI should be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest
      - No: Any resulting gain or loss is recognised in profit or loss

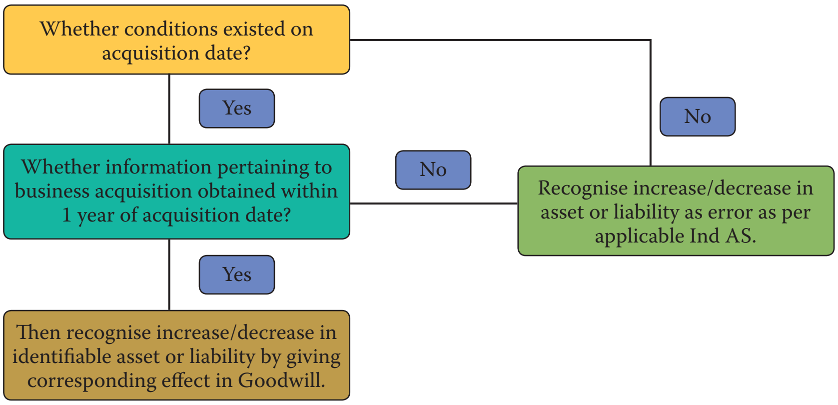
A Business Combination Achieved Without the Transfer of Consideration

- The acquisition method of accounting applies to such business combinations
- It includes following circumstances:
  - The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control
  - Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights
  - The acquirer and acquiree agree to combine their businesses by contract alone
    - **Example:** Bringing two businesses together in a stapling arrangement or forming a dual listed corporation
- The equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest

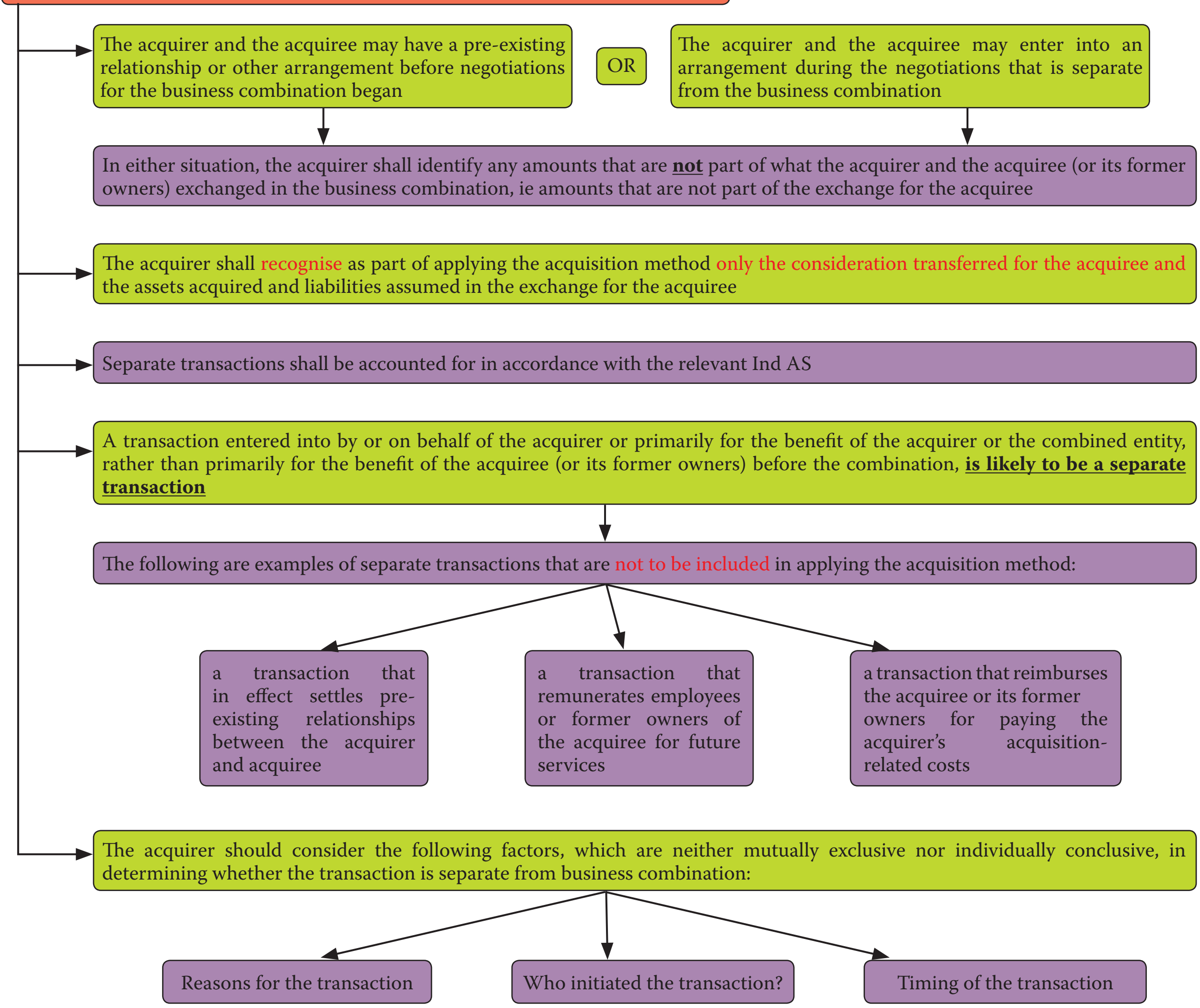
Measurement Period

- **Definition** → It is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination
- **Duration** → It ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable
  - **Note:** The measurement period shall not exceed one year from the acquisition date
- **Time of occurrence of information and its accounting/ adjustment**
  - Information that existed at the acquisition date → **Accounting / Adjustment:**
    - Retrospectively adjust the provisional amounts
    - Recognise new assets/liabilities to reflect the new information
    - Adjust the goodwill accordingly
  - Information occurred during the measurement period → **Accounting / Adjustment:**
    - Include adjustments for such developments after the acquisition date but during the measurement period only (like changes in estimates)
    - Prospectively adjust the provisional amounts to reflect new information arising after the acquisition date
    - No adjustment to goodwill
    - Correct the errors retrospectively in accordance with Ind AS 8
  - Post-measurement period information → **Accounting / Adjustment:**
    - No adjustment to the accounting for the business combination
    - Accounting for a business combination is amended only to correct an error as per Ind AS 8

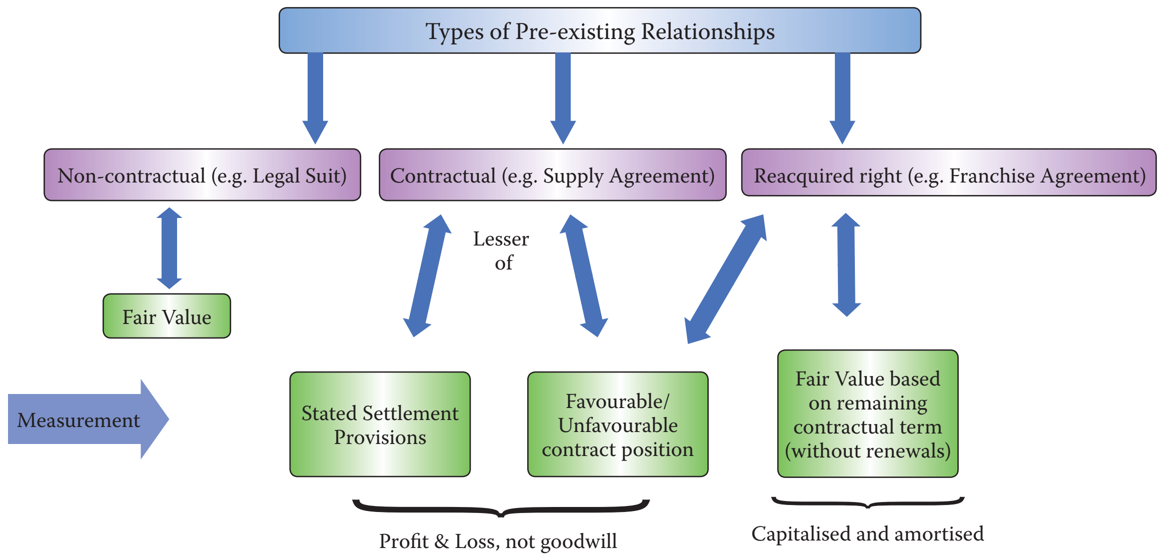
Measurement Period Review



Determining what is Part of the Business Combination Transaction

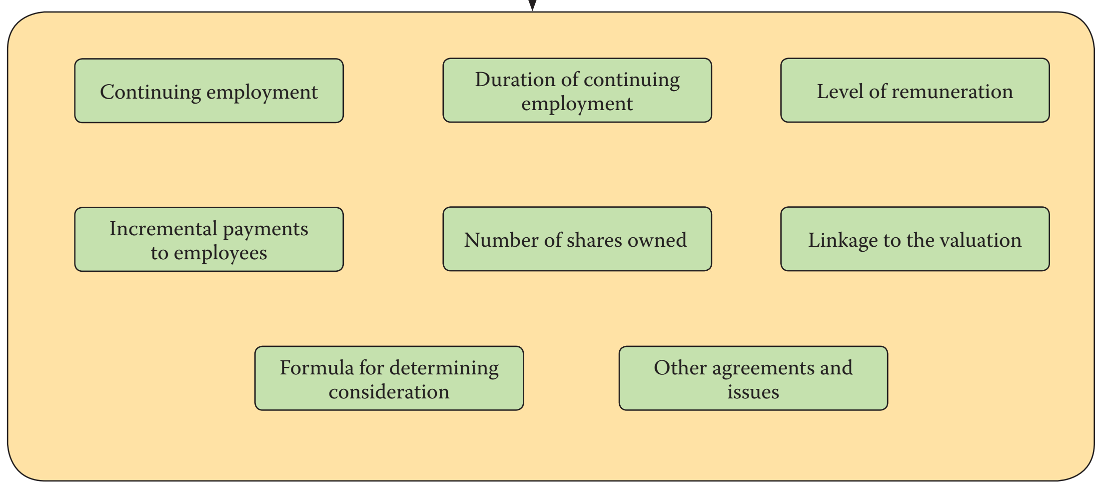


Accounting for a Pre-existing Relationship



Contingent Payments to Employees or Selling Shareholders

To identify an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:



Acquirer Share Based Payment Awards Exchanged for Awards Held by the Acquiree's Employees

Business combination transaction → An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree

Nature of awards → The above share based payment awards will include vested and unvested shares

Type of Accounting → Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards as per Ind AS 102

Objective of Accounting → *To allocate the replacement award's value* between the amounts attributable to:
- pre-combination service (treated as part of consideration transferred)
- post-combination service (accounted for as compensation expense in the post combination financial statements)

Accounting

- Pre-combination period service cost = Market-based measure of the acquiree award × (Completed vesting period as on the acquisition date ÷ Greater of total original vesting period or total revised vesting period)
- Post-combination period service cost = Market based measure of the replacement award − Amount attributed to pre combination service

Market based measure means that awards will be re-measured on the acquisition date as per the requirements of Ind AS 102

Important Notes →

- The acquirer shall attribute a portion of a replacement award to post combination service if it requires post combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquistion date
- Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination.
- The effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for as per Ind AS 102 in determining remuneration cost for the period in which an event occurs
- Requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument as per Ind AS 102
- The income tax effects of replacement awards of share-based payments shall be recognised as per Ind AS 12

Equity-Settled Share-Based Payment Transactions of the Acquiree

- Acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions
- Acquiree's existing award will be settled in its own shares and the consequential shareholders will become the Non-controlling shareholders
- Accounting
  - Vested shares
    - Measured at their market-based measure and the value credited to Share based payment reserve
    - Such acquiree share-based payment transactions are part of NCI
  - Unvested shares
    - Pre-combination period → Considered as a part of NCI → Market-based measure of the acquiree award ✖ Completed vesting period as on the acquisition date ÷ Greater of total original vesting period or total revised vesting period
    - Post-combination period → Debited as employee cost and credited to NCI in the balance sheet → Market based measure of the replacement award − Amount attributed to pre combination service

Subsequent Measurement and Accounting

An acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business *combination in accordance with other applicable Ind AS*

Exception: Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination

- **Reacquired rights**
  - • Recognised as an intangible asset
    • Amortised over the remaining contractual period of the contract in which the right was granted
  - **On subsequent selling** to a third party, acquirer shall include the carrying amount of the intangible asset in determining the gain or loss on the sale
- **Contingent liabilities recognised as of the acquisition date**
  - After initial recognition and until the liability is settled, cancelled or expired, the acquirer shall measure it at the higher of
    - The amount that would be recognised as per Ind AS 37
    - The amount initially recognised less the cumulative amount of income recognised as per Ind AS 115
- **Indemnification assets**
  - It results when the seller in a business combination contractually indemnifies the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability
  - In each subsequent reporting period, the acquirer shall
    - Measure an indemnification asset on the same basis as the indemnified liability or asset
    - For an indemnification asset that is not subsequently measured at its fair value, management needs to do assessment of its collectability
    - Derecognise the indemnification asset only when it collects the asset, sells it, or otherwise loses the right to it
- **Contingent consideration**
  - Refer chart given earlier in this chapter on contingent consideration

Other Ind AS that Provide Guidance on Subsequent Measurement and Accounting in a Business Combination

- Ind AS 38 prescribes the accounting for identifiable intangible assets acquired in a business combination
- The acquirer measures goodwill at the amount recognised at the acquisition date less any accumulated impairment losses. Ind AS 36 prescribes the accounting for impairment losses

Ind AS 104 provides guidance on the subsequent accounting for an insurance contract acquired in a business combination

Ind AS 12 prescribes the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities acquired in a business combination

Ind AS 102 provides guidance on subsequent measurement and accounting for the portion of replacement share-based payment awards issued by an acquirer that is attributable to employees' future services

Ind AS 110 provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained

Common Control Business Combinations

Applicable pronouncement → Appendix C of Ind AS 103 deals with accounting for business combinations of entities or businesses under common control

Definition → It is a business combination involving entities or businesses in which all the combining entities or businesses are ultimately CONTROLLED by the SAME party or parties both BEFORE and AFTER the business combination, and that control is not transitory

Inclusion → Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group

Role of NCI →
- The extent of NCI in each of the combining entities before and after the business combinations is not relevant to determine whether a combination involves entities under common control
- Partially owned subsidiary is always under the control of the parent entity

Scope →
- It is not necessary that combining entities are included as part of the same CFS
- A group of individuals shall be considered as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory

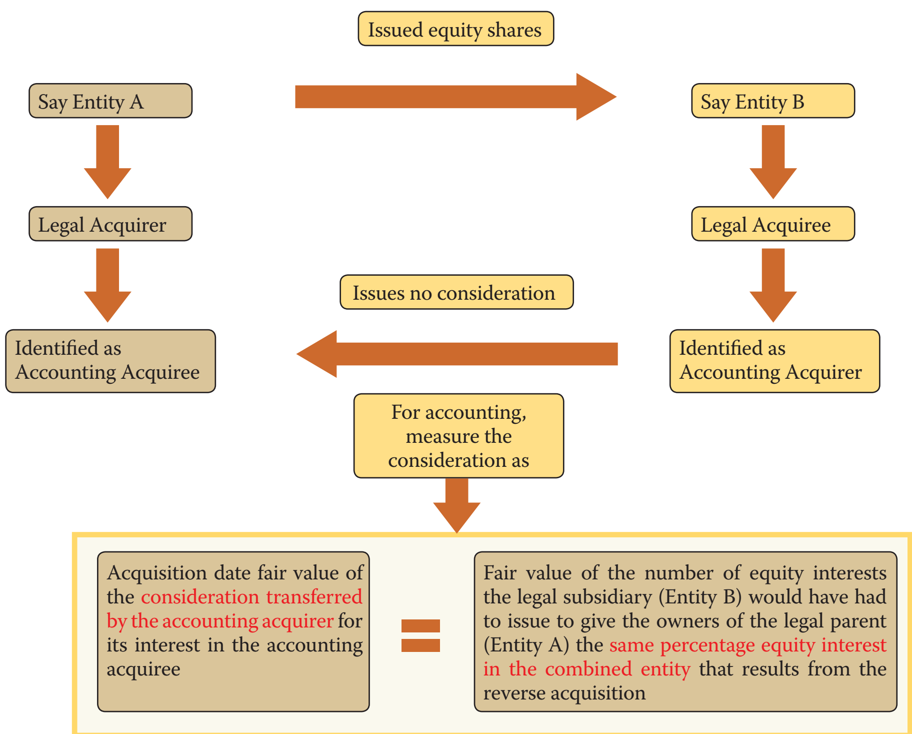
Accounting → Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method

Method of Accounting for Common Control Business Combinations

- Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method
- Assets and liabilities of the combining entities are reflected at their carrying amounts
  - Only adjustments that are made are to harmonise accounting policies
- No adjustments are made to reflect fair values, or recognize any new assets or liabilities
- No 'new' goodwill is recognized as a result of the combination
- Any expenses of the combination are written off immediately in the P&L
- Financial information in financial statements in respect of prior periods should be restated as if business combination had occurred from beginning of preceding period in financial statements, irrespective of actual date of combination
  - However, if business combination had occurred after that date, prior period information shall be restated only from that date
- Consideration and securities:
  - Consideration for business combination may consist of securities, cash or other assets
  - Securities shall be recorded at nominal value
  - Assets other than cash shall be considered at their fair values
- Identity of reserves shall be preserved and shall appear in financial statements of transferee in same form in which they appeared in financial statements of transferor
  - General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination.
- Difference, if any, between amount recorded as share capital issued plus any additional consideration in form of cash or other assets and amount of share capital of transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes

Summary of Accounting for Common Control Business Combination		
S. No.	**Particular**	**Treatment**
1.	Method of accounting	Pooling of interests method
2.	Assets and liabilities of transferor company taken over by the transferee company	At carrying values
3.	Adjustments in accounting of business combination	Adjustments are made only to harmonise the accounting policies
4.	Financial information in financial statements in respect of prior periods	Restated as if business combination had occurred from beginning of preceding period in financial statements, irrespective of actual date of combination. However, if business combination had occurred after that date, prior period information shall be restated only from that date.
5.	Reserves of transferor company	Identities are preserved and shall appear in financial statements of transferee in same form in which they appeared in financial statements of transferor company
6.	Goodwill	Not recognised
7.	Expenses incurred on combination of business	Written off immediately in the Profit and Loss account
8.	Purchase Consideration (PC)	Consists of securities, cash or other assets
9.	Securities given under purchase consideration	Recorded at nominal value
10.	Assets other than cash given under purchase consideration	Considered at their fair values
11.	Cash given under purchase consideration	Actual value
12.	Difference, if any, between amount recorded as share capital issued plus any additional consideration in form of cash or other assets and amount of share capital of transferor	Transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes

Reverse Acquisitions



Preparation and Presentation of Consolidated Financial Statements (Reverse Acquisitions)

Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree)

But it is described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree).

Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

(a) the assets and liabilities of the legal subsidiary (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.

(b) the assets and liabilities of the legal parent (the accounting acquiree) recognised and measured in accordance with this Ind AS.

(c) the retained earnings and other equity balances of the legal subsidiary (accounting acquirer) before the business combination.

(d) the amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree).

(e) in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-combination carrying amounts of the legal acquiree's net assets *even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.*

In a reverse acquisition, some of the owners of the legal acquiree (the accounting acquirer) might not exchange their equity interests for equity interests of the legal parent (the accounting acquiree).
Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition.

For Earnings per Share for the current period

In calculating the weighted average number of ordinary shares outstanding (the denominator of the earnings per share calculation) during the period in which the reverse acquisition occurs:

(a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be computed on the basis of the weighted average number of ordinary shares of the legal acquiree (accounting acquirer) outstanding during the period multiplied by the exchange ratio established in the merger agreement; and

(b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal acquirer (the accounting acquiree) outstanding during that period.

For Earnings per Share for the comparative period

The basic earnings per share for each comparative period before the acquisition date presented in the consolidated financial statements following a reverse acquisition shall be **calculated by dividing**:

(a) the profit or loss of the legal acquiree attributable to ordinary shareholders in each of those periods by

(b) the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement

Main Disclosures

- General information on the business combination
- Assets acquired and liabilities assumed
- Goodwill or a gain on bargain purchase
- Transactions that are not part of the business combination;
- In which the acquirer holds less than 100 percent of the acquiree;
- Business combinations achieved in stages, i.e., step acquisitions;
- Pro forma information about revenue and profit or loss; and
- Measurement period adjustments and contingent consideration adjustments.
- Revenue and profit or loss of combined entity for current reporting period as though acquisition date for all business combinations that occurred during the year had been as of beginning of annual reporting period
- Reconciliation of movements in goodwill:
  - Opening amounts for gross goodwill and impairment losses
  - Additional goodwill recognised in the period
  - Adjustments from recognition of deferred tax assets
  - Movements in goodwill of a 'disposal group' under Ind AS 105
  - Impairment losses recognised in the period
  - Net exchange differences arising in the period
  - Any other changes arising in the period
  - Closing amounts for gross goodwill and impairment losses
- Other disclosures as prescribed in the standard

Carve-Out in Ind As 103 From IFRS 3

- **As Per IFRS**
  - IFRS 3 requires bargain purchase gain arising on business combination to be recognised in **profit or loss** as income
- **Carve-Out**
  - Ind AS 103 requires the bargain purchase gain to be recognised in **other comprehensive income** and accumulated in equity as **capital reserve**
  - Unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as **capital reserve**
- **Reason for Carve-Out**
  - Bargain purchase gain occurs at the time of acquiring a business
  - Recognition of such gains in profit or loss would result into recognition of unrealized gains, which may get distributed in the form of dividends
  - Such a treatment may lead to structuring through acquisitions, which may not be in the interest of the stakeholders of the company

Carve-In in Ind As 103 From IFRS 3

- **As Per IFRS**
  - IFRS 3 excludes from its scope- business combinations of entities under common control
- **Carve-In**
  - Appendix C of Ind AS 103, *Business Combinations* gives guidance on business combinations of entities under common control

INDIAN ACCOUNTING STANDARD (IND AS) 105: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Objective Accounting for assets held for sale Presentation and disclosure of asset held for sale and discontinued operations → Scope out - Measurement provisions Deferred tax assets - Ind AS 12 Financial Assets - Ind AS 109 Agriculture - Ind AS 41 Contractual rights - Ind AS 104 Employee benefits - Ind AS 19 → Criteria for classifying existing assets as held for sale → Measurement of assets classified as held for sale → Presentation and Disclosure of Non-current asset held for sale → Presentation and Disclosure of Discontinued Operations

Objective

Ind AS 105

Classification

- Accounting for non-current assets held for sale or disposal groups
- Discontinued operations

Measurement and Presentation

- Measurement = at the lower of carrying amount and fair value - costs to sell
- Cessation of depreciation on such assets
- Presented separately in the balance sheet
- Results of discontinued operations to be presented separately in the statement of profit and loss
- Disclosure

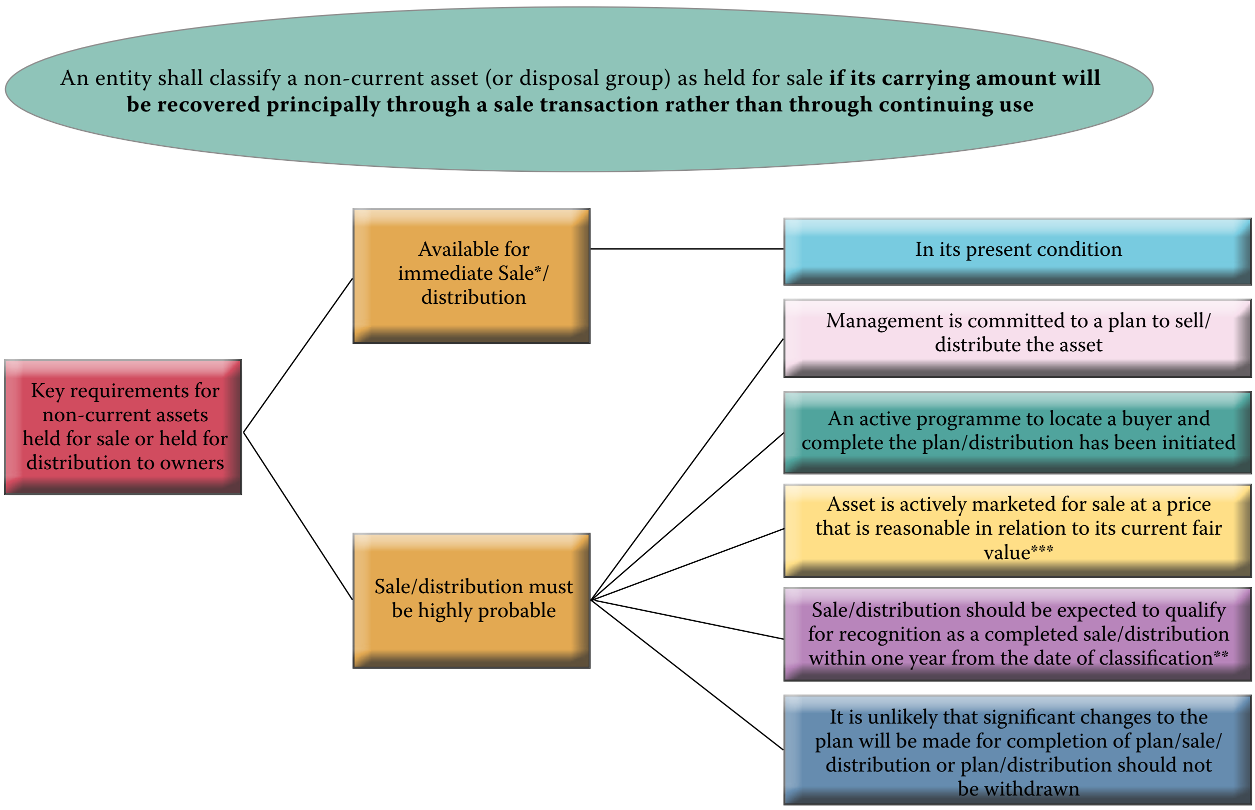
Measurement provisions of Ind AS 105 do not apply to

- Deferred tax Assets — Ind AS 12
- Assets arising from Employee benefits — Ind AS 19
- Financial Assets — Ind AS 109
- Non-current Assets which are measured at Fair value less cost to sell — Ind AS 41
- Contractual rights under Insurance contracts — Ind AS 104

Note:

1. Assets classified as non-current (as per Ind AS 1), shall not be reclassified as *current assets* until they meet the criteria to be classified as held for sale as per Ind AS 105.
2. Non-current assets acquired exclusively for resale shall not be classified as current unless they meet the criteria to be classified as held for sale as per Ind AS 105.
3. Disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.
4. The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded from the measurement requirements of this Ind AS.
5. Measurement requirements of this Ind AS apply to the group as a whole, so that the **group is measured at the lower of its carrying amount and fair value less costs to sell**.
6. The classification, presentation and measurement requirements in this Ind AS are applicable to both non-current asset (or disposal group) that is classified as:
   - held for sale; and
   - held for distribution to owners.
7. This Ind AS specifies the disclosures required in respect of non-current assets (or disposal groups) **classified as held for sale** or **discontinued operations**. Disclosures in other Ind ASs do not apply to such assets.

Classification of non-current assets (or disposal groups) as held for sale or held for distribution to owners



* Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance

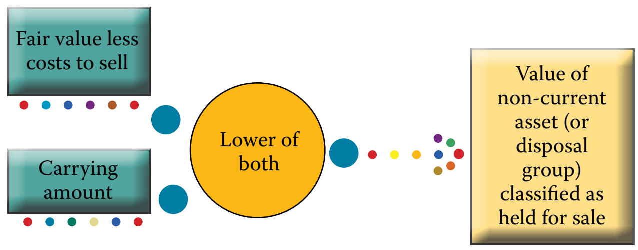
**If the entity remains committed to its plan to sell the asset (or disposal group), events or circumstances beyond the entity's control may extend the period to complete the sale beyond one year

***Not applicable for non-current assets held for distribution to owners

Note:

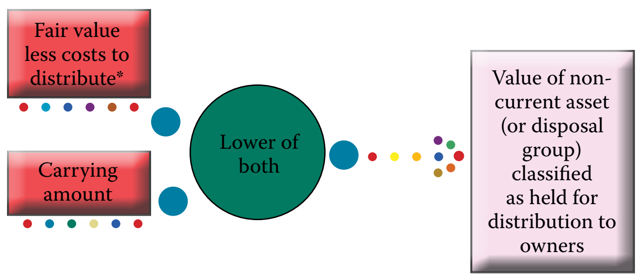
S. No.	Particular	Details
1.	Acquisition of non-current asset (or disposal group) with intention to subsequent sale within a year	Classify the non-current asset (or disposal group) as held for sale subject to the conditions specified in the above chart
2.	Non-current assets that are to be abandoned	It shall **not** be classified as held for sale since its carrying amount will be recovered principally through continuing use and not from sale

Measurement of non-current assets (or disposal groups) classified as held for sale



Note:

If the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.



*Costs to distribute are the incremental costs directly attributable to the distribution, excluding finance costs and income tax expense.

Recognition of impairment losses and reversals

- An entity shall **recognise an impairment loss for any initial or subsequent write-down of the asset** (or disposal group) to fair value less costs to sell.
- An entity shall **recognise a gain for any subsequent increase in fair value less costs to sell** of an asset to the extent of the cumulative impairment loss that has been recognised previously
- An entity shall **not depreciate (or amortise)** a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale.
- Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.

Changes to a plan of sale or to a plan of distribution to owners

- If an asset (or disposal group) classified as held for sale or as held for distribution to owners previously, no longer meets the criteria for such classification, then it shall be ceased to classify as the asset (or disposal group) held for sale or held for distribution to owners (respectively).
- If an entity reclassifies an asset (or disposal group) directly from being held for sale to being held for distribution to owners, or directly from being held for distribution to owners to being held for sale, **then the change in classification is considered a continuation of the original plan of disposal.**
- The entity shall **not change the date of classification.**

Measurement in case of above changes

Lower of

- Carrying amount **before** the asset was classified as held for sale/distribution to owners, **adjusted** for any depreciation, amortisation or revaluations that would have been **recognised had the asset (or disposal group) not been classified as held for sale or as held for distribution to owners.**
- Its recoverable amount at the date of the subsequent decision not to sell or distribute.

Value of a non-current asset (or disposal group) on reclassification

Any required **adjustment to the carrying amount** of a non-current asset **shall be in profit or loss from continuing operations**

Presentation and Disclosure of a non-current asset (or disposal group) classified as held for sale

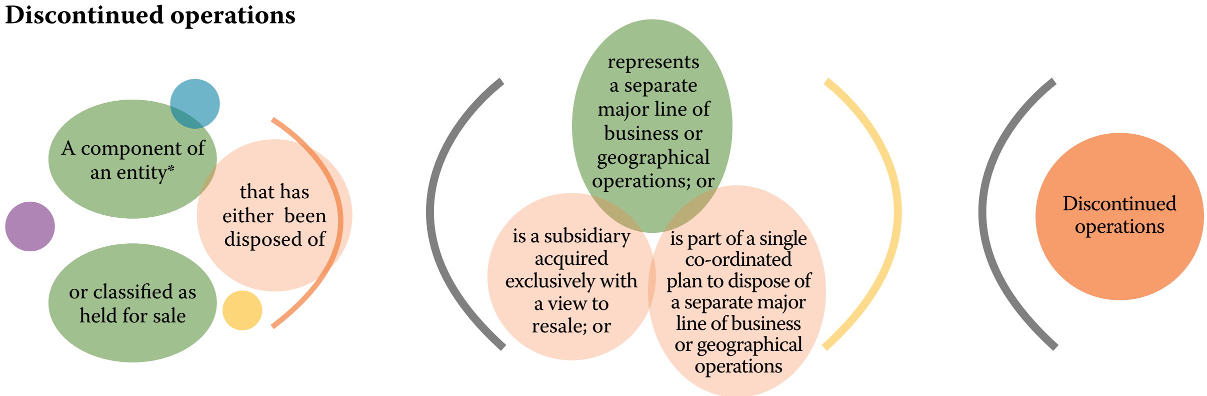
Presentation

- **Present a non-current asset classified as held for sale separately** from other assets in the balance sheet.
- **Present the liabilities of a disposal group classified as held for sale separately** from other liabilities in the balance sheet. **Those assets and liabilities should not be offset and presented as a single amount.**
- **Separate disclosure is required for major classes of assets and liabilities** classified as held for sale.
- **Present separately any cumulative income or expense recognised in OCI** relating to such non-current asset classified as held for sale.
- **Comparative amounts are <u>not</u> reclassified or re-presented** to reflect the classification in the balance sheet for the latest period presented.
- Any gain or loss on the remeasurement does not meet the definition of a discontinued operation shall be included in profit or loss from continuing operations.

Disclosure

- Description of the non-current asset (or disposal group)
- Description of facts and circumstances of the sale, or leading to the expected disposal and the expected manner and timing of that disposal
- Gain or loss recognised and if not presented separately on the face of the income statement, the caption in the income statement that includes that gain or loss
- The reportable segment in which the non-current asset (or disposal group) is presented, if any
- If there is a change of plan to sell, a description of facts and circumstances leading to the decision and its effect on results

Discontinued operations



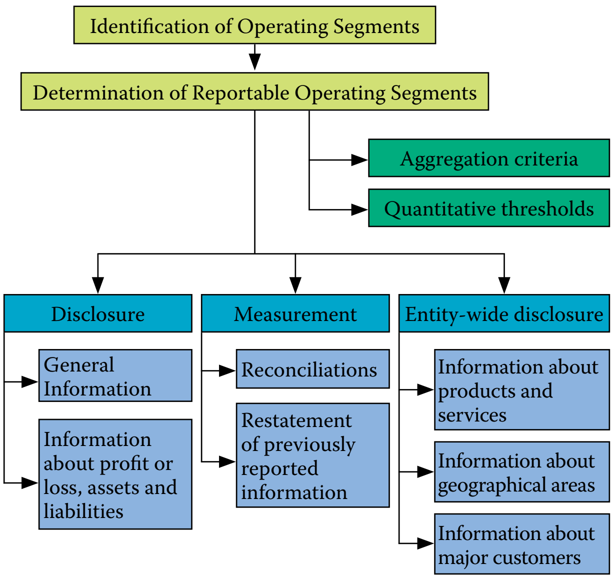
* A component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use

Presentation and Disclosure of Discontinued Operations

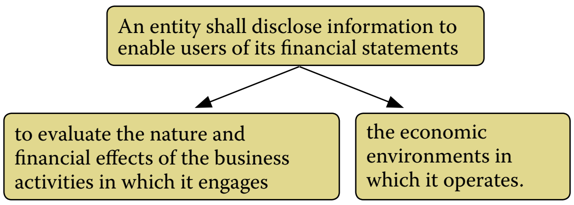
S.No.	Particulars	Detail disclosure
1.	Separate presentation	▪ Presentation and disclosure shall enable users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups) ▪ This allows the user to distinguish between continuing operations and those which will not
2.	In the statement of profit and loss	▪ Disclose a single amount comprising the total of: (a) the post-tax profit or loss of discontinued operations; and (b) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation. ▪ Disclose the analysis of this single amount into: (a) the revenue, expenses and pre-tax profit or loss of discontinued operations; (b) the related income tax expense as required in Ind AS 12; (c) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and (d) the related income tax expense as required in Ind AS 12 ▪ Present the analysis in the notes or in the statement of profit and loss ▪ Disclosure of analysis is **not** required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition ▪ Disclose the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of profit and loss
3.	In the statement of cash flows	▪ Disclose the net cash flows attributable to the operating, investing and financing activities of discontinued operations either in the notes or in the financial statements ▪ These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition ▪ Comparative figures for prior periods are also re-presented
4.	Adjustment to prior period disposals	Adjustments in the current period to amounts previously presented in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period should be classified separately in discontinued operations. The nature and amount of such adjustments are disclosed.

INDIAN ACCOUNTING STANDARD (IND AS) 108: OPERATING SEGMENTS

Overview



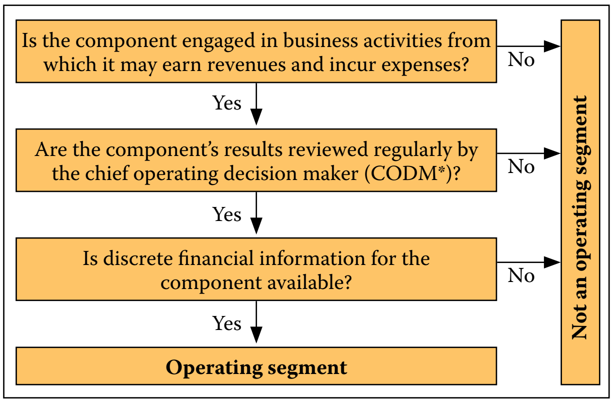
Core Principle



Important points:

1. If an entity that is not required to apply Ind AS 108 chooses to disclose information about segments that does not comply with Ind AS 108, it should not describe the information as segment information.
2. If a financial report contains both the consolidated financial statements of a parent that is within the scope of Ind AS 108 as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

Identification of Operating Segment (a component of an entity)



* The term 'Chief Operating Decision Maker' (CODM) identifies a function, not necessarily a manager with a specific title. The chief operating decision maker of an entity may be
- ➢ chief executive officer, or
- ➢ chief operating officer, or
- ➢ a group of executive directors or others.

Important Points regarding identification of operating segment

1. An operating segment may engage in business activities for which it has yet to earn revenues.
2. An entity's post-employment benefit plans are not operating segments.
3. If CODM uses more than one set of segment information, other factors may identify a single set of components as constituting an entity's operating segments, like
   a. the nature of the business activities of each component,
   b. the existence of managers responsible for them, and
   c. information presented to the board of directors.
4. If the characteristics for identifying the operating segment apply to more than one set of components of an organisation but there is only one set for which segment managers* are held responsible, that set of components constitutes the operating segments.

* The term 'segment manager' identifies a function, not necessarily a manager with a specific title. He is directly accountable to and maintains regular contact with the chief operating decision maker. A CODM may also be a segment manager for some operating segments.

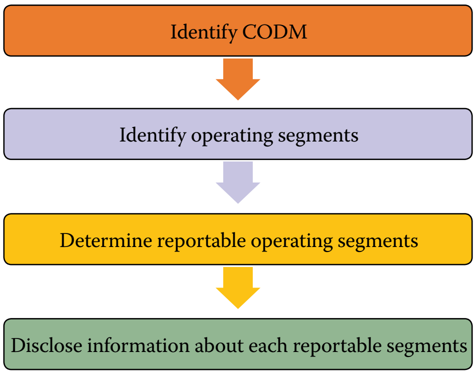
Reportable segments

An entity should report separately information about each operating segment that:

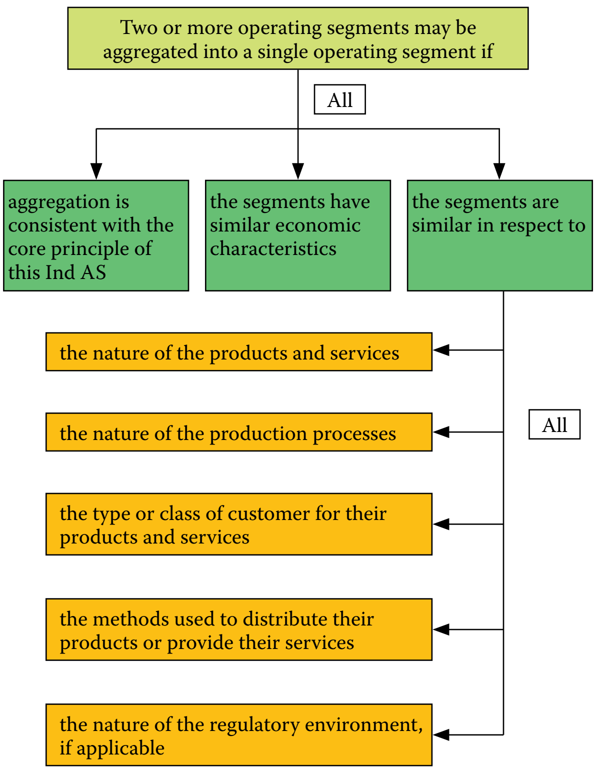
(a) has been identified as operating segment or results from aggregating two or more of those segments (as per aggregation criteria); AND

(b) exceeds the quantitative thresholds.

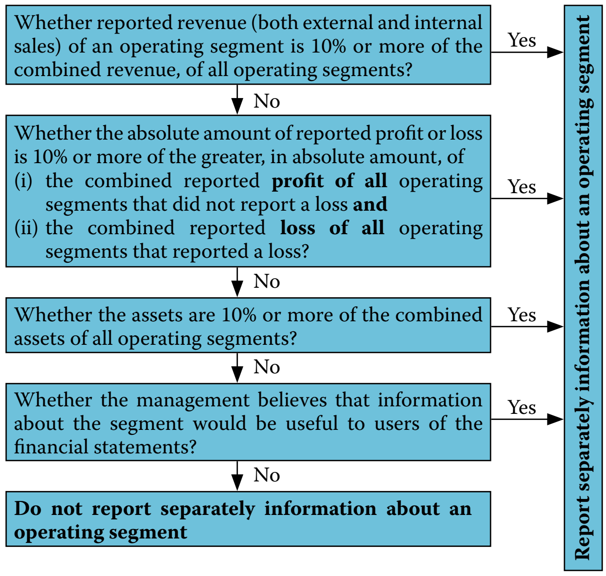
Standard specifies other situations in which separate information about an operating segment should be reported.

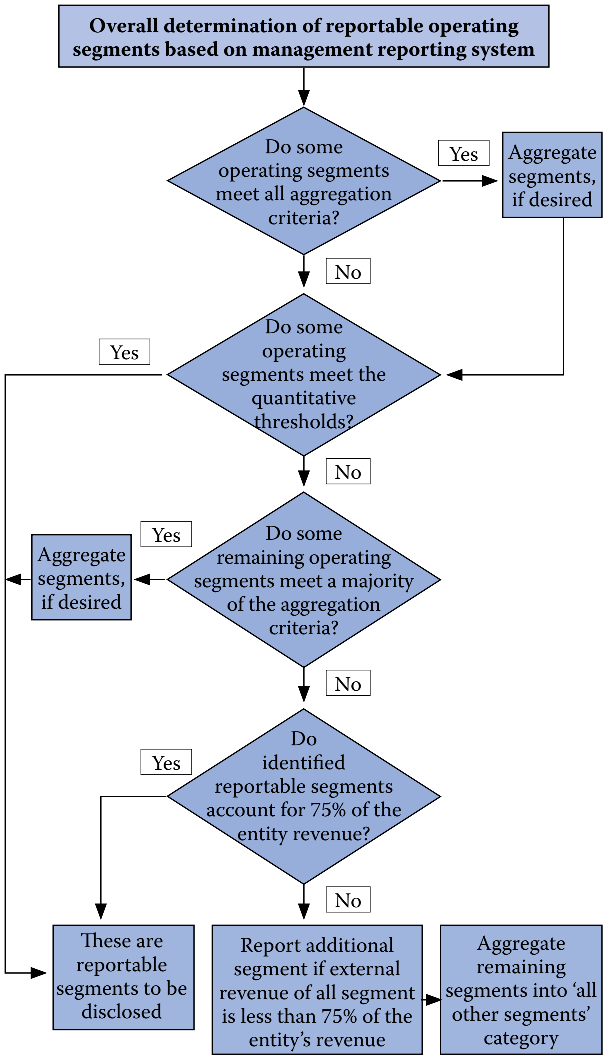


Aggregation Criteria



Quantitative Thresholds Criteria





Important points:

1. The information about two or more operating segments that do not meet the quantitative thresholds may be combined to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.
2. Based on the management judgement, information about immediate preceding period reportable operating segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability.
3. If a new operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated, if practicable.

Disclosure

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

General information:
(a) factors used to identify the entity's reportable segments, including the basis of organisation
(b) the judgements made by management in applying the aggregation criteria ie
  (i) a brief description of the operating segments that have been aggregated and
  (ii) the economic indicators that have been assessed;
(c) types of products and services from which each reportable segment derives its revenues.

Information about reported segment profit or loss, including
- specified revenues and expenses included in reported segment profit or loss,
- segment assets,
- segment liabilities; and
- the basis of measurement.

Reconciliation of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts

Note:

1. An entity shall report a measure of profit or loss for each reportable segment.
2. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker.

Measurement

1. The amount of each segment item reported should be the measure reported to the CODM for the purposes of making decisions about allocating resources to the segment and assessing its performance.
2. Adjustments and eliminations made in preparing an entity's financial statements are included in the measure of reporting of segment items only if that is used by the chief operating decision maker.
3. If CODM uses only one measure, then that measure shall be used for reporting operating segment. However, if CODM uses more than one measure, then the reported measures should be those that are most consistent with those used in measuring the corresponding amounts in the entity's financial statements.

Reconciliations

An entity shall provide reconciliations of all of the following:
(a) the total of the reportable segments' revenues to the entity's revenue.
(b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations.
(c) the total of the reportable segments' assets to the entity's assets if the segment assets are reported.
(d) the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are reported.
(e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items shall be separately identified and described.

Other information to be disclosed

1. An entity should report the following geographical information, if possible:
   (a) revenues from external customers
      (i) attributed to the entity's country of domicile and
      (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues should be disclosed separately alongwith the basis.
   (b) non-current assets other than financial instruments, deferred tax assets, post- employment benefit assets, and rights arising under insurance contracts
      (i) located in the entity's country of domicile and
      (ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets should be disclosed separately.
2. If revenues from transactions with a single external customer amount to 10% or more of an entity's revenues, the entity should disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues.

INDIAN ACCOUNTING STANDARD (IND AS) 109: FINANCIAL INSTRUMENTS

Classification of Financial Instruments

- **Financial Assets**
  - Amortized Cost
  - Fair Value through other comprehensive income (FVTOCI)
  - Fair Value through profit or loss (FVTPL)
- **Financial Liabilities**
  - Amortized Cost
  - Fair Value through profit or loss (FVTPL)

Classification of Financial Assets

- **Amortized Cost**
  - Business Model 'Hold-to-collect' + SPPI Contractual cash flow test
- **Fair Value through other comprehensive income (FVTOCI)**
  - Business Model 'Hold-to-collect' and sell + SPPI Contractual cash flow test
- **Fair Value through profit or loss (FVTPL)**
  - Held for trading
  - Residual category

Financial Assets Measured at

Amortized Cost

If below conditions are met:

(a) FA is held with BM whose objective is to hold financial assets in order to collect contractual cash flows

(b) Contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Fair value through Other Comprehensive Income

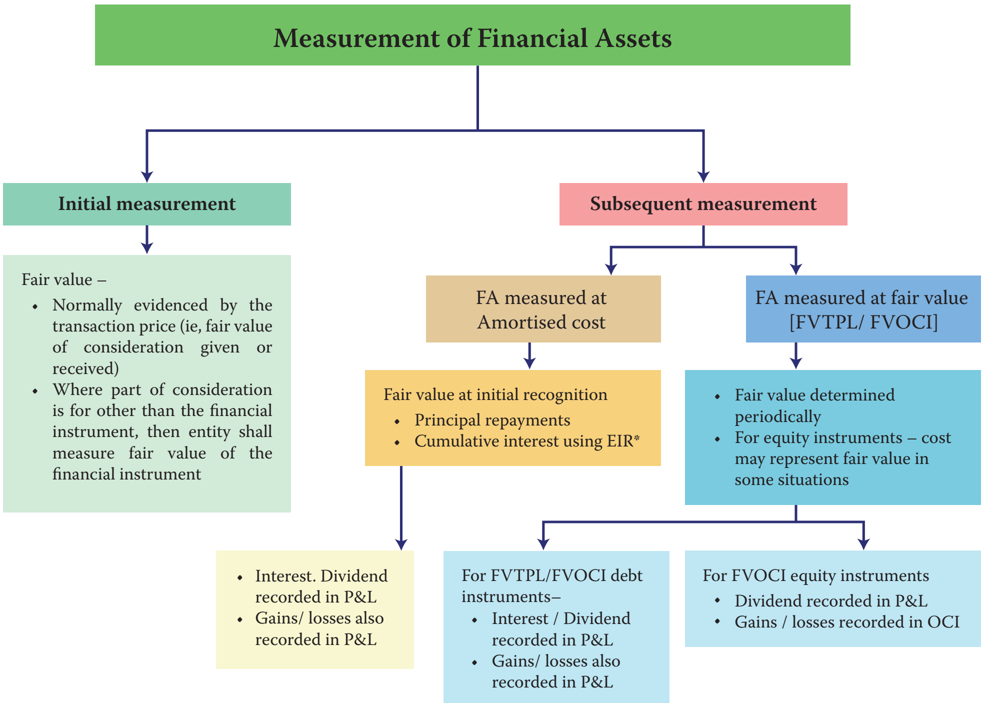
- FA shall be measured at FVOCI if below conditions are met:
  (a) FA is held with BM whose objective is achieved both by collecting contractual cash flows and selling FA
  (b) Contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
- Any equity instruments for which the entity makes an irrevocable election to carry at fair value through OCI

Fair value through profit or loss

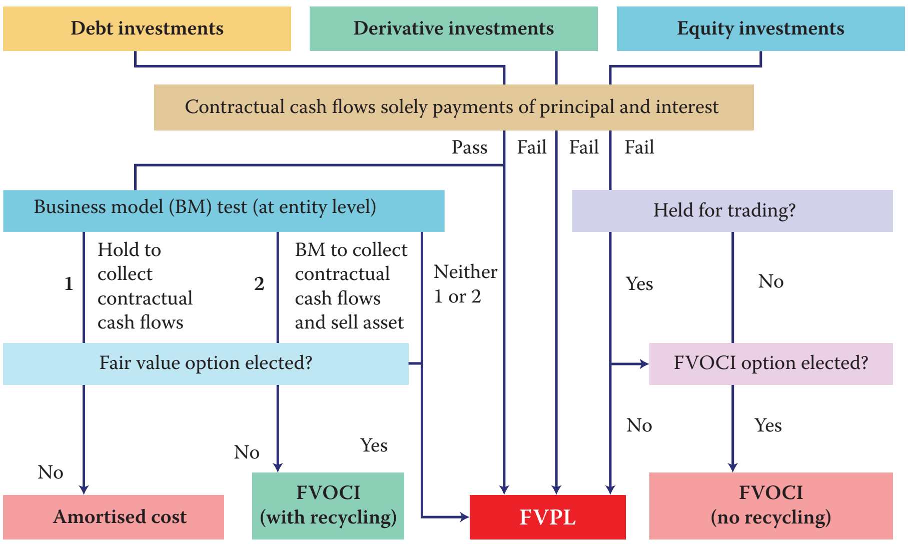
FA are accounted at FVTPL if:

(a) Any asset which is not measured at amortised cost and not measured at FVOCI; or

(b) If on initial recognition, any asset may irrevocably be designated as FVTPL if specific criteria met.



The decision tree for classification of financial assets can be understood with the help of following flow chart



What Is Amortized Cost?

Particulars	Amount
Initial Recognition (Fair value / Transaction value)	XXXX
Less : Principal repayment	XXXX
Less : Cumulative amortization (EIR)	XXXX
Less : Impairment / un-collectability	XXXX
Amortized costs	**XXXX**

- Effective interest rate (EIR) method is used to calculate the amortized costs of a financial asset or a financial liability as well as the allocation & recognition of interest revenue or expense in income statement.
- EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability.
  The computation of EIR includes all cash flows between the parties in the contract e.g. Fees, transaction costs, premium or discounts.
- Transactions costs are the incremental costs that are directly attributable to the acquisition or issue of any financial assets or liability.

Accounting For Transaction Costs For The Purpose Of Effective Interest Rate Method

Fees that are integral part of effective interest rate	Fees that are not an integral part of effective interest rate
(a) **Origination fee** received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.	(a) **Fee** charged for **servicing a loan;**
(b) **Commitment fee** received by the entity **to originate a loan where it is probable that the entity will enter into a specific lending arrangement.** These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry.	(b) **Commitment fee** to originate a loan when it is unlikely **that a specific lending arrangement will be entered into;**
(c) **Origination fee** paid on issuing financial asset measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.	(c) **Loan syndication fee** received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants).

Financial Asset (FA) Classified as Subsequently Measured at Amortised Cost

if it meets both of following criteria:

'Hold-to-collect' business model test + **'SPPI' contractual cash flow characteristics test**

'Hold-to-collect' business model test: Objective is to hold the financial asset in order to collect contractual cash flows

'SPPI' contractual cash flow characteristics test: Objective is to hold the financial asset in order to collect contractual cash flows

Note: Equity instrument can never be classified at amortized costs

Examples of FA classified and accounted for at amortised cost:

- Trade receivables
- Investments in government bonds (not held for trading)
- Investments in term deposits (at standard interest rates)
- Loan receivables with 'basic' features

Business Model Tests

- An entity's business model refers to how an entity manages its financial assets so to generate / realise cash flows
- In other words, business model is concerned with whether an entity will collect contractual cash flows by holding them to maturity or sell those financial assets or both.

- An entity is not required to perform this assessment on 'worst case' or 'stress case' scenarios
- Rather, it is determined on the basis of scenarios which are reasonably expected to occur
- For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario which is not likely to occur, the entity will not consider such scenario to determine its business model.

An entity may have one of the following models for its **debt instruments :**

(a) Hold to collect contractual cash flows:

An entity holds financial assets to collect contractual **cash flows till maturity.** That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows.

(b) Hold to collect contractual cash flows and selling financial assets:

- In this type of business model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieve the objective of the business model.
- Consider that an entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long—term financial assets so that it can fund the expenditure when needed. Many financial assets have contractual lives which exceed the entity's anticipated investment period. Hence, the entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell the financial assets to reinvest cash in other financial or non-financial assets with a higher return.

(c) Other business model – Actively buying & Selling :

- In this business model, an entity manages its financial assets with the objective of realising cash flows through the sale as against realizing contractual cash flows.
- The entity makes decisions to hold / sell the investment based on an asset's fair values and manages its financial assets to realise their fair values.
- In this case, the entity's objective will typically result in an active buying and selling. This business model results in measurement as at FVTPL.

SPPI TEST

- Contractual terms give rise to cash flows that are **Solely Payments of Principal and Interest on the principal amount outstanding**
- Contractual cash flows consistent with a basic lending arrangement
- **Interest element – Consider factors like:**
  - Time value of money
  - Credit risk
  - Liquidity
  - Profit margin
  - Service or administrative costs.
- Interest rate can be fixed or floating, zero /any other interest rate
- Contractual cash flows linked to features such as changes in equity or commodity prices, would not pass the SPPI test because they introduce exposure to risks or volatility
- SPPI Test will be met if there is a prepayment penalty i.e. additional compensation for early termination or extension of contract

Features consistent with SPPI Test	Features not consistent with SPPI Test
Prepayment option	Options, forward and swaps
Fixed / variable rate of interest	Conversion options
Caps, floors, collars	

Financial Assets Classified as Fair Value Through OCI (FVOCI)

Financial asset (FA) is measured at FVOCI

if it meets both of following criteria:

'Hold-to-collect and sell' business model test

Objective is achieved by both holding the financial asset in order to collect contractual cash flows and selling the financial asset

+

'SPPI' contractual cash flow characteristics test -characteristics test

Contractual terms give rise to cash flows that are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding.

Intention of the entity is to sell the instrument before the investment matures.

Examples of FA classified and accounted for at FVOCI:
- Investments in government bonds where the investment period is likely to be shorter than maturity
- Investments in corporate bonds where the investment period is likely to be shorter than maturity

FVOCI – Debt Instruments – Accounting Requirement

For Debt instruments classified as FVOCI, accounting requirements are as follows:

S.No	Nature of Item	Accounting treatment
1	Interest income	To be recognised in profit or loss using the effective interest rate method
2	Other changes in the carrying amount on re-measurement to fair value	To be recognized in OCI
3	when the related financial asset is derecognised	Cumulative fair value gain or loss recognised in OCI is recycled to profit or loss.

- For debt instruments that are classified as FVOCI, entities will need to track both the amortised cost and fair value
- The amounts recorded in profit or loss will reflect amortised cost and the balance sheet will reflect the fair value of the financial asset

FVOCI – Equity Instruments – Accounting Requirement

Default Approach –
- Ind AS 109 requires all equity investments to be measured at fair value
- All changes in fair value to be recognised in profit or loss

FVOCI category option – Equity investments (not held for trading)
- Entities can make an irrevocable election at initial recognition to classify the instruments as at FVOCI
- Such option is available instrument by instrument i.e. (item by item)
- All subsequent changes in fair value being recognised in OCI
- Dividends received on equity investments to be recognised in profit or loss

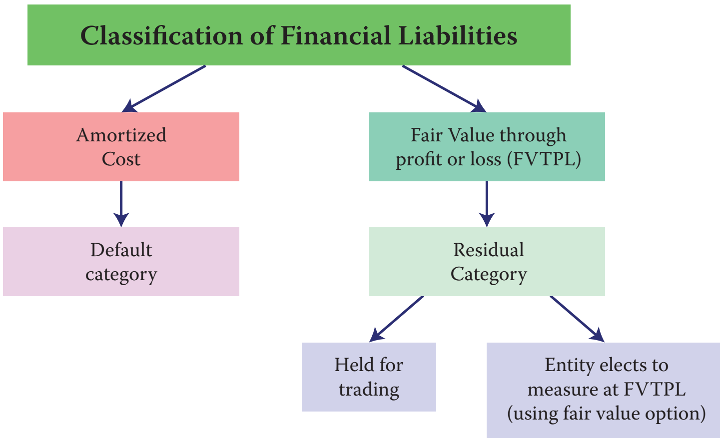
Financial Assets Classified as Fair Value Through PL (FVTPL)

Fair value through profit or loss (FVTPL) is the residual category in Ind AS 109

Financial asset (FA) classified and measured at FVTPL if FA is:
- A held-for-trading financial asset
- A debt instrument that does not qualify to be measured at amortised cost or FVOCI
- An equity investment which the entity has not elected to classify as at FVOCI

Examples of FA classified and accounted for at FVTPL are:
- Derivatives that have not been designated in a hedging relationship, e.g.:
  - Interest rate swaps
  - Commodity futures/option contracts
  - Foreign exchange futures/option contracts
- Investments in shares that the entity has not elected to account for at FVOCI
- Contingent consideration receivable from the sale of a business

Under Ind AS 109, consideration is first given to whether a financial asset is to be measured at amortised cost and FVOCI and, if it is not, it will be measured at FVTPL



Financial liability is classified into two categories:		
Category	**Main use**	**Examples**
Amortised Cost (Default category)	All liabilities not in the **below** category	• Trade payables • Bank borrowings
Fair value through profit or loss	• Financial liabilities that are held for trading (including derivatives). • Financial liabilities that are designated as FVTPL the entity on initial recognition. • Contingent consideration recognised by an acquirer in a business combination	• Derivatives eg. Interest rate swaps, Commodity futures/option contracts • Contingent consideration payable arising from one or more business combinations.

Initial Recognition

An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the **entity becomes party to the contractual provisions of the instrument**

Initial Measurement

- On initial recognition, financial assets or financial liabilities are measured at **FAIR VALUE.**
- If the financial assets or financial liabilities are not recognized at fair value, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability are adjusted against the fair value

What is Transaction Cost?

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument.

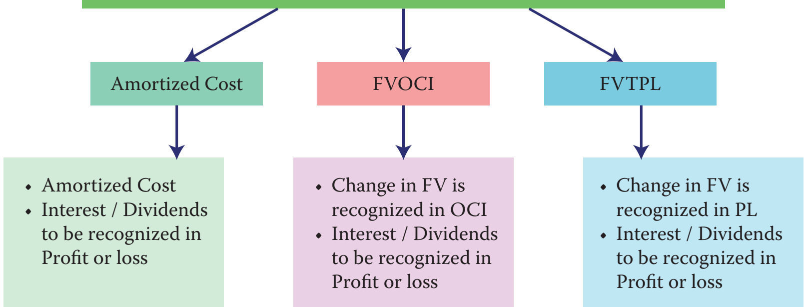
Examples of costs that qualify as transaction costs	Examples of costs that do not qualify as transaction costs
Fees and commissions paid to agents, advisers, brokers and dealers	Debt premiums or discounts
Levies by regulatory agencies and securities exchanges	Financing costs
Transfer taxes and duties	Internal administration costs
Credit assessment fees and registration charges	

Initial Measurement & Transaction Costs – Financial Assets & Liabilities

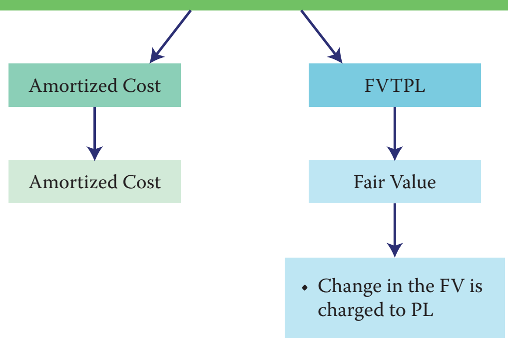
Financial asset	Initial measurement	Transaction costs
At amortized cost	Fair value	Capitalize
At fair value through OCI	Fair value	Capitalize
At fair value through profit or loss	Fair value	Expense

Financial liability	Initial measurement	Transaction costs
Amortized cost	Fair value	Deduct from the amount originally recognized
At fair value through profit or loss	Fair value	Expense

Subsequent Recognition of Financial Assets



Subsequent Recognition of Financial Liabilities



The classification and measurement of financial instruments are summarized as below:

	Financial Assets			Financial Liabilities		
Classification	Amortised Cost	FVTOCI	FVTPL	Amortised Cost	FVTPL	
Basis of Classification	• BM test to collect • SPPI test	• BM test to collect & sell • SPPI test	• Held for trading (SPPI or BM test fail)	• Default criterial	• If held for trading • Entity elects FVTPL (using fair value option)	
Initial recognition	• Fair Value	• Fair Value	• Fair Value	• Fair Value	• Fair Value	• Fair Value
Subsequent recognition	• Amortised Cost	• Fair Value	• Fair Value	• Amortised Cost	• Fair Value	• No Re-measurement

Reclassification of Financial Assets

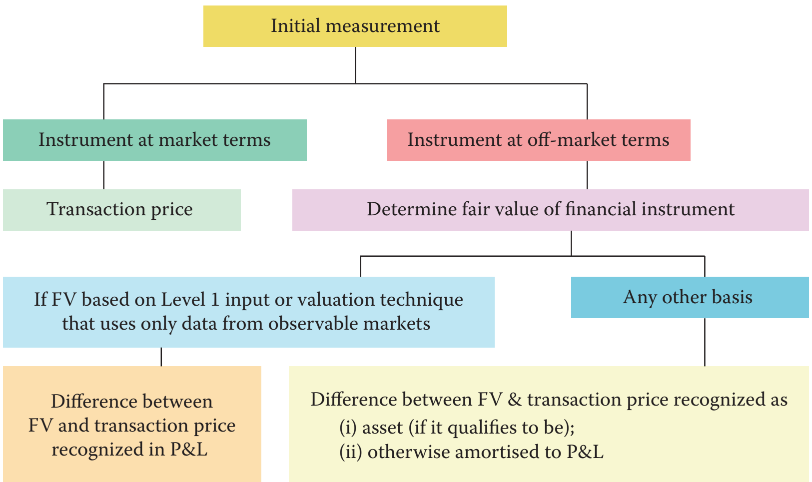
- An entity shall reclassify financial assets, only if the entity changes its business model for managing those financial assets
  - Such changes are determined by the **entity's senior management as a result of external or internal changes** and must be significant to the entity's operations and demonstrable to external parties
  - Accordingly, a change in an entity's business model will occur only when an entity either **begins or ceases to perform an activity** that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line
  - Such changes are expected to be very infrequent
- **Examples of a change in business model include the following:**
  (a) An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
  (b) A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.
- **Following are not changes in business model:**
  (a) A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions);
  (b) Temporary disappearance of a particular market for financial assets;
  (c) A transfer of financial assets between parts of the entity with different business models.
- A change in the objective of the entity's business model must be **effected before the reclassification date**
- If an entity reclassifies financial assets, it should apply the reclassification **prospectively from the reclassification date**
- The entity should **not restate any previously recognised gains, losses** (including impairment gains or losses) or interest

Reclassification Of Financial Assets – Accounting

Original Classification	Revised Classification	Accounting treatment
Amortised Cost	FVTPL	• **Fair value** is measured at reclassification cost date • **Difference** between previous amortized cost and fair value is recognised in **P&L**
	FVTOCI	• Fair value is measured at reclassification cost date. • Difference between previous amortised cost and fair value is **recognised in OCI** • No change in EIR due to reclassification.
FVTPL	Amortised Cost	• **Fair value** at reclassification date becomes **its new gross carrying amount** • EIR is calculated based on the new gross carrying amount
	FVTOCI	• **Fair value** at reclassification date becomes its **new carrying amount** • No other adjustment is required
FVTOCI	Amortised Cost	• **Fair value** at reclassification date becomes its **new amortised cost carrying amount** • **However, cumulative gain or loss in OCI is adjusted against fair value.** Consequently, the asset is measured as if it had always been measured at amortised cost
	FVTPL	• Assets continue to be measured at fair value • **Cumulative gain or loss previously recognized in OCI is reclassified to P&L at the reclassification date**

Reclassification of financial liability is not allowed

Accounting for Instruments Exchanged at Off Market Terms



Impairment- Financial Instruments

General Approach	Simplified Approach
• In General Approach, impairment loss is recognized based on either 12 month ECL or lifetime ECL. • Impairment loss will be lower in 12 month ECL as it focusses only on the probability of default within next 12 months as compared to lifetime ECL as it focusses on probability of default over life the life of an instrument. • This method depends whether there has been a significant increase in credit risk. • One needs to track the change in credit rating / quality.	• This approach does not require an entity to track the changes in credit risks. • Each entity recognizes the impairment loss based on lifetime ECL at each reporting date right from its initial recognition. • This approach is mandatory for Trade receivables that do not contain a significant financing component.

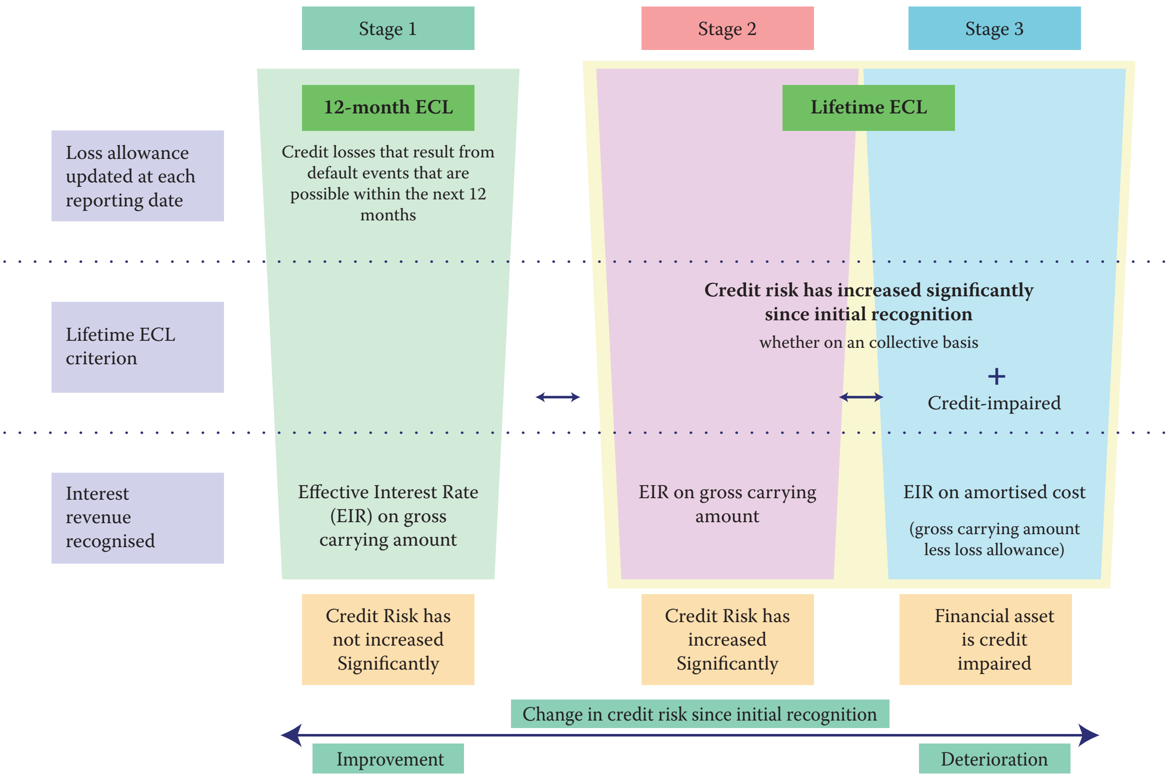
Scope and variation of the expected credit loss model

	Scope of ECL requirements	General approach	Simplified approach
1.	**Ind AS 109 Financial Instruments**		
	• Trade receivables that do not contain a significant financing component		✓
	• Trade receivables that contain a significant financing component	Policy election at entity level	
	• Other debt financial assets measured at AC or at FVOCI	✓	
	• Loan commitments and financial guarantee contracts not accounted for at FVPL	✓	
2.	**Ind AS 115 Revenue iron Contracts with Customers**		
	• Contract assets that do not contain a significant financing component		✓
	• Contract assets that contain a significant financing component	Policy election at entity level	
3.	**Ind AS 116**		
	• Lease receivables	Policy election at entity level	

What is a credit loss allowance?

Amount of Credit loss = Contractual cash flows that are due to an entity - Discounted value of cash flows that the entity expects to receive

General Approach



Three Stage Model for Impairment

Particular	Stage 1 Initial Recognition	Stage 2 Significant increase in credit risk	Stage 3 Credit Impaired
Credit Risk	Low	Moderate to High	Significant
ECL Model	12 Month ECL	Life-time ECL	Life-time ECL
Interest recognition	Interest on gross recognition	Interest on gross recognition	Interest on net carrying amount

What is a 'significant' increase in credit risk?

Interpretation of 'significant'

Original credit risk at initial recognition	Expected life or term structure
• Change in absolute probability of default (PD) occurring is more significant for financial instruments with lower initial credit risk as compared to financial instrument with higher initial risk of default occurring	• Risk of a default occurring increases with the expected life of the financial instrument • PD will decrease less quickly over time for instrument with significant payments obligations close to maturity

Factors or Indicators of Change in the Risk of a Default Occurring

Factors or indicators of change in the risk of a default occurring:

- Credit spread (e.g., credit default swap)
- Operating results
- Business, financial or economic conditions
- Regulatory, economic or technological environment
- Collateral, guarantee or financial support, if this impacts the risk of a default occurring
- Payment status and behaviour
- Credit risk management approach
- Rates or terms (e.g., covenants, collateral)
- Credit rating (internal or external)

Simplified Approach: Provision Matrix

According to the simplified approach, for trade receivables and contract assets that do not contain a significant financing component, an entity shall always measure loss allowance at an amount equal to lifetime expected credit losses

A provision matrix could be used to estimate ECL for these financial instruments

For example, an entity may set up the following provision matrix based on its historical observed default rates, which is adjusted for forward-looking estimates:

- non-past due: 0.3% of carrying value
- 30 days past due: 1.6% of carrying value
- 31-60 days past due: 3.6% of carrying value
- 61-90 days past due: 6.6% of carrying value
- more than 90 days past due: 10.6% of carrying value

Probability of Default

Expected credit loss (ECL) = EAD * PD * LGD

Exposure at default (EAD) will be the gross amount of debt financial asset or borrowing

Probability of default (PD) is the likelihood that a loan will not be repaid and will fall into default. It must be calculated for each borrower. The credit history of the borrower and the nature of the investment must be taken into consideration when calculating PD

Loss given default (LGD) is the fractional loss due to default

LGD = 1 – Recovery Rate (RR)

Recovery Rate (RR) is defined as the proportion of a bad debt that can be recovered

Derecognition of Financial Assets

Derecognition refers to the timing of removing a financial asset from the balance sheet

Process

Determine whether the de-recognition principles below are applied to a part or all of an asset (or group of similar assets)

Have the rights to the cash flows from the asset expired
- Yes → Derecognise the asset
- No ↓

Has the entity transferred its contractual rights to receive the cash flows from the asset?
- Yes → Has the entity transferred substantially all risks and rewards?
- No ↓

Has the entity assumed an obligation to pay the cash flows from the asset under pass-through arrangement
- No → Continue to recognise the asset
- Yes ↓

Has the entity transferred substantially all risks and rewards?
- Yes → Derecognise the asset
- No ↓

Has the entity retained substantially all risks and rewards?
- Yes → Continue to recognise the asset
- No ↓

Has the entity retained control of the asset?
- No → Derecognise the asset
- Yes ↓

Continue to recognise the asset to the extent of the entity's continuing involvement

Derecognition of Financial Liabilities

An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position **when, and only when, it is extinguished** - ie when the obligation specified in the contract is discharged or cancelled or expires

A financial liability (or part of it) is extinguished when the debtor either:

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

(b) Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor.

Legal release by creditor

A debtor can derecognise a liability can only if the creditor legally releases the debtor from the liability

Accounting for an Extinguishment of Financial Liability

1. The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss
2. Any costs or fees incurred on extinguishment shall be charged to profit & loss

Exchange or Modification of Financial Liability

Debt Restructuring

An exchange between an existing borrower and lender of debt instruments with **substantially different terms** shall be accounted for as:

(a) A extinguishment of the original financial liability, and

(b) Recognition of a new financial liability.

The substantially different terms are as below:

(A)		(B)	
Present value of: • cash flows under the new terms, • any fees paid • net of any fees received	LESS	Discounted present value of the remaining cash flows of the original financial liability	Is greater than or equal to 10% of (B)

Accounting treatment – Costs of fees incurred on extinguishment or Modification

Scenario	Accounting
Where exchange of debt instruments or modification is **accounted for as an extinguishment**	Any costs or fees incurred are recognised as part of the **gain or loss in PL** on the Extinguishment
Where exchange of debt instruments or modification is **not accounted for as an extinguishment**	Any costs or fees incurred shall be **adjusted in** the carrying amount of the liability and are amortised over the remaining term of the modified liability

Exchange or Modification of Financial Liability – Accounting Treatment

If the 10% test is passed, principle of "extinguishment accounting" are applied, that is:

1. **De-recognition** of the existing liability.
2. **Recognition of the new or modified liability** at its **FAIR VALUE** (net of any fees incurred directly related to the new liability). Fair value of the new or modified liability is estimated based on the expected future cash flows of the modified liability, discounted using the interest rate at which the entity could raise debt with similar terms and conditions in the market.
3. Gain or loss on extinguishment : Charge to PL.
4. **Recognising any incremental costs or fees incurred** for modification (and not for the new liability), and any consideration paid or received, **in profit or loss.**
5. **EIR Accounting for New Loan :** Calculating a new effective interest rate for the modified liability, which is then used in future periods.

Modification of Financial Liability – Accounting Treatment

Two alternate approaches are possible: Approach 1 and Approach 2

Approach 1: Recognition of gain or loss on date of modification
1. Under this approach, the difference between:
(a) discounted present value of the remaining cash flows of the original financial liability, and
(b) discounted present value of the remaining cash flows of the new financial liability both computed using original effective interest rate, is recognized in profit or loss.
2. In addition, any fees or costs incurred will also be recognized in profit or loss.

Approach 2: Amortisation of gain or loss on date of modification
Under this approach,
1. Fees or costs incurred are netted against the existing liability;
2. the effective interest rate is recalculated. This is the rate which discounts the future cash flows as per modified contractual terms to the adjusted carrying amount mentioned above
3. the adjusted effective interest rate is used to determine the amortised cost and interest expense in future periods

Derivatives and Embedded Derivatives

DERIVATIVE DEFINITION

Three characteristics

- Fair value changes in response to changes in one or more underlying variables
- No or little initial net investment
- Settled at a future date

- Measured at Fair Value
- Any change in Fair value needs to be recognised in PL (except for hedge accounting)

Examples of derivatives and underlying

Type of contract	Main variable
Interest rate swap	Interest rate
FX forward	Foreign exchange rate
Commodity option	Commodity price
Credit default swap	Credit risk
Purchased or written stock call or put option	Equity price

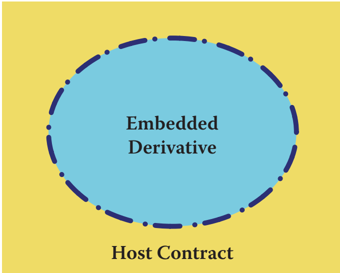
Accounting Treatment of Derivative

All derivatives are measured at fair value with changes in **fair value being recognized in profit or loss** for the period, except derivatives that qualify as hedging instruments

Particulars	DR / CR	Amount
Derivative Assets (BS)	Dr	XXXX
To income on account of derivative (PL)	Cr	XXXX
(Derivative assets is recorded in case of MTM gain)		
Expense on account of derivative (PL)	Dr	XXXX
Derivative Liability (BS)	Cr	XXXX
(Derivative liability is recorded in case of MTM loss)		

Embedded Derivatives

Hybrid Instrument



Host Contract may be Debt , Equity, Executory Contract, Lease, Insurance

Embedded derivative may be Interest rate index, Commodity Index, Equity index

An embedded derivative is:

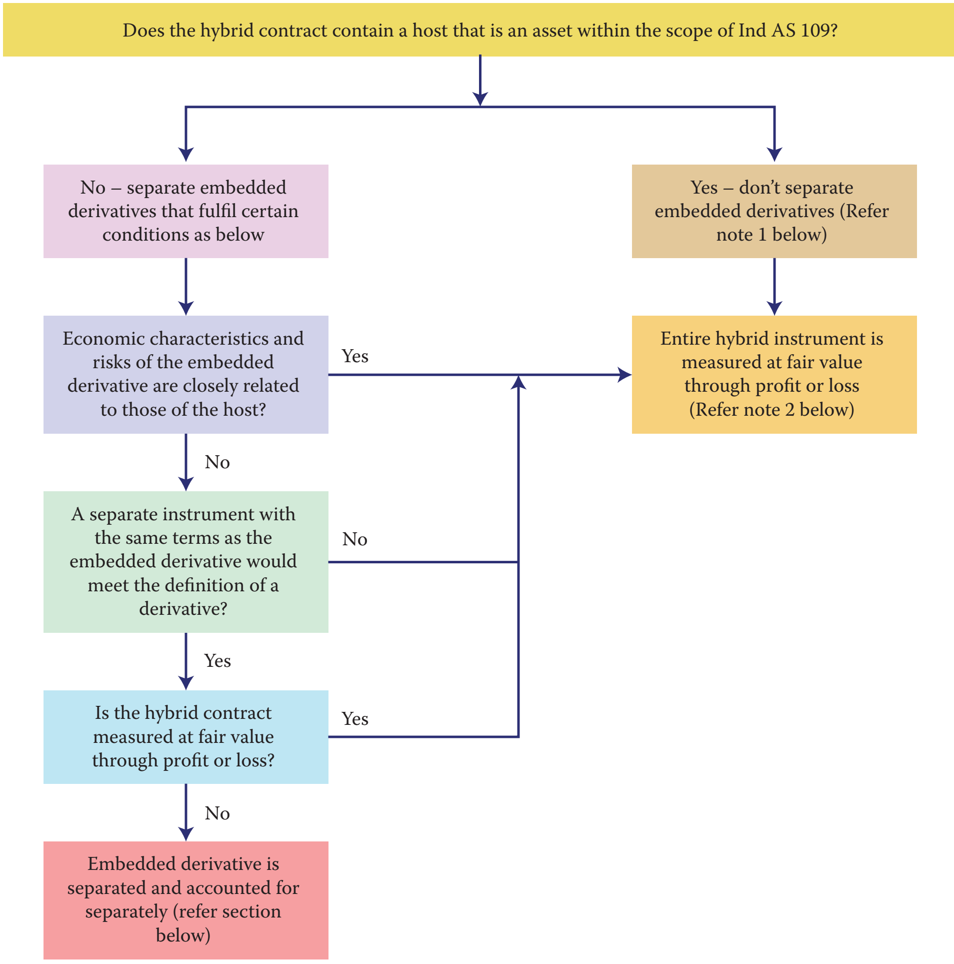
- a component of a hybrid contract
- that also includes a non-derivative host
- with the effect that some of the cash flows of the combined instrument vary in a way similar
- to a stand-alone derivative.

An embedded derivative causes:

- Some or all of the **cash flows** that otherwise would be required by the contract
- **to be modified** according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable,
- provided **in the case of a non-financial variable that the variable is not specific to a party to the contract.**

	Particulars	Host Contract	Embedded Derivative
1	Company A holds a bond which is convertible into the ordinary shares of Company B	Bond Asset	Conversion option of Bond into shares
2	Company A enters into a lease contract with an inflation factor such that each year, rentals are adjusted for changes in Risk Price Index (RPI)	Lease contract	Adjustment to RPI
3	Company A sells PPE to Company B of USD 1 lac. Both the Companies are located in India.	Sale Contract	INR / USD foreign Exchange

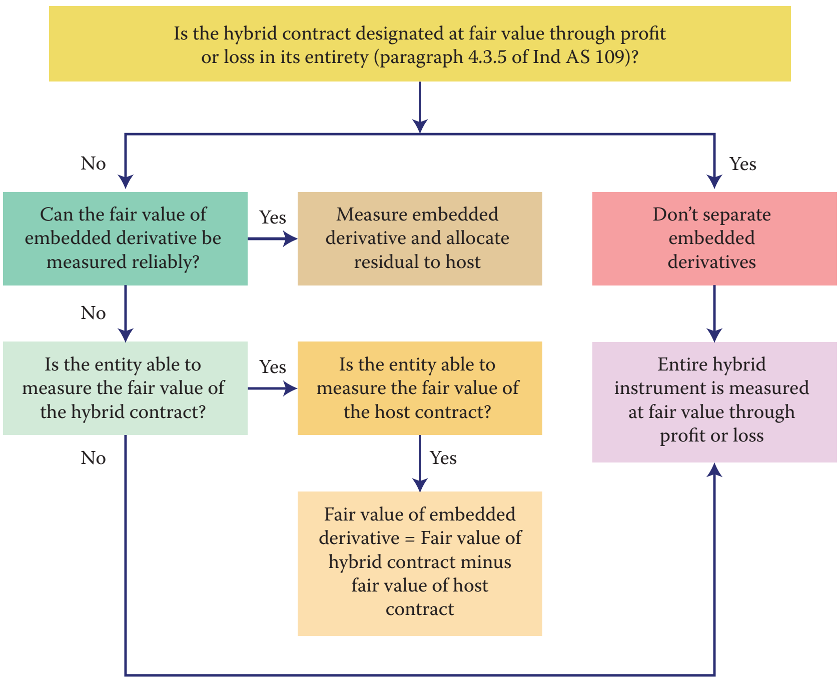
Separation of Embedded Derivatives from Host Contract



Note 1:
This implies that embedded derivatives are permitted to be separated from only such hybrid contracts that contain a host which is either a (a) financial instrument classified as financial liability or equity or compound; or (b) contract for purchase or sale of a non-financial item.

Note 2:
If both the host and embedded derivative have economic characteristics of an equity instrument, the hybrid instrument is not carried at fair value through profit or loss. In other words, this measurement category is applicable only for host contracts which are financial liabilities.

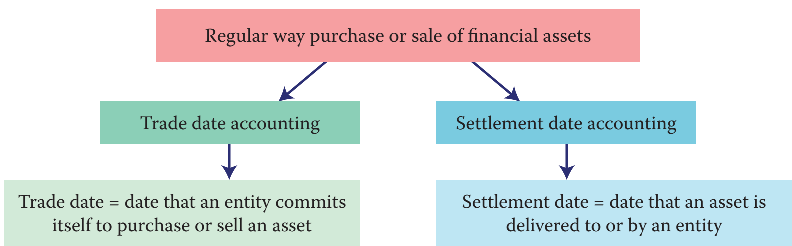
Accounting For Embedded Derivatives



Regular Way Purchase or Sale of Financial Assets

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

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



Regular Way Purchase or Sale of Financial Assets – Examples

- For instance, on the Bombay Stock Exchange in India, all transactions in all groups of securities in the Equity segment, Fixed Income securities and Government securities are settled on **"T+2" basis.**
- In this case, "T" is the trade date and "T+2" is the settlement date i.e. exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade date.
- **It follows that if a contract is entered into with a broker for purchase or sale of securities which is normally traded on the Bombay Stock Exchange, with a settlement period that differs from the norms mentioned above, it would not be regarded as a regular way purchase or sale.**

Trade Date & Settlement Date Accounting

Books	Trade Date	Settlement Date
In the books of buyer	**Initial Recognition :** • **Recognises :** Financial asset and Financial liability on the trade date itself. **Subsequent Recognition :** • Subsequently measures the financial asset in accordance with its classification category.	• Account for any change in the fair value of the asset to be received during the period between the trade date and the settlement date. **Classification wise accounting:** • **Amortized costs:** change in value is not recognized; • **FVTOCI :** FV changes to be recognized in OCI . • **PVTPL :** FV changes to be recognized in PL.
In the books of seller	• Seller derecognises the financial asset. • Recognises any gain or loss on sale on the trade date.	• **Derecognises** financial asset at the settlement date. • **Does not recognise** any fair value changes between the trade date and settlement date.

INDIAN ACCOUNTING STANDARD (IND AS) 110: CONSOLIDATED FINANCIAL STATEMENTS

MULTIPLE STANDARDS FOR GROUP ACCOUNTS

GROUP ACCOUNTS/CONSOLIDATION

- **Ind-AS-27 Separate financial statements**
  - Presenting separate financial statements (investor)
- **Ind-AS-28 Investment in associates**
  - Accounting for associates
  - Equity method
- **Ind-AS-103 Business combination**
  - Define business combination
  - Recognition
  - Measurements
- **Ind-AS-110 Consolidated financial Statements**
  - Control
  - Consolidated financial Statements
  - Procedures
  - Investment entities
- **Ind-AS 111 Joint Arrangement**
  - Joint ventures
  - Joint operations

Ind-AS-112: Disclosures of interests in other entities

TYPES OF INVESTMENTS

	Subsidiary	Associate	Joint Arrangement	Other Investments
Criteria	Control	Significant influence	Joint Control	Not applicable
Share (Guidance only)	>50%	20%+	Not Applicable	<20%
Accounting	Acquisition Method (Full Consolidation)	Equity Method Accounting	Depends on Type	Financial Instrument Ind-AS 109

IND AS 110: CONSOLIDATED FINANCIAL STATEMENTS

TYPES OF CONTROL –OUTRIGHT CONTROL AND JOINT CONTROL

Control can be

1 Outright Control

Apply Ind-AS 110

2 Joint Control

Apply Ind AS-111

- Using Ind AS-110 Principles:
  - First, decide, if there is a control?
  - Then decide, is the control jointly exercised?
- If Joint Control – then, it is a Joint Arrangement
- Classify between Joint Venture and Joint Operation

TYPES OF CONTROL – DE FACTO CONTROL

De Facto Control

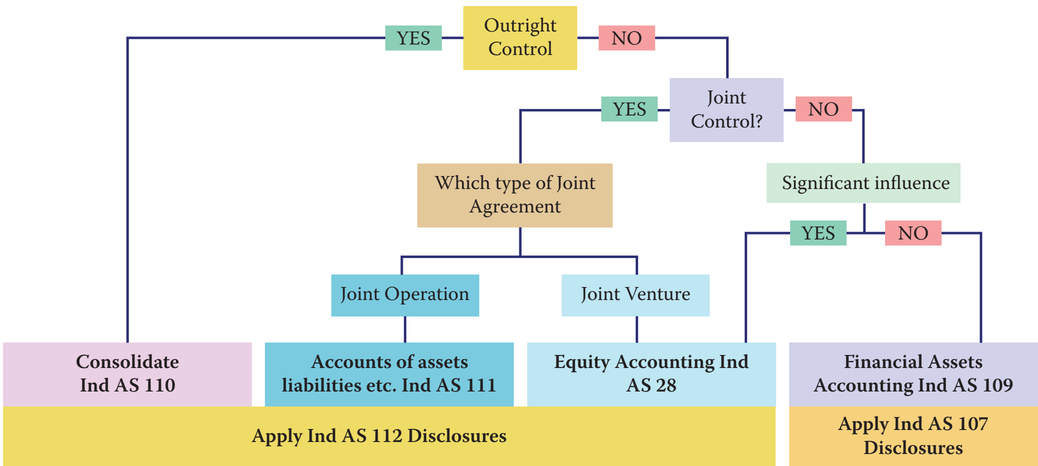
De Facto Control represents a situation, where Power (as defined in Ind-AS 110) exists with less than 50% of the voting rights

Example:

- Parent owns 20% of voting rights and the balance 80% voting rights are spread over 2000 shareholders across the country
- There exists a contractual arrangement to direct, despite having just 20% voting rights

Control is **possible** without majority of voting rights

INTERACTION BETWEEN IND-AS 110,IND-AS 111, IND-AS 112 AND IND-AS 28



OBJECTIVE OF IND AS 110

Objective of Ind AS 110 → To establish principles for preparation and presentation of:
- Consolidated Financial Statements (CFSs) when an entity controls another entity

Objective Ind AS 110

- Consolidate Financial statements
- Control
- Accounting requirement
- Investment entities

SCOPE OF IND AS 110

More specifically Ind AS 110

SCOPE OF IND AS 110

- requires an entity (a parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements (CFS)
- defines the principle of control and establishes Control as the basis for consolidation
- provides guidance on how to interpret or apply control
- sets out how to identify whether the investor controls the investee
- sets out the accounting requirements for the preparation of CFS
- defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity

Ind AS 110 does not cover the following

	Covered by
1. Business Combination and initial recognition of goodwill	Ind AS 103
2. Accounting for investments without having control	Ind AS 111, Ind AS 28, Ind AS 109
3. Disclosures	Ind AS 112

KEY DEFINITIONS

Parent	Parent is an entity that controls one or more subsidiaries
Subsidiary	Subsidiary is an entity that is controlled by another entity
Associate	Associate is an entity, over which an investor has significant influence and which is neither a subsidiary nor an interest in joint venture
Joint Arrangement	An arrangement of which two or more parties have joint control
Consolidated Financial Statements (CFS)	CFSs are the financial statements of a Group in which (1)assets (2)liability (3)equity (4)income (5)expenses and (6)cash flows of the parent and the subsidiary – are presented as those of a single economic activity

Power

(a)Existing rights that give the (b)current ability to direct the c) relevant activities

Assume that:

- **CT Corp owns 40% shares of ABSPL**
- **ABSPL's shares are structured in such a way that every share has one voting right**
- **CT Corp also owns options (that are** exercisable at any stage) under which CT Corp can obtain another 20% share capital of ABSPL
- At the reporting date, CT Corp has the financial ability and the intention to exercise these options and acquire 20% shares of ABSPL
  Does CT Corp controls ABSPL?

YES

In this case:

- Power over investee Voting Rights + Potential Voting Rights
- Exposure to Variability:
  - o CT Corp's profit will depend on ABSPL's financial performance (Equity Shares)
- Ability to Affect the Outcome:
  - o The voting rights give CT Corp the ability to control decisions made by the BODs, viz. the relevant activities are affected by CT Corp's

Power arises from **right** which can be (a) voting rights (b) potential voting rights (c) arising from contractual arrangements or (d) a combinations of these rights

Relevant Activities

Activities of the investee that significantly affect investee's returns

- Assume that a structured entity (SE) is formed to manage debts of a financial institution including activities such as (a) restructuring of debts (b) debt collection (c) debt management (d) legal process relating to debt management etc.
- In this case, the party which controls the above activities actually control the SE

If more than one investors direct **different relevant activities,** identify which investors can direct that activities that **most significantly affect return**

Control = Power + Exposure to variability in return + Link between power and return

Removal Rights → Rights to deprive the decision-maker of its decision-making authority

Participative Rights → Participative rights generally do not provide the holder of such rights with power, but may preclude another party from having power

Protective Rights

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

- When entering into a contract, there may be certain T&C that protect the interest of the party under certain circumstances
- These rights apply only under those circumstances
- Therefore, protecting rights are not considered as substantive in all circumstances, and hence are not seen as Power

Protective Rights held by others **can't** prevent control

Substantive Rights

- Substantive rights are that are exercisable when decisions about the relevant activities of the investee need to be made
- The investor must have the current ability to direct relevant activities
- The holder of these rights has the practical ability to exercise them; they are not merely in the nature of protective rights

Key factor to consider-to determine if the rights are substantive in nature

Are their barriers that prevents holder from exercising the rights?	Do several parties need to agree for the right to become exercisable or operational
Would party holding the rights benefits from their exercise	Practical ability to exercise the rights

- Only substantive rights are considered in assessing Power
- Determination of whether the rights are substantive calls for judgement and is based on considering all facts and circumstances

Potential Voting Rights

- Potential Voting Rights are considered in assessment of power **only if** they are substantive

Purpose and Design also considered

- Potential voting rights that are substantive-can give the holder power
- Determining whether potential voting rights are substantive require judgement !

DEFINITION OF "CONTROL" UNDER IND-AS 110

Control →

An investor controls an investee when the investor:

- is exposed to (or, has right to) variable returns from its involvement with the investee
- has the ability to affect those returns
- through its power over the investee

Here a subsidiary is the investee

Three Elements of Control, which are the basis of consolidation under Ind-AS 110

Control = 1 Power + 2 Variability of returns + 3 Link between power and variability

1 Power	2 Variability of returns	3 Link between power and variability
Power is signified by existing (substantive) rights that give the current ability to direct the relevant activities of the investee	Returns that are not fixed and have the potential to vary – with the performance of the investee	Ability to use power to affect returns

To have power, it is necessary for the investor to have (a) existing (substantive) rights that give it (b) current ability to direct (c) the relevant activities (that significantly affect the investee's returns)

The new control model under Ind-AS 110 is based on the existence of three elements of control:

Control = 1 Power + 2 Variability of returns + 3 Link between power and variability

When all of these three elements of control are present, then an investor is considered to control an investee and consolidation is required

An Investor takes into account all facts and circumstances to assess whether control exists

Protective Rights don't provide Control

Consider Potential Voting Rights only if they are substantive (Consider factors like exercise price, date, procedures etc)

Control is re assessed, if there is a change in the underlying facts & circumstances

Potential Voting Rights need to be currently exercisable and must take into account the economic reality viz. Is it practically to exercise - considering financial and intention to exercise

When one or more of the elements is not present, an investor will not consolidate, but instead be required to determine the nature of its relationship with the investee (eg. Significant influence, joint control) and will follow appropriate accounting under the requisite Ind AS

SINGLE CONTROL MODEL... UNDER IND-AS 110

Control = 1 Power + 2 Variability of returns + 3 Link between power and variability

Control assessed on continuous basis

Re-assessment of control is required if facts and circumstances indicate that ANY of THREE key elements have CHANGED

Ind-AS 110 requires extensive use of judgment; and Ind-AS 112 requires disclosure of such areas of judgment

- Same criteria for all entities – for determination of control
- For determining control, consider all facts and circumstances
- Temporary control does not prevent consolidation

WHAT IS POWER ?

Need not be exercised

Power is the (a) existing right – that give an investor (b) current ability to direct (c) the relevant activities

Power arises from substantive rights to direct the relevant activities

Does not arise from Protective Rights

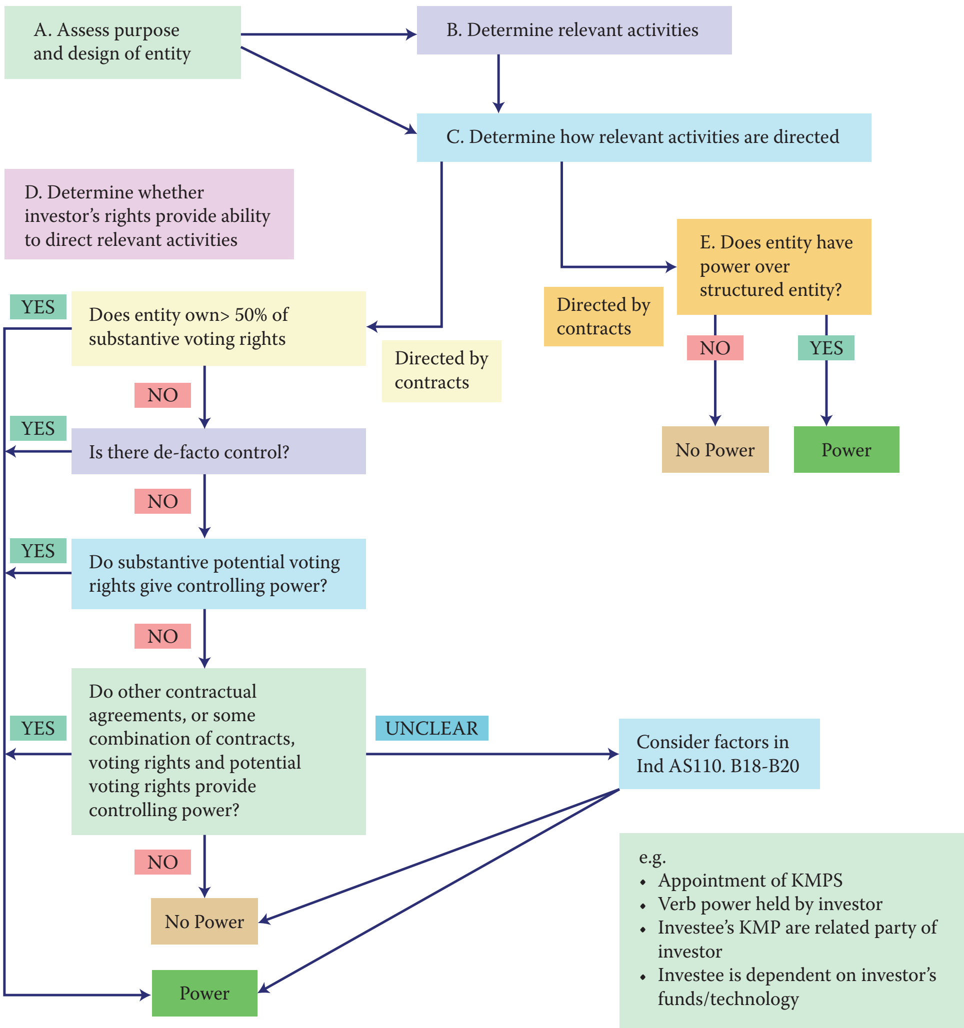
Rights →
- Rights depend on the (a) nature of activities, (b) legal structure and (c) the manner in which decisions are taken
- Can arise from voting rights, potential voting rights, contractual rights, or a combination
- Evaluate the impact of various rights and their interaction

Substantive →
- Practical ability to exercise the right
- Current ability to direct relevant activities
- Rights need not be actively exercised (a passive majority owner has the power)

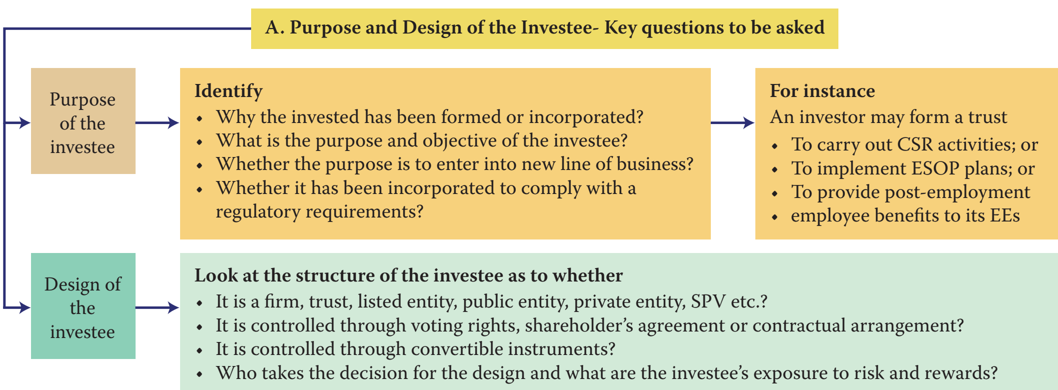
Relevant Activities →
- These are activities that significantly affect the returns
- Examples include (a) purchases/sales, (b) financial assets management, (c) acquisition/disposal of investments, (d) R&D, (e) financing etc.

Rights that are solely protective:
DO NOT provide Power and DO NOT prevent another investor from having control

EVALUATION OF POWER



FACTORS TO CONSIDER IN EVALUATING POWER



FACTORS TO CONSIDER IN EVALUATING POWER

B. and C. Relevant activities and how decisions are made w.r.t. these relevant activities	• How (a) operating and capital decisions (b) budget (c) appointment and remuneration of KMPs etc. are made? • How decisions that arise only in response to specific circumstances are made? • If different investors have ability to direct different activities – which activities most significantly affect returns?
D. Current ability to direct relevant activities	• Consider all substantive rights • Protective vs participating rights • Direct and indirect rights (financing, guarantees, operational ties)

Power can exist - even if others participates in directing the relevant activities.
For instance, other participating may have significant influence over the investee

Evidence that an investor directed activities in the past is an indicator of power, but is not conclusive

APPLYING SINGLE CONTROL MODEL UNDER IND AS 110

- Identify the investee
- Identify the relevant activities of the investee
- Identify how decisions about the relevant activities are made
- Assess whether the investor has power over the relevant activities
- Assess whether the investor is exposed to variability in returns
- Assess whether there is a link between power and returns

HOW CONTROL IS ASSESSED?

Application of Single Control Model under Ind AS 110 entails several steps

1. Identify the investee (legal entity or SILO)
2. Identify the relevant activities of the investee
3. Identify how decision about the relevant activities are made
4. Assess whether the investor has power over the relevant activities

4A. Consider only substantive rights

- Voting rights are relevant
  - Majority of voting rights
    - Consider
      - Rights may be held by others
  - 4D. Rights other than voting rights are relevant
    - Consider
      - Agreement with other vote holders
      - Other contractual agreement
      - 4B. Potential voting rights
      - 4C. De facto power
- 4D. Rights other than voting rights are relevant
  - Consider
    - Purpose and design
    - Evidence of practical ability to direct
    - Special relationship
    - Large exposure to variability in returns

5. Assess whether the investor is exposed to variability in returns
6. Assess whether there is link between power and returns

IDENTIFY THE INVESTEE (LEGAL ENTITY OR SILO)

Control by an Investor is generally assessed @ entity level

However, in some circumstances, the assessment is made for a portion of an entity viz'- over only specified assets and liability (i.e. a Silo)

Silo = portion of an entity that is treated as a deemed separate entity →

- None of the silo's assets can be used to pay other obligations of the entity
- The Silo's assets are the only source of payment for the silo's liabilities and
- Other than the silo's creditors, no party has any rights or obligations related to the silo's assets or to residual cashflows from those assets

This will be the case if all the assets, liabilities and equity of that part of the investee are ring-fenced from the rest of the entity

Note: If an Investor has control over specified assets of an investee, it treats that portion('silo') of the investee as a separate entity

Existence of silos is not confined to structured entities but is more likely to arise there

IDENTIFY THE INVESTEE (LEGAL ENTITY OR SILO)

Legal entity

New Millennium Fund

Tech Fund | Pharma Fund

Que: Whether Tech and Pharma Funds are silos?

Yes

- New Millennium Fund is open-ended investment fund with two sub-funds, viz. Tech Fund and Pharma Fund, that are cells within the legal entity
- Assets of Tech Fund are not available to meet liabilities of Pharma Fund, including in the event of insolvency – and vice versa
- Contracts entered into each sub-fund implies that the counterparty does not have access to the assets of the other
- No liquidity assistance available from New Millennium Fund

IDENTIFY RELEVANT ACTIVITIES OF THE INVESTEE

Relevant activities are those activities that significantly affect the investor's returns

Example of relevant activities include the following:

- Establishing operating, capital and financing policies
- Determining funding structure and obtaining funding
- Appointing, remunerating, and terminating employment of service providers or KMPs
- Researching and developing new products or processes

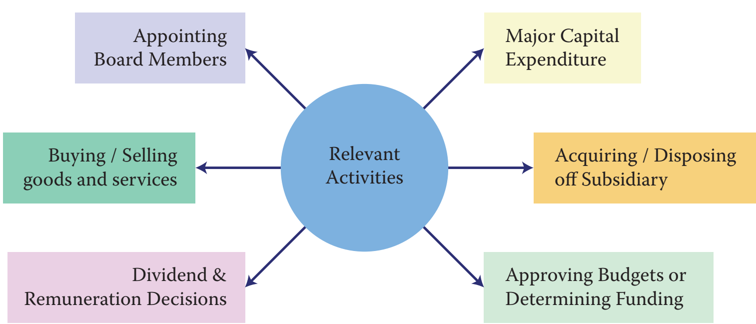
If two investors direct different relevant activities, identify which investor can direct the activities that most significantly affect the investor's returns

Also, consider and understand the purpose and design of the investee

Determination of relevant activities will often entail the following:

- Understand purpose and design of the investee
- Identify the activity that significantly affects returns
- Identify which investor can direct the activities that most significantly affect returns
- Investors' exposure to variability of returns

IDENTIFY RELEVANT ACTIVITIES OF THE INVESTEE



IDENTIFY RELEVANT ACTIVITIES OF THE INVESTEE

Relevant Activities	Key Take Away
Examples of activities that can potentially be relevant activities include: • Selling and purchasing of goods or services • Managing financial assets during their life (including on default) • Selecting, acquiring or disposing of assets • Researching & developing new products / processes • Determining a funding structure or obtaining funding etc.	Assess which activity most significantly affects investee's returns, considering the following factors: • Purpose and design of the investee • Factors that determine profit margin, revenue, value of the investee • Effect of each investor's decision-making authority on investee's returns • Investor's exposure to variability of returns

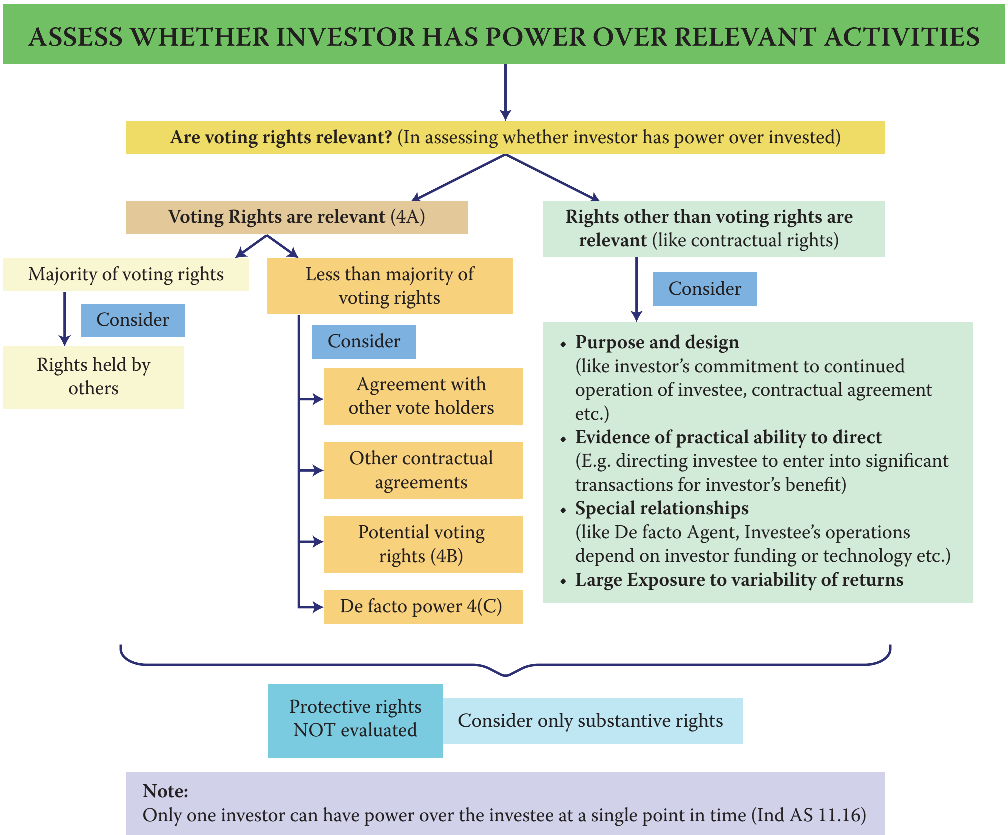
Relevant activities can change over a period of time..........need for continuous assessment.....

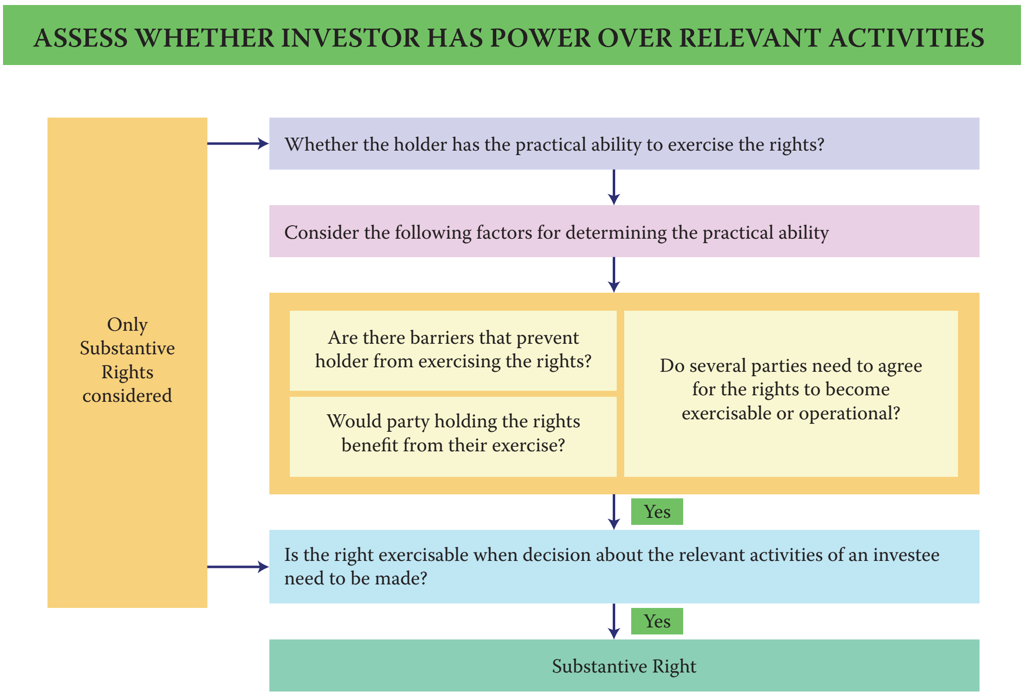
IDENTIFY HOW DECISIONS ABOUT RELEVANT ACTIVITIES ARE MADE

Are voting rights **relevant**? (In assessing whether investors has over investee)

Yes – Voting rights are relevant	No- Voting rights are not relevant	More Complex Cases
Investee is controlled by means of voting rights	Investee is controlled by means of contractual rights	
Focus on and consider: Which investor has voting rights sufficient to direct investee's relevant activities	Focus on and consider: Rights other than voting rights	Number of factors relevant in assessing what drives power

Determine	How decisions about relevant activities are taken?
	What is the process of making decisions with respect to relevant activities?
	Who is the decision maker – Shareholders / BoDs / Contractually Appointed Person?


ASSESS WHETHER INVESTOR HAS POWER OVER RELEVANT ACTIVITIES
Are voting rights relevant? (In assessing whether investor has power over invested)
Voting Rights are relevant (4A)
Rights other than voting rights are relevant (like contractual rights)
Majority of voting rights
Consider
Rights held by others
Less than majority of voting rights
Consider
Agreement with other vote holders
Other contractual agreements
Potential voting rights (4B)
De facto power 4(C)
Consider
• Purpose and design (like investor's commitment to continued operation of investee, contractual agreement etc.)
• Evidence of practical ability to direct (E.g. directing investee to enter into significant transactions for investor's benefit)
• Special relationships (like De facto Agent, Investee's operations depend on investor funding or technology etc.)
• Large Exposure to variability of returns
Protective rights NOT evaluated
Consider only substantive rights
Note:
Only one investor can have power over the investee at a single point in time (Ind AS 11.16)


ASSESS WHETHER INVESTOR HAS POWER OVER RELEVANT ACTIVITIES
Only Substantive Rights considered
Whether the holder has the practical ability to exercise the rights?
Consider the following factors for determining the practical ability
Are there barriers that prevent holder from exercising the rights?
Would party holding the rights benefit from their exercise?
Do several parties need to agree for the rights to become exercisable or operational?
Yes
Is the right exercisable when decision about the relevant activities of an investee need to be made?
Yes
Substantive Right

ASSESS WHETHER INVESTOR HAS POWER OVER RELEVANT ACTIVITIES

Substantive vs. Protective Rights

Substantive Rights

- Substantive Rights are rights that are exercisable when decision on relevant activities are made
- Substantive rights are existing rights, that give the investor the current ability to direct the relevant activities of the investee
- A right is substantive if the holder has the practical ability to exercise that right, when decisions about relevant activities are made

Protective Rights

Protective rights are right that:

- Are intended solely to protect the interest of their holders rather than to transfer power to that party
- Relate to fundamental changes in entity's activities or apply only in exceptional circumstances

Factors to consider is assessing whether a right is substantive, inter alia, include the following:

- Are there barriers (economic or otherwise) that would prevent the holder from exercising their rights?
  - Exercise or conversion price
  - Penalties that may prevent/deter exercise
  - Absence of explicit mechanism allowing exercise
  - Inability to obtain information required for exercise
  - Legal or regulatory constraints
  - Other constraints, making it unlikely for exercise of rights
- Do the holders have the practical ability to exercise their rights - in cases where exercise requires agreement by more than one investor?
- Would the investor that holds the rights benefit from their exercise of conversion?
- Are the rights currently exercisable or convertible?

POTENTIAL VOTING RIGHTS

Potential Voting Rights are considered in assessment of power, only if they are substantive (considering factors like exercise price, date, procedures, etc.)

Factors for evaluating whether options are substantive:

- Exercise price/conversion price, relative to market terms
- Ability to obtain financing
- Timing and length of exercise period
- Benefits, which the investor could derive from exercising these instruments (like economies of scale, synergies etc)

Other aspects to be considered

- Purpose and design of the instrument
- Investor's apparent expectations, motives and reasons for agreeing the terms of the instrument
- Combination of potential voting rights and other rights (voting or contractual)
- Other involvements the investor has with the investee

Example

Parameters	Substantive	Non-substantive	Depends on facts and circumstances
Exercise Price	At market (fair value) OR in-the-money	Deeply out-of-the-money	Out-of-the-money
Exercise Period	Currently exercisable	Not exercisable	Exercisable, but decisions need to be made
Financial Ability to Exercise	Holder has cash/financing readily available	Holder has no financial ability	Holder would have to raise financing

ASSESS WHETHER INVESTOR IS EXPOSED TO VARIABLE RETURNS

Variable Return	Examples of Variable Returns
Exposure to variability in returns is a broader concept than ownership benefits ⁎ Variability in returns is not limited to: • Distributions and changes in value of investment ⁎ Also include: • Fees • Tax benefits • Residual interest in net assets • Exposure to loss providing credit or liquidity support etc. • Returns that are not available to other interest holders e.g. the investor's ability to use investee's assets… in combination with its own to achieve economies of scale	• Residual interests • Dividends / changes in value • Fixed interest payments from bond (exposes investor to credit /default risk of the issue) • Remuneration for servicing assets or liabilities • Synergistic returns (like economies of scale, cost savings and other synergies) • Tax benefits • Access to future liquidity • Fees for exposures to loss from providing credit / liquidity support

- Exposure to variable returns is an indicator of control
- Greater the exposure – greater incentive to obtain power
- Other parties may also share in the returns (e.g.NCI)

ASSESS WHETHER THREE IS A LINK BETWEEN POWER AND RETURN

Delegated Rights – an overview	
Delegated Rights	• An agent is a party engaged to act on behalf of other party (the Principal) • A principal may delegate some or all decision-making authority to the agent • An agent does not control an investee • All facts and circumstances must be considered

If the agent gains any benefit from the arrangement – the agent could be regarded as the "Principal" and could then "Control" the investee

The conclusion as to whether the agent Controls and investee is to be drawn after considering all facts and circumstances, including the following:

- Rights of the agent
- Discretion available to the agent
- Range of Decision-making authority of the agent
- Agent's level of involvement with the investee
- Financial benefit enjoyed by the agent

LINK BETWEEN POWER AND RETURN

Ability to use Power to affect Return Ability Returns

On its own account as Principal

On Behalf of Other Investors as Agent

- An investor with decision-making power shall determine – whether it is a principal or an agent
- An agent is primarily engaged to act on behalf of and for the benefit of others
- Principal's power may be held and exercisable by an agent, but on behalf of the principal
- Only principal may have control, and not agent

Principal	Agent
Power	Power
+	+
Exposure to Variability in returns	Exposure to Variability in returns
+	+
Use of Power – primarily to generate returns for itself	Use of Delegated Power – primarily for the benefit of others
=	=
Investor is a Principal	Investor is an Agent

CONSOLIDATION EXEMPTION FOR INVESTMENT ENTITIES

Investment entities:
- should not consolidate controlled investments
- measure investments at FVTPL

A parent of an investment entity should consolidate all subsidiaries it controls, unless the parent itself is an investment entity

CONTINUOUS ASSESSMENT OF CONTROL

When to re-assess?	• Reassess to determine whether the investor continue to control the investee • Reassessment must be done if facts and circumstances suggest there is a change to one / more of the criteria for control

If change in market conditions affect **one of the Control criteria**, re-evaluate control

Consolidation of an investee shall:
- begin from the date the investor obtains control of the investee; and
- cease when the investor loses control of the investee

CONSOLIDATION PROCEDURE UNDER IND AS 110

Step 1	Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries
Step 2	Offset (eliminate): • Carrying amount of parent's investment in subsidiary • Parent's portion if equity of each subsidiary
Step 3	Offset (eliminate) items related to intragroup transactions

TRANSACTIONS WITHIN THE GROUP (CONSOLIDATION PROCEDURE)

Eliminate in full intra-group....

- Balances
- Income and expense
- Dividends

Profits / losses from intra-group transactions recognized in assets are eliminated in full

Intra-group losses may indicate an impairment

OTHER KEY REQUIREMENTS RELATED TO CONSOLIDATION

Apply uniform accounting policies to all subsidiaries
(Adjustment is required, if different accounting policies followed and impact is significant)

Parent and Subsidiary to use the same reporting date unless impracticable
(Difference in period ends cannot exceed 3 months)

Significant events adjusted, even if difference in period ends is up to 3 months

- NCI is shown separately within Equity
- Losses are allocated to NCI even if NCI balance goes Negative

EXEMPTION FROM PREPARING CFS

A parent need not present Consolidated Financial Statement, If all the following conditions are met:

1	Entity is a subsidiary (wholly owned or, partially owned) and no owners object to non-consolidation
2	No debt or equity instrument traded in public market
3	Did not file and is not in the process of filing its financial statements with a regulatory organization – to issue any class of instruments in a public market
4	The ultimate parent (or, any intermediate parent of the parent) produces a CFS that comply with Ind-AS & the same is available for public use

Note: There is mandatory consolidation exception for an investment entity

DE FACTO CONTROL → De facto control is a situation, where an entity that owns less than 50% of the voting rights in another entity is deemed to have control, when it has the practical ability to direct relevant activities of the entity

↓

To ascertain if... De facto control exists, consider all facts and circumstances like

- Contractual arrangements between the investor and other vote holders
- Contractual rights arising from other arrangements (such as operational or financial agreements that may provide significant substantive rights)
- Potential voting rights of the investor and/or other investors
- Relative size of the investor's % of vote and dispersion of the voting rights
- Size of an investor's voting rights
  - Voting rights (absolute amount and relative to other vote holders)
  - Number of other vote holders that will need to act together
  - Voting patterns at previous shareholders' meetings

Note:
If after considering the above factors, it is **not clear** that the investor has power- then **the investor does not control** the investee

ACCOUNTING TREATMENT ON LOSS OF CONTROL OF A SUBSIDIARY

If a parent loses control of a subsidiary, it shall follow the accounting treatment mentioned below:

Derecognise:	Recognise:	Reclassify:	Recognises gain / loss:
• the assets (including any goodwill) and liabilities of the subsidiary • the carrying amount of any non-controlling interests in the former subsidiary	• the fair value of the consideration received • if loss of control involves a distribution of shares of the subsidiary to owners, then that distribution; and • any investment retained in the former subsidiary at its fair value at the date when control is lost (refer **note 1** below)	• to profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in other comprehensive income in relation to the subsidiary (refer **note 2** below)	• recognise any resulting difference as a gain or loss in profit or loss attributable to the parent

Note 1:
The fair value at which the retained interest is recognized shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

Note 2:
If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.

LOSS OF CONTROL OF A SUBSIDIARY IN TWO OR MORE ARRANGEMENTS (TRANSACTIONS)

In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

- They are entered into at the **same time or in contemplation of each other.**
- They form a single transaction designed to **achieve an overall commercial effect**
- The occurrence of one arrangement is **dependent** on the occurrence of at least one other arrangement.
- One arrangement considered on its own is **not economically justified, unless it is considered together** with other arrangements. (e.g. when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market)

DISCLOSURES RELATED TO INTERESTS IN SUBSIDIARIES

An entity shall disclose information that enables users of its consolidated financial statements

to understand

- the composition of the group; and
- the **interest that non-controlling interests have** in the group's activities and cash flows; and

to evaluate

- the **nature and extent of significant restrictions** on its ability to access or use assets, and settle liabilities, of the group
- the **nature of, and changes in, the risks associated** with its interests in consolidated structured entities
- the **consequences of changes in its ownership interest** in a subsidiary that do not result in a loss of control; and
- the **consequences of losing control** of a subsidiary during the reporting period

When the financial statements of a subsidiary used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements, an entity shall disclose:

- the date of the end of the reporting period of the financial statements of that subsidiary; and
- the reason for using a different date or period

THE INTEREST THAT NON-CONTROLLING INTERESTS HAVE IN THE GROUP'S ACTIVITIES AND CASH FLOWS

An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:

- the name of the subsidiary.
- the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.
- the proportion of ownership interests held by non-controlling interests.
- the proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held.
- the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.
- accumulated non-controlling interests of the subsidiary at the end of the reporting period.
- summarised financial information about the subsidiary

THE NATURE AND EXTENT OF SIGNIFICANT RESTRICTIONS

An entity shall disclose following:

Significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:

- those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group.
- guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group.

The **nature and extent** to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a subsidiary).

The carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

INDIAN ACCOUNTING STANDARD (IND AS) 111 : JOINT ARRANGEMENTS

Objective and Scope

The objective of Ind AS 111

- Defining the Objective (Para 1)
  - What is sought? → Establish Principles for financial reporting
  - For whom? → Entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements)
- How is the objective met?
  - Defines → Joint Control
  - Outlines the Requirement → An entity that is a **party to a joint arrangement** should **determine the type of joint arrangement** in which it is involved by assessing its rights and obligations and to **account for those rights and obligations in accordance with that type of joint arrangement.**

Scope of Ind AS 111 → This Ind AS shall be applied by all entities that are a party to a joint arrangement.

Appendix A: Defined Terms

Joint Arrangement	An arrangement of which two or more parties have **joint control.**
Joint Control	The contractually agreed sharing of control of an arrangement, which exists **only** when **decisions about the relevant activities** require the **unanimous consent** of the parties sharing control.
Joint Operation	A joint arrangement whereby the parties that have joint control of the arrangement have **rights to the assets,** and **obligations for the liabilities,** relating to the arrangement.
Joint Venture	A joint arrangement whereby the parties that have **joint control** of the arrangement have **rights to the net assets** of the arrangement.

The Concept of Joint Arrangements

Characteristics of a Joint Arrangement

- The parties are bound by a contractual arrangement
- A joint arrangement is either a joint operation or a joint venture
- The contractual arrangement gives two or more of those parties joint control of the arrangement

Assessment of Joint Control →

In assessing whether an entity has joint control of an arrangement, an entity shall **assess** first whether **all the parties,** or a **group of the parties, control the arrangement.**

Ind AS 110 defines 'control' and shall be used to determine whether all the parties, or a group of the parties
(a) are exposed, or have rights, to variable returns from their involvement with the arrangement and
(b) have the ability to affect those returns through their power over the arrangement.

When **all the parties, or a group of the parties, considered collectively, are able to direct the activities** that significantly affect the returns of the arrangement (i.e., the relevant activities), the **parties control the arrangement collectively.**

The Concept of Joint Arrangements

Does the contractual arrangement give **all** the parties, or a **group** of the parties, **control** of the arrangements **collectively**? **(Control as defined in Ind AS 110)**

- NO → No Joint Control. Outside the scope of Ind AS 111.
- YES → Do decisions about the relevant activities require the **unanimous consent** of **all** the parties, or of a **group** of the parties, that collectively control the arrangement?
  - NO → No Joint Control. Outside the scope of Ind AS 111.
  - YES → Joint control exists. Hence, the arrangement is a Joint Arrangement.

No Joint Control. Outside the scope of Ind AS 111. → Interest in such arrangement is accounted in accordance with relevant Ind ASs, such as Ind AS 110, Ind AS 28 or Ind AS 109.

The Concept of Joint Arrangements

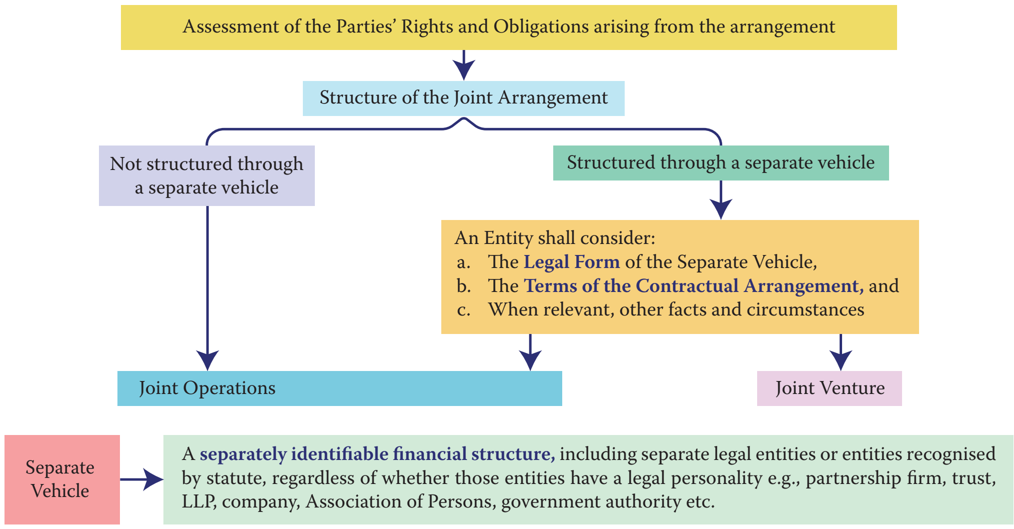
Key Points:

1. In a joint arrangement, no single party controls the arrangement on its own. A party with joint control of an arrangement can prevent any of the other parties, or a group of the parties, from controlling the arrangement.
2. An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. Ind AS 111 distinguishes between parties that have joint control of a joint arrangement (joint operators or joint venturers) and parties that participate in, but do not have joint control of, a joint arrangement.
3. An entity will need to apply judgement when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances.
4. If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.

Types / Forms of Joint Arrangements

Forms of Joint Arrangements	Joint Operation	Joint Venture
Nature of Rights / Obligations	a. Rights to the Assets, and b. Obligations for the Liabilities relating to the arrangement	Rights to the **Net Assets** of the Arrangement
Joint Arrangement is called as	Joint Operation	Joint Venture
Parties to the Arrangement are called as	Joint Operators	Joint Venturers

Classification of a Joint Arrangement



Classification of a Joint Arrangement

Assessing the terms of the Contractual Arrangement: An illustrative (and not exhaustive) list

	Joint Operation	Joint Venture
The terms of the contractual arrangement	The contractual arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (i.e., it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).
Rights to assets	The parties to the joint arrangement share all interests (e.g. rights, title or ownership) in the assets relating to the arrangement in a specified proportion (e.g. in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (i.e., no rights, title or ownership) in the assets of the arrangement.
Obligations for Liabilities	The parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (e.g. in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them). The parties to the joint arrangement are liable for claims raised by third parties.	The joint arrangement is liable for the debts and obligations of the arrangement. The parties to the joint arrangement are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both. The creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.

	Joint Operation	Joint Venture
Revenues, expenses, profit or loss	Revenues and expenses are allocated on the basis of the relative performance of each party to the joint arrangement. However, the parties might have agreed to share the profit or loss relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	Each party has share in the profit or loss relating to the activities of the arrangement.
Guarantees	The parties to joint arrangements might provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (whether they are guaranteed by the parties or not is irrelevant).	

Classification of a Joint Arrangement

Assessing Other Facts and Circumstances

When to assess?

A joint arrangement might be structured in a separate vehicle whose **legal form confers separation** between the parties and the separate vehicle. The **contractual terms agreed among the parties might not specify the parties' rights** to the assets **and obligations** for the liabilities, **yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation.** This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

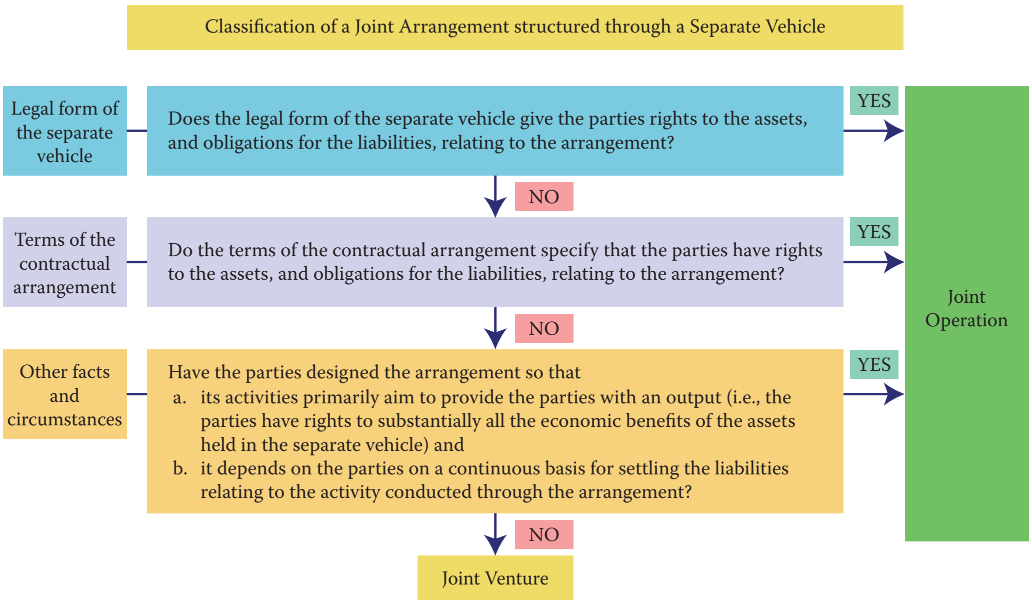
How to determine whether joint operation or joint venture?

The **activities** of the arrangement are **primarily designed for the provision of output to the parties,** (i.e., the parties have rights to substantially all the economic benefits of the assets held in the separate vehicle).

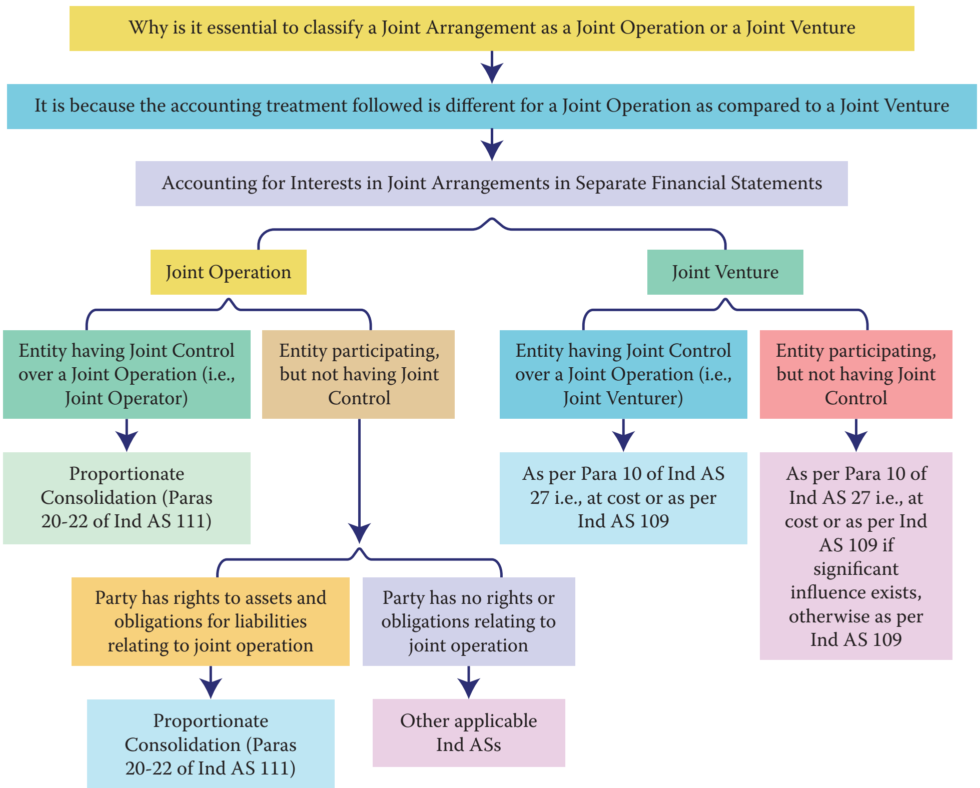
The **parties** are substantially **the only source of cash flows** contributing to the continuity of the operations of the arrangement. Hence, the arrangement depends on the parties on a continuous basis for settling the liabilities relating to the activity conducted through the arrangement.

If both these conditions are satisfied, the arrangement is a joint operation.

Classification of a Joint Arrangement



Classification of a Joint Arrangement



Accounting of Joint Arrangements

Paras 20-21 of Ind AS 111: Accounting for Joint Operations in Separate Financial Statements

Para 20: A joint operator shall recognise in relation to its interest in a joint operation:

a. its assets, including its share of any assets held jointly;

b. its liabilities, including its share of any liabilities incurred jointly;

c. its revenue from the sale of its share of the output arising from the joint operation;

d. its share of the revenue from the sale of the output by the joint operation; and

e. its expenses, including its share of any expenses incurred jointly

Para 21: The above assets, liabilities, revenue and expenses shall be accounted as per respective Ind ASs for those assets, liabilities, revenue and expenses.

Accounting of Joint Arrangements

Para 22 of Ind AS 111: Accounting for transactions between Entity and Joint Operation

Sale or Contribution of Assets to a Joint Operation:

a. The entity (i.e., joint operator) is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

b. When above transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognised fully by the joint operator.

Purchase of Assets from a Joint Operation

a. The entity (joint operator) shall not recognise its share of the gains and losses until it resells those assets to a third party.

b. When such transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognise its share of those losses.

Accounting of Joint Arrangements

Paras 21A of Ind AS 111: Acquisition of Interest in Joint Operations

Acquisition of interest in Joint Operation which is a business as defined in Ind AS 103:

- Apply, to the extent of its share / interest, all of the principles on business combinations accounting in Ind AS 103, and other Ind ASs, that do not conflict with the guidance in Ind AS 111 (measuring identifiable assets and liabilities at fair value, recognizing acquisition related costs as expenses, deferred tax implications on initial recognition of assets or liabilities, recognition of goodwill and impairment testing thereof), and
- Increase in interest in a joint operation by acquiring additional stake: Do NOT remeasure previously held interests.
- If acquisition of interest is a common control transaction, apply the guidance specified in Appendix C of Ind AS 103.

INDIAN ACCOUNTING STANDARD (IND AS) 113: FAIR VALUE MEASUREMENT

Need for Ind AS 113

Normally **assets and liabilities** are **exchanged** between parties at their **agreed** terms and conditions based on the prices which might **not be at arm's length prices.**

Entity-specific Prices

Buyer ⟷ Seller

e.g.: reduced prices; reduction in interest rates; long credit period as compared to market participants

To define fair values, it should be ensured that the values reflect all assumptions/ adjustments to change from transaction specific/ entity specific to normal transaction which is common for all interested parties.

Market-based Value

Buy - Sell ⟷ Market participants

Value should be from the perspective of market participants (i.e. arm's length prices), instead of it being transaction specific / entity specific

What would happen without Ind AS 113?

Significance of Fair Value under the Ind AS Regime

Shift in Accounting Perspective

IGAAP → Ind AS

IGAAP: Primarily Cost Model of accounting

Ind AS: Fair Value Model of accounting e.g. Ind AS 109 / Ind AS 40 / Ind AS 105

Absence of guidelines to compute Fair Value

↓

True and Fair View of Financial Statements will not be achieved

↓

Relevance and Faithful Representation (fundamental qualitative characteristics) and Verifiability (enhancing qualitative characteristics) violated!!

↓

Violation of Para 2.8, 2.18 and 2.30 of Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

Hence Ind AS 113 assumes significance since it ensures compliance with the Conceptual Framework

Objective and Scope of Ind AS 113

Objective and Scope of Ind AS 113

Objective (Para 1)
- = to define Fair Value
- + set out in a single Ind AS Framework for measuring Fair Value
- + require Disclosures

Scope (Para 5)

Applicability

When another Ind AS requires / permits fair value measurement (and measurements, such as FVLCTS, based on fair value or disclosures about those measurements) e.g.

WHEN	**Ind AS 109**
HOW	**Ind AS 113**

Non-applicability

Measurement and Disclosure
- SBP - Ind AS 102
- Leases - Ind AS 116
- Measurement similar to Fair Value but not Fair Value e.g. NRV in Ind AS 2 or value in use in Ind AS 36

Disclosures of Ind AS 113
- Plan Assets at FV -Ind AS 19
- Assets for which recoverable amount is FV less costs of disposal - Ind AS 36.

What is Fair Value?

Fair Value (Para 9) = 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.**

Key Aspects in Fair Value Measurement
- **Price**
- **Orderly Transaction**
- **Appropriate Market**
- **Measurement Date**
- **Market Participants**

Key Aspects: Asset or Liability Specific Fair Value

FAIR VALUE IS MARKET-SPECIFIC AND NOT ENTITY-SPECIFIC

Fair Value Measurement takes into account the characteristics of the asset or liability, e.g. the condition and location of the asset and restrictions, if any, on its sale or use. However, the **restrictions or conditions** that might be **related to a particular entity should not be taken into account** because a fair value will be based on market participant assumptions rather to an entity specific conditions or restriction which usually will not affect fair valuation of an asset/ liability.

An entity shall **measure the fair value** of an asset or a liability **using the assumptions that market participants would use** when pricing the asset or liability, assuming that market participants act in their economic best interest.

RULE

ENTITY-SPECIFIC RESTRICTIONS / CONDITIONS: IGNORED
ASSET / LIABILITY-SPECIFIC RESTRICTION / CONDITIONS TRANSFERRED TO BUYER: CONSIDERED

Key Aspects: Unit of Account

Liability / Asset → Standalone asset / liability; Group of assets / liabilities → Unit of Account: The level at which an asset or a liability is aggregated or disaggregated in an Ind AS for recognition and / or measurement purposes.

- Ind AS 113 describes how to measure fair value, not what is being measured at fair value. Other Ind AS specify whether a fair value measurement considers an individual asset or liability or a group of assets or liabilities (i.e. the unit of account).
- Whether the asset or liability is a **stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities** for recognition or disclosure purposes depends on its unit of account.
- The **unit of account** for the asset or liability shall be **determined in accordance with the Ind AS that requires or permits the fair value measurement,** except as provided in this Ind AS.

Key Aspects: Market Participants

Fair Value is always computed **from the perspective of the market participant** i.e. price that would be received / paid on sale / settlement or transfer of an asset / liability by / to a market player.

What are Market Participants?

The parties which eventually transact the assets/ liabilities either in the principal market or the most advantageous market in their best economic interest

Characteristics of Market Participants

- They should be **independent and not a related party.** However, if **related parties** have done similar transaction **on arm's length price,** then it can be between related parties as well.
- The parties should **not be under any stress or force** to enter into these transactions
- All parties should **have reasonable and sufficient information** about the same.

Key Aspects: Appropriate Market

Principal Market	Most Advantageous Market
Market which is normally the place in which the assets / liabilities are being transacted with highest volume with high level of activities comparing with any other market available for similar transactions. If there is principal market, the price in the market must be used even if the prices in the other market are more advantageous. Because the principal market is the most liquid market for the asset or liability, that market will provide the most representative input for a fair value measurement.	This is the market which either maximizes the amount that would be received (Net Proceeds) when an entity sells an asset or minimizes the amount that is to be paid while transferring the liability. Net Proceeds = Available Price (-) Transport Costs (-) Transaction Costs In the absence of principal market, this market is used for Fair Valuation of the Assets/ Liabilities. In many cases Principal market & most advantageous market will be same.

Key Aspects: Price

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction **in the principal** (or most advantageous) market at the measurement date **under current market conditions (i.e. an exit price)** regardless of whether that price is **directly observable or estimated** using another valuation technique.

FAIR VALUE (PRICE) = AVAILABLE PRICE (LESS) TRANSPORTATION COST

Transaction costs e.g. brokerage, commission, STT etc. are not a characteristic of an asset or a liability, but a **characteristic of the transaction.** Hence, it would **not be** appropriate to consider any transaction cost further while assessing fair values. However, **they would be considered while ascertaining Net Proceeds for determining the most advantageous market.**

NET REALIZABLE VALUE (NRV) = FAIR VALUE (LESS) TRANSACTION COSTS

Transport cost is the cost that would be **incurred to transport the asset from its current location to its principal (or most advantageous) market.** Unlike transaction costs, transport costs arise from an event (transport) that **does change a characteristic of an asset (its location)** and hence, **it is deducted from available price to arrive at Fair Value.**

Valuation of Non-Financial Assets (e.g. Land, Biological Assets)

Highest and Best Use Concept

- It is a valuation concept used to value many non- financial assets (e.g. real estate). The highest and best use of a non- financial asset must be **physically possible, legally permissible and financially feasible.**
- The highest and the best use is determined from market participant perspective. **It does not matter whether the entity intends to use the asset differently.**
- To find out the best possible use, one has to identify its market participants and then to find the best legitimate use of this non-financial asset which one would normally do.
- All **restrictions specific to any market participant would not be considered** while finding out fair value of the non-financial asset.
- In absence of potential best use which is not easily available, current use would be considered as best use.
- **While considering fair value under any alternative use, deduct the estimated cost to be incurred in order to make the asset ready for alternative use.**

Valuation Techniques

- The **objective** of using a valuation technique is to **estimate the price (i.e. quoted prices are not available in the principal / most advantageous market)** at which an orderly transaction would take place between market participants at the measurement date under current market conditions.
- An entity shall **use valuation techniques** that are **appropriate** in the circumstances and for which sufficient data are available to measure fair value, **maximizing the use of relevant observable inputs** and **minimizing the use of unobservable inputs.**

Inputs to Valuation Techniques

Observable Inputs	Unobservable Inputs
Based on Market Data obtained from independent sources e.g. share prices on BSE, gold rate on commodity exchange	Based on entity's own assumptions about financial factors e.g. projected future cash flows
OBJECTIVE	HIGHLY SUBJECTIVE

Valuation Techniques

Inputs to Valuation Techniques: Fair Value Hierarchy

LEVEL 1 INPUTS	LEVEL 2 INPUTS	LEVEL 3 INPUTS
Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. e.g. quoted prices of equity shares on the BSE/NSE, quoted price of gold held as investment	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs include quoted prices for similar assets or liabilities requiring certain adjustments e.g. entity holding 21 KT gold, whereas price of 24 KT gold is only available.	Unobservable inputs for the asset or liability which shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk e.g. financial forecasts, historical volatility required for valuing options under Black-Scholes model etc.

Note: More than one level of input could be used; level of input for the class of asset / liability will depend on overall significance

Valuation Techniques

Adjustment to Quoted Price when it does not reflect the Fair Price

In certain situations, a quoted price in an active market might not faithfully represent the fair value of an asset or liability, such as when significant events occur on the measurement date but after the close of trading

→ In these situations, companies should adjust the quoted price to incorporate this new information into the fair value measurement. However, if the quoted price is adjusted, the resulting fair value measurement would no longer be considered a Level 1 measurement.

→ A company's valuation policies and procedures should address how these 'after hour' events will be identified and assessed. Controls should be put in place to ensure that any adjustments made to quoted prices are appropriate and are applied in a consistent manner.

Valuation Techniques

Approaches to Valuation

Market Approach

- Uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.
- Using market multiples derived from a set of comparable companies e.g. EV/EBITDA or P/E multiple

Income Approach

- The income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount i.e. DCF Method e.g. Gordon's formula
- Assumption of future cash flows and appropriate discount rate would be based on market participant's views. Related risks and uncertainty to be considered would be taken in cash flow or discount rate.

Cost / Asset Approach

- This method describes how much cost is required to replace existing asset/ liability in order to make it in a working condition. All related costs will be its fair value. It actually considers replacement cost of the asset/ liability for which we need to find fair value.
- For valuing a business / share, it may be the NAV.

Valuation Approach should be consistently followed. If there is a change in Valuation Approach, it shall be treated as a change in Accounting Estimate as per Ind AS 8 i.e. disclose the reason for such change.

Applying Fair Value Rules to Liabilities and Own Equity

Assumption made while carrying out fair value measurement:

Financial Liability e.g. borrowings, trade payables

OR

Non-financial Liability e.g. advance received towards sale of PPE

OR

Entity's own equity instruments e.g. equity issued as consideration in business combination

Transferred to a market participant at the measurement date

Assumption under Ind AS 113

The liabilities and /or equity instruments so transferred will remain outstanding on the date of measurement

Standard prescribes to **use all observable inputs** (if direct quoted prices are not available) and should **minimize any unobservable inputs.** The **transaction** considered to find fair value **should be evaluated** in line with an **orderly transaction (not entity specific).**

Ind AS 113 **specifically provides guidance** on the respective scenarios while evaluating fair values of the liabilities and own equity instruments in case **direct quoted prices are not available.**

Applying Fair Value Rules to Liabilities and Own Equity

Liabilities and / or Equity Instruments of the entity

Held by other parties as assets
e.g. equity shares / debentures issued by the entity

When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available, an entity shall **measure FV of the liability / equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.**

Preference 1: Use the quoted price in an active market for identical item held by another party as an asset, if available

Preference 2: If quote price is not available, use other observable inputs such as quoted price in a market that is not active for the identical items held by another party as an asset

Preference 3: If observable prices in (1) and (2) are not available, use a valuation technique such as income or market approach.

Not held by other parties as assets
e.g. decommissioning liabilities, provision for expenses

When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available, an entity shall **measure FV of the liability / equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.**

Applying Fair Value Rules to Liabilities and Own Equity

General Principles: → Assume **transfer** and **not settlement** of a liability / own equity instrument

Is there a quoted price? → YES → Use quoted price

NO ↓

Is there identical item held as asset by another party?

YES → Use FV of identical asset = Adjust quoted price only if factors specific to the asset, but not to liability / own equity are present

NO → Use valuation technique = apply present value technique; include expectations of costs / compensations

L = A

Applying Fair Value Rules to Liabilities and Own Equity

FV of liability reflects → **Non-performance risk**

(includes entity's own credit risk)

Transfer Restrictions → no separate input / adjustment

FL with demand feature → FV is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid

Applying Fair Value Rules to Financial Assets and Financial Liabilities with Offsetting Positions in Market Risks or Counterparty Credit Risk

Measurement exception → Financial assets and liabilities with offsetting positions

MARKET RISK → $₹ → FX loss + FX gain = 0

Trade Receivables (USD) → FX loss

Liabilities (USD) → FX gain

FV on net basis: → Price receivable to sell net long position / Price payable to transfer net short position

CHOICE

1. Documented risk management / investment strategy
2. Info to key managerial personnel
3. FV at the end of each reporting period

Applying Fair Value Rules to Financial Assets and Financial Liabilities with Offsetting Positions in Market Risks or Counterparty Credit Risk

Analysis of applying offsetting position in market or credit risk

- This exception is **allowed only in case the other market participants also manage the similar risk on net basis.**
- There should **ideally be same information and market practice available** for making these assets / liabilities on net basis.
- Once the exception to fair value certain assets / liabilities on net basis is being used, then **unit of account to measure fair value would be considered as net.**
- **Market risk should be same while combining any asset / liability** e.g. interest rate risk cannot be netted with commodity price risk.
- **Duration of a market risk should be identical** to use the exception for valuing assets / liabilities on net basis e.g. an interest rate swap of longer period will only be allowed to value at net basis up to the duration of financial instrument of the same duration.

Fair Value at Initial Recognition

Normal Transaction
- An entity (A Ltd.) acquires an asset or assumes a liability (from B Ltd.) in a normal market transaction
- A Ltd. enters the transaction, and B Ltd. exits the transaction, and therefore:

Transaction Price → **Normal Transactions**: Entry Price = Exit Price; **Special Cases**: Entry Price ≠ Exit Price ← However, Fair value as per Ind AS 113

Special Cases:

I. Related Parties	II. Under duress / seller forced	III. Different unit of account	IV. Not on principal / most advantageous market

Transaction Price – Fair Value = Day 1 PROFIT → **Recognize in P/L, if cannot be attributed to Transaction Costs**

Disclosure Requirements

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

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

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

Summary of Disclosure Requirements:

	Fair Value Measurement						Disclosure		
	Recurring			Non-recurring					
	level 1	level 2	level 3	level 1	level 2	level 3	level 1	level 2	level 3
Fair Value at each reporting date	•	•	•	•	•	•			
Reasons for measurement				•	•	•			
Level of Hierarchy	•	•	•	•	•	•	•	•	•
Transfers	•	•	•						
Valuation Techniques		•	•		•	•		•	•
If change in valuation techniques		•	•		•	•		•	•
Quantitative information about significant unobservable inputs			•			•			
Reconciliation of opening and closing			•						
Unrealized gains / losses from remeasurement			•						
Valuation process and policies			•			•			
Sensitivity to changes in unobservable inputs			•						
If highest and best use differs from actual	•	•	•	•	•	•	•	•	•

INDIAN ACCOUNTING STANDARD (IND AS) 115: REVENUE FROM CONTRACTS WITH CUSTOMERS

Ind AS 115 is based on a core principle that requires an entity to recognise revenue:
(a) In a manner that depicts the transfer of goods or services to customers
(b) At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

To achieve the core principle, an entity should apply the following five-step model:

Identify the contract(s) with a customer → Identify the performance obligations → Determine the transaction price → Allocate the transaction price to the performance obligations → Recognise revenue when or as an entity satisfies performance obligations

Step 1 : Identify the contract(s) with a customer

An accounting contract exists only when an arrangement with a customer meets each of the following five criteria:

Consider if the contract meets each of the five criteria to pass Step 1:

Have the parties approved the contract? (approval may be written, oral, or implied, as long as the parties intend to be bound by the terms and conditions of the contract)
Yes / No

Can the entity identify each party's rights regarding the goods/services to be transferred?
Yes / No

Can the entity identify the payment terms for the goods/services to be transferred?
Yes / No

Does the contract have commercial substance?
Yes / No

Is it probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods/services that will be transferred to the customer?
Yes / No

Yes: Proceed to Step 2 and only reassess the Step 1 criteria if there is an indication of a significant change in facts and circumstances.

No: Recognise consideration received as a liability until each of the five criteria in Step 1 are met or one of the following occurs:
1. entity has no remaining performance obligations and substantially all consideration has been received and is non-refundable.
2. contract is terminated and consideration is non-refundable

Continue to assess the contract to determine if the Step 1 criteria are met.

Notes:
1. *If at the inception of an arrangement, an entity concludes that the criteria below are not met, it should not apply Steps 2 through 5 of the model until it determines that the Step 1 criteria are subsequently met.*
2. *When a contract meets the five criteria and 'passes' Step 1, the entity will not reassess the Step 1 criteria unless there is an indication of a significant change in facts and circumstances.*
3. *Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with the same customer (or with related parties), and if one of the following conditions exists:*
   (a) The contracts are negotiated as a package with a single commercial objective;
   (b) The amount of consideration paid in one contract depends on the price or performance in the other contract; or
   (c) The goods or services promised in the contract are a single performance obligation.

Combining contracts

An entity is required to combine two or more contracts and account for them as a single contract if they are entered into at or near the same time and meet any one of the following criteria:

Are the contracts negotiated as a package with a single commercial objective? — Yes → **Treat as a single contract**
No ↓

Whether consideration in one contract depends on the price or performance of another contract? — Yes → **Treat as a single contract**
No ↓

Whether goods or services promised in the contract are a single performance obligation? — Yes → **Treat as a single contract**
No ↓

Treat as separate contracts

Accounting for the modification

Are both of the following true:
- The scope of the contract increases because distinct promised goods or services are added to the contract.
- The consideration increases by the stand-alone selling price of the added goods or services.

Yes → Account for the modification as a separate contract.

No ↓

Are the remaining goods or services distinct from the goods or services transferred on or before the date of the contract modification?

Yes → Allocate the remaining transaction price not yet recognised to the outstanding performance obligations. In other words, treat as a termination of the old contract and the creation of a new contract.

No ↓

Are the remaining goods or services not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification?

Yes → Account for the contract modification as if it were a part of the existing contract—that is, the adjustment to revenue is made on a cumulative catch-up basis.

No ↓

Are some of the remaining goods or services distinct and others not distinct?

Yes → Follow the guidance for distinct and non-distinct remaining goods or services.

Step 2: Identifying performance obligations

A contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer. Therefore. performance obligations under a contract with the customer are not always explicit or clearly mentioned in the contract, but there can be implied promises or performance obligation under the contract as well.

Performance obligations has been defined as a promise in a contract with a customer to transfer to the customer either:
(a) good or service (or a bundle of goods or services) that is distinct; or
(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Distinct

- Customer can benefit either alone or with other readily available resources
  - Readily available resource = Sold separately or customer has already obtained

+

- Separately identifiable from other promises in the contract
  - Significant integration services not provided
  - No significant customisation or modification
  - Not highly dependent or interrelated

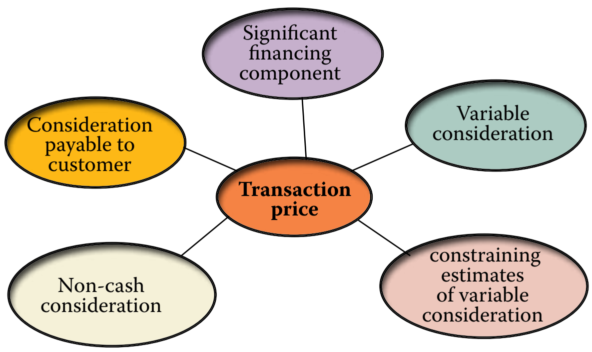
Promise to transfer a series of distinct goods or services	This will be considered as single performance obligation, **if the consumption of those services by the customers is symmetrical** i.e. they meet both of the following criteria: (a) each distinct good or service would meet the criteria to be a performance obligation satisfied over time; and (b) In each transfer, same method is used to measure the entity's progress towards complete satisfaction of the performance obligation.

Multiple Element Arrangements/ Goods and services that are not distinct	▸▸ If the goods or services are not considered as distinct, those goods or services are combined with other goods or services under the contract till the time the entity identifies a bundle of distinct goods or services. ▸▸ The combination would result in accounting of multiple goods or services in the contract as a single performance obligation. ▸▸ An entity may end up accounting for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods and services is the only distinct performance obligation identified.

Customer options for additional goods or services	⏩ When an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation **if it provides a material right to the customer**. The right is material if it results in a discount that the customer would not receive without entering into the contract. ☐ If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires. ⏩ If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right. ☐ Account for only when the customer exercises the option to purchase the additional goods or services. ☐ Allocate the transaction price to performance obligations on a relative stand-alone selling price basis. ☐ If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following: (a) any discount that the customer could receive without exercising the option; and (b) the likelihood that the option will be exercised.
Long term arrangements	⏩ It may be appropriate to treat long term arrangements as separate one-year performance obligations, if the contract can be renewed or cancelled by either party at discrete points in time (that is, at the end of each service year). ⏩ Separately account for its rights and obligations for each period in which the contract cannot be cancelled by either party. ⏩ When the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.
Consignment Arrangements	⏩ Revenue generally would **not be** recognised for consignment arrangements when the goods are delivered to the consignee because control has not yet transferred. ⏩ Revenue is recognised when the entity has transferred control of the goods to the consignor or the end consumer
Principal vs agent consideration	⏩ When the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled. ⏩ When the entity is acting as an agent, the revenue recognised is the net amount i.e. the amount, entity is entitled to retain in return for its services under the contract. The entity's fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party. Since the identification of the principal in a contract is not always clear, Ind AS 115 provides following indicators that a performance obligation involves an agency relationship: (a) the entity is primarily responsible for fulfilling the contract. This typically includes responsibility for the acceptability of the specified good or service; (b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). (c) the entity has discretion in establishing prices for the goods or services.
Non-refundable upfront fees	It is an advance payment for future goods and services and, therefore, would be recognised as revenue when those future goods and services are provided, even though it relates to an activity undertaken at or near contract inception to fulfil the contract and the activity does not result in the transfer of a promised good or service to the customer.

Step 3: Determining the transaction price

- The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.
- For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.
- The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price.
- When determining the transaction price, an entity shall consider the effects of all of the following:



Variable consideration		
1	**Penalties**	⏩ Accounted for as per the substance of the contract. ⏩ Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration.
2	**Estimating the amount of variable consideration**	Estimate an amount of variable consideration by using either of the following methods: (a) **Expected value -** It is the sum of probability-weighted amounts in a range of possible consideration amounts. It will be appropriate if an entity has a large number of contracts with similar characteristics. (b) **Most likely amount –** It is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). It will be appropriate, if the contract has only two possible outcomes. An entity shall apply one method consistently throughout the contract.
3	**Refund liabilities**	⏩ Recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. ⏩ A refund liability is measured at the amount of consideration received / receivable for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price). ⏩ The refund liability shall be updated at the end of each reporting period for changes in circumstances.
4	**Constraining estimates of variable consideration**	Include in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will **not** occur when the uncertainty associated with the variable consideration is subsequently resolved.
5	**Reassessment of variable consideration**	At the end of each reporting period, account for changes in the transaction price, if any.
6	**Sale with a right of return**	⏩ To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following: (a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned); (b) a refund liability; and (c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability. ⏩ Promise to stand ready to accept a returned product during the return period shall not be accounted for as a performance obligation in addition to the obligation to provide a refund. ⏩ For any amounts received (or receivable) for which an entity does not expect to be entitled, the entity shall not recognise revenue when it transfers products to customers but shall recognise those amounts received (or receivable) as a refund liability. ⏩ Subsequently, at the end of each reporting period, the entity shall update its assessment of amounts for which it expects to be entitled in exchange for the transferred products and make a corresponding change to the transaction price and, therefore, in the amount of revenue recognised. ⏩ An entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity shall recognise corresponding adjustments as revenue (or reductions of revenue). ⏩ An asset recognised for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product **less** any expected costs to recover those products. ⏩ An entity shall present the asset separately from the refund liability. ⏩ Exchanges by customers of one product for another of the same type, quality, condition and price are not considered returns. ⏩ Return of a defective product in exchange for a functioning product shall be evaluated as warranties.

Warranties

- Customer has option to purchase separately
  - ↓ Distinct service, as the entity promises to provide service in addition to the product's described functionality
  - ↓ Account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation
- Customer does not have option to purchase separately
  - ↓ Warranty provides an assurance that the product complies with agreed-upon specifications
  - ↓ Account for the warranty in accordance with Ind AS 37

Significant financing component	Adjust the promised amount of consideration for the effects of the time value of money. In assessing whether a contract contains a financing component and whether that financing component is significant to the contract, consider **both** (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and (b) the combined effect of both of the following: (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and (ii) the prevailing interest rates in the relevant market. Use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances. If the combined effects for a portfolio of similar contracts were material to the entity as a whole, but if the effects of the financing component were not material to the individual contract, such financing component shall not be considered significant and shall not be separately accounted for. **Exception** A contract with a customer would **not** have a significant financing component if any of the following factors exist: (a) the **customer paid for the goods or services in advance** and the timing of the transfer of those goods or services is at the discretion of the customer.
	(b) a **substantial amount of the consideration promised by the customer is variable** and the amount or **timing** of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is **not substantially within the control of the customer or the entity** (c) the difference between the promised consideration and the cash selling price of the good or service arises for **reasons other than the provision of finance to either the customer or the entity,** and the difference between those amounts is proportional to the reason for the difference
Non-cash consideration	⏩ measure the non-cash consideration (or promise of non-cash consideration) at fair value. ⏩ And, if it cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.
Subsequent measurement of non-cash consideration	⏩ If the fair value of the non-cash consideration varies after contract inception because of its form, the entity **does not adjust** the transaction price for any changes in the fair value of the consideration. ⏩ If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration, apply the guidance on variable consideration and the constraint when determining the transaction price.

Consideration payable to a customer

Is the consideration payable to a customer a payment for a distinct good or service from the customer?

→ Yes: Account for the consideration as a reduction of the transaction price.

↓ No

Does the consideration exceed the fair value of the distinct goods or services that the entity receives from the customer?

→ Yes: Account for the excess as a reduction of the transaction price.

↓ No

Account for the purchase of the good or service in the same way that the entity accounts for other purchases from suppliers.

Step 4: Allocating the transaction price to performance obligations

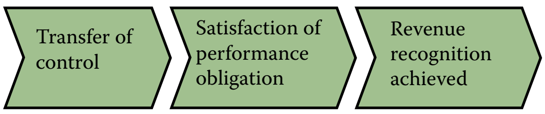
Allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis **except** for

- ⏩ allocating discounts, and
- ⏩ allocating variable consideration

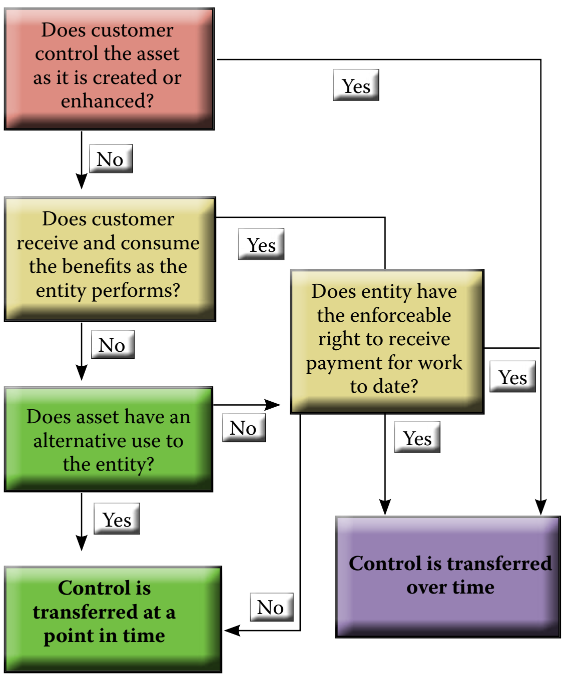
Determining stand-alone selling price	The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a stand-alone selling price is - **the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.** Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following: (a) Adjusted market assessment approach (b) Expected cost plus a margin approach (c) Residual approach A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices.

Allocation of a discount	Allocate a discount proportionately to all performance obligations in the contract on the basis of the relative stand-alone selling prices of the underlying distinct goods or services.
When to allocate discount to 'less than all' performance obligations?	Allocate a discount entirely to one or more, but not all, performance obligations in the contract **if all of the following criteria are met:** (a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis; (b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and (c) the discount attributable to each bundle of goods or services described in (b) above is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs. ***Note:*** *– As a **first step**, always allocate the discount entirely to one or more performance obligations in the contract (if applicable), and then as a **second step**, use the residual approach to estimate the stand-alone selling price of a good or service.*
Allocation of variable consideration	Variable consideration may be attributable to (1) the entire contract or (2) a specific part of the contract, such as either of the following: (a) one or more, but not all, performance obligations in the contract. (b) one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation.
How to allocate variable consideration?	Allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation **if both of the following criteria are met:** ⏩ the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and ⏩ allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service when considering all of the performance obligations and payment terms in the contract.

STEP 5: Satisfying performance obligation

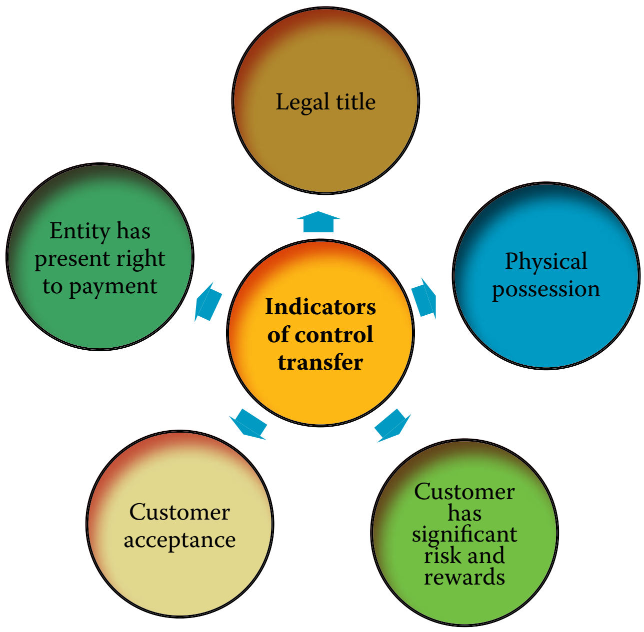


Transfer of control over a period of time



Transfer of control at a point in time

Where a company does not meet any of the criteria for recognising revenue over a period of time, then revenue shall be recognised at a point in time.



Repurchase agreements

Forward: An entity's obligation to repurchase the asset.

Call option: An entity's right to repurchase the asset.

Put option: An entity's obligation to repurchase the asset at the customer's request.

Contract Cost

Contract acquisition

- Incremental costs to obtain a contract that would not be incurred if contract not obtained (Eg. Sales commission)
- Recognise as an asset the incremental costs to obtain a contract that are expected to be recovered.

Contract fulfilment

- Cost to fulfil (i.e. perform/deliver) a contract. Consider deferral under Ind AS 115.95 only if **not covered in** scope of **another standard.**
- Recognise as an asset under this standard if costs:

All

Directly relate to a contract (or anticipated contract), such as direct labour and materials, indirect costs of production, etc.

Generate or enhance resources that will be used to satisfy performance obligations in the future, AND

Expect to be recovered

Service Concession Arrangements

Does the grantor control or regulate what services the operator must provide with the infrastructure, to whom it must provide them, and at what price?

No → OUTSIDE THE SCOPE OF APPENDIX SEE INFORMATION NOTE 2

Yes ↓

Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the service arrangements? Or is the infrastructure used in the arrangements for the entire useful life?

No

Yes ↓

Is the infrastructure constructed or acquired by the operator from a third party for the purpose of the service arrangement?

No → Is the infrastructure existing infrastructure of the grantor to which the operator is given access

No

Yes ↓

WITHIN THE SCOPE OF APPENDIX

Operator does not recognise infrastructure as property, plant and equipment or as a leased asset

Does the operator have a contractual right to receive cash or other financial asset from or at direction of the grantor as described in paragraph 16 of Appendix?

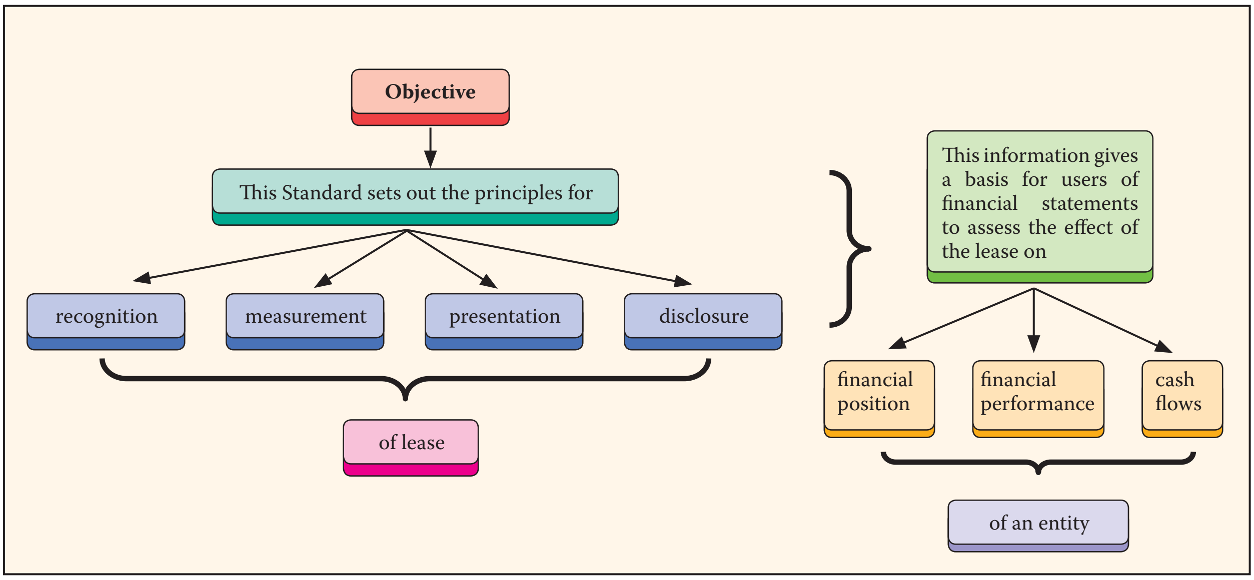
Yes → Operator recognises a financial asset to the extent that it has a contractual right to receive cash or another financial asset as described in paragraph 16 of Appendix.

No → Does the operator have a contractual right to charge users of the public services as described in paragraph 17 of Appendix?

Yes → Operator recognises an intangible asset to the extent that has a contractual right to receive an intangible asset as described in paragraph 17 in Appendix.

No → Outside the scope of Appendix A, see paragraph 27 of Appendix A

INDIAN ACCOUNTING STANDARD (IND AS) 116: LEASES



Scope

Ind AS 116 shall be applied to **ALL LEASES**, including leases of Right-of-Use (ROU) assets in a sub-lease, **EXCEPT** for:

Sr. No.	Particulars	Reason
1	Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources	Within the scope of Ind AS 106 *'Exploration for and Evaluation of Mineral Resources'*
2	Leases of biological assets held by a lessee	Within the scope of Ind AS 41 *'Agriculture'*
3	Service concession arrangements	Within the scope of Appendix D of Ind AS 115 *'Revenue from Contracts with Customers'*
4	Licences of intellectual property granted by a lessor	Within the scope of Ind AS 115 *'Revenue from Contracts with Customers'*
5#	Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights	Within the scope of Ind AS 38 *'Intangible Assets'*

#A lessee may, but is not required to, apply Ind AS 116 to leases of intangible assets other than those described herein.

Recognition Exemptions

- **Short-term leases**
  - A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less
  - +
  - A short-term lease does not include an option to purchase the underlying asset
  - This exemption can be made by **class of underlying asset** (assets of a similar nature and use) to which the right of use relates.
- **Leases for which the underlying asset is of low-value**
  - ONLY IF BOTH the conditions are satisfied
  - The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee
  - +
  - The underlying asset is not highly dependent on, or highly interrelated with, other assets
  - The exemption can be made on a **lease-by-lease basis**

Note: A lease cannot be classified as short-term if the lease term is subsequently reduced to less than 12 months

Note:

1. The exemption for leases of low-value items intend to capture leases that are high in volume but low in value
2. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset, i.e., an intermediate lessor who subleases, or expects to sublease an asset, cannot account for the head lease as a lease of a low-value asset

Important points regarding the leases of low-value assets

- Value of an underlying asset to be assessed based on the value of the asset when it is new, regardless of the age of the asset being leased *
- Leases of low-value assets are exempted regardless of whether those leases are material to the lessee
- Examples of low-value underlying assets can include:
  - tablet
  - personal computers,
  - small items of office furniture
  - telephones
- The assessment performed on an absolute basis. It is not affected by the size, nature or circumstances of the lessee

* A lease of an underlying asset does not qualify as a lease of low value asset if the nature of the asset is such that, when new, the asset is typically not of low value. ***For e.g.,*** leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

Accounting on election of recognition exemption

↓

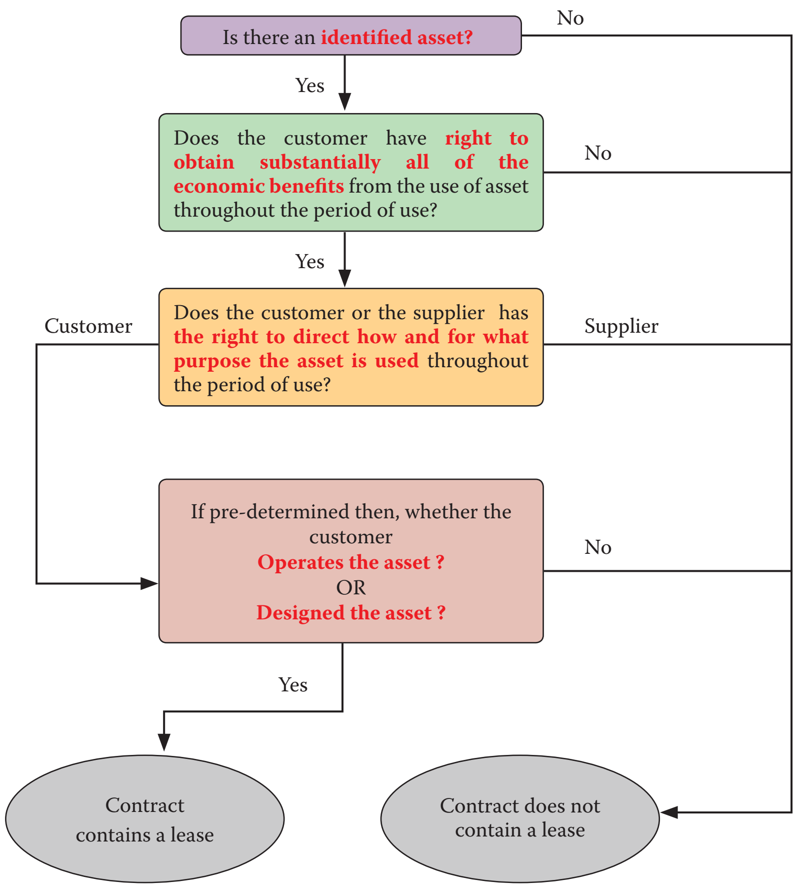
The lease payments shall be recognised as an **expense**

- either: Straight-line basis over the lease term
- or: Another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

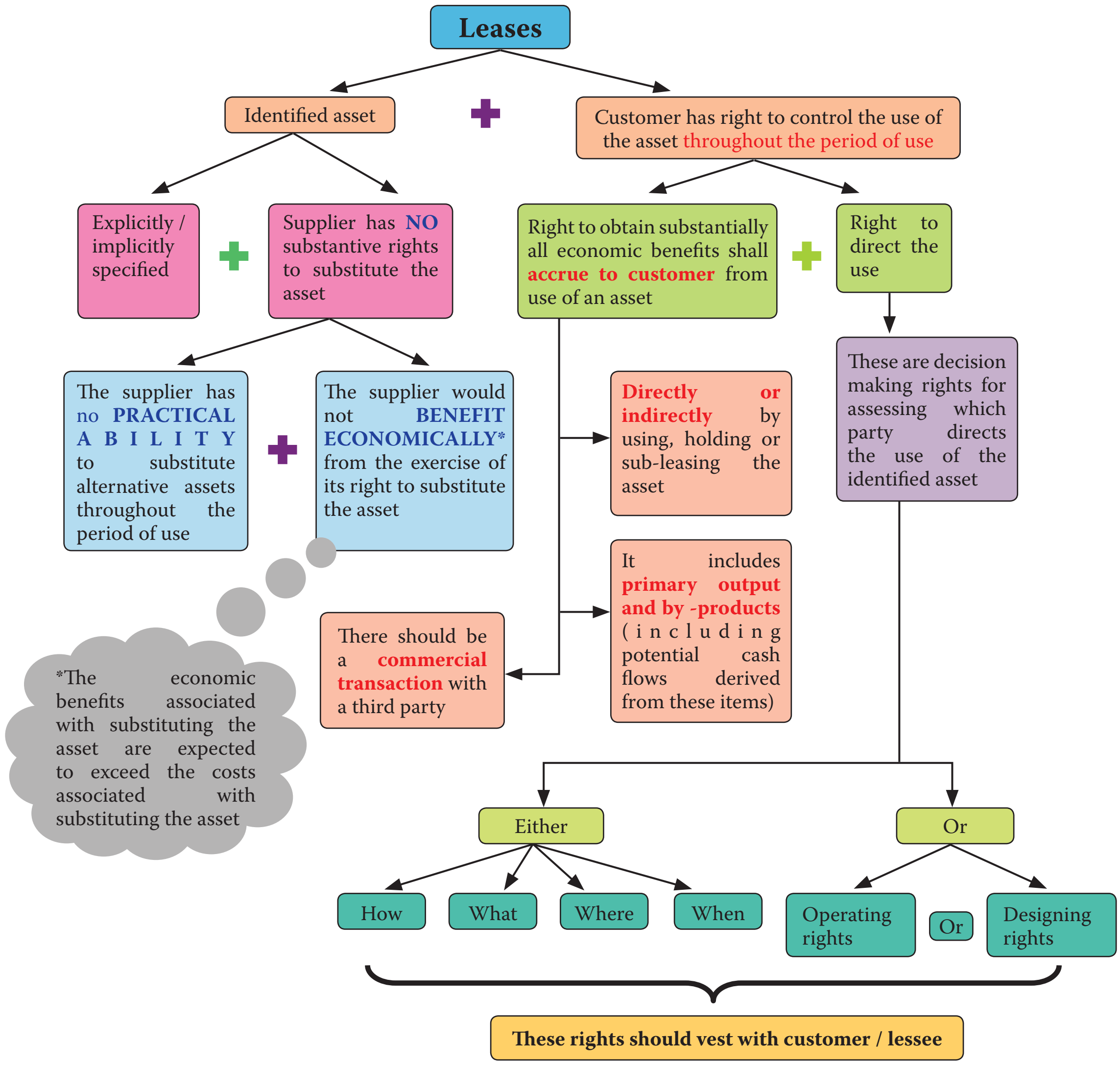
Lease as per Ind AS 116

Definition	A lease is defined as a contract, or part of a contract that conveys the **right to control** the use of an **identified asset** for a **period of time** in **exchange for consideration**.
Date to identify the contract as a lease	Ind AS 116 requires customers and suppliers to determine whether a contract is or contains a lease **at the inception of the contract**.
Inception date	The inception date is defined as the ***earlier*** of the following dates: • date of a lease agreement • date of commitment by the parties to the principal terms and conditions of the lease

Whether an Arrangement contains Lease?



The above chart can be elaborated as follows:



Note:

1. In the case of substitution rights, the analysis primarily considers factors from the supplier's perspective.
2. If the supplier has a right or an obligation to substitute the asset only on or after either a **particular date**, or the occurrence of a specified event, the supplier's substitution right is **not substantive** because the supplier does **not have the practical ability** to substitute alternative assets **throughout the period of use**.
3. An entity's evaluation of whether a supplier's substitution right is substantive is based on **facts and circumstances at inception** of the contract. At inception of the contract, an entity should not consider future events that are not likely to occur.
4. Contract terms that allow or require a supplier to substitute alternative assets only when the underlying **asset is not operating properly** (*for e.g.*, a normal warranty provision) or when a **technical upgrade** becomes available **do not create a substantive substitution right**.
5. Circumstances, at inception of the contract, if are not likely to occur, are **excluded** from the evaluation of whether a supplier's substitution right is substantive throughout the period of use:
6. The right to control the use of an asset may not necessarily be documented, in form, as a lease agreement.
7. A customer should **presume** that a supplier's substitution right is **not substantive** when the customer **cannot readily determine** whether the supplier has a substantive substitution right. This requirement is intended to clarify that a **customer is not expected to exert undue effort to provide evidence that a substitution right is not substantive**.
8. An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of an asset. Similarly, a capacity or other portion of an asset that is not physically distinct is not an identified asset unless it represents **substantially all** of the capacity of the asset and thereby provides the customer with the **right to obtain substantially all of the economic benefits** from use of the asset.

Examples of circumstances that, at inception of the contract, are not likely to occur and, thus, are **excluded** from the evaluation of whether a supplier's substitution right is substantive throughout the period of use:

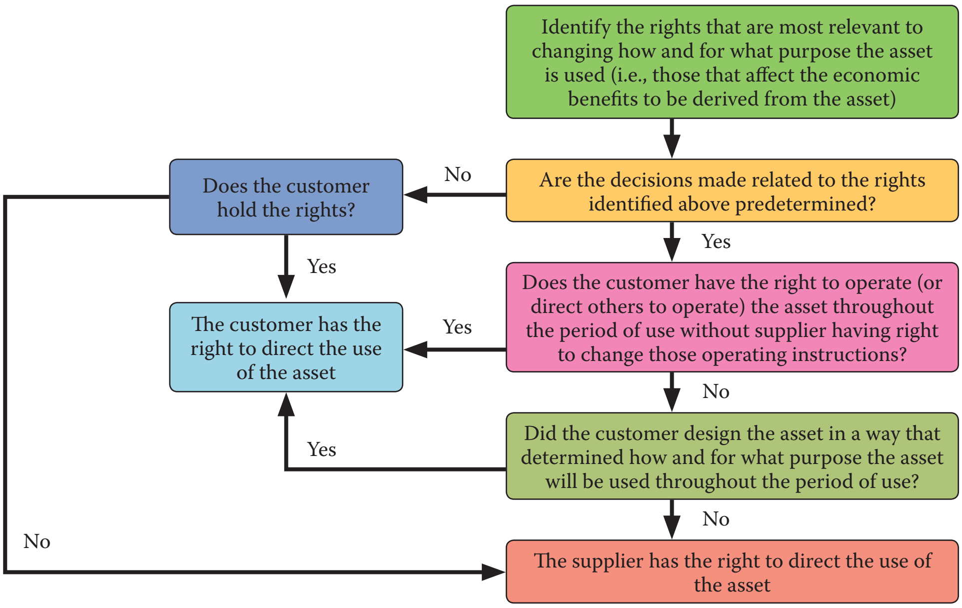
(1)
An agreement by a future customer to pay an above market rate for use of the asset

(2)
The introduction of new technology that is not substantially developed at inception of the contract

(3)
A substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract

(4)
A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract

Right to Direct the Use



Examples of relevant decision-making rights that grant the right to change how and for what purpose the asset is used

1	Lease of trucks / aircraft / rail cars etc	• Which goods are transported? • When the goods are transported and to where? • How often the asset is used? • Which route is taken?
2	Retail unit	• Which goods will be sold? • Prices at which the goods will be sold? • Where and how the goods are displayed?
3	Power plant	• How much power will be delivered and when? • When to turn the power plant on/off?
4	Fibre-optic cable	• When and whether to light the fibres? • What and how much data the cable will transport? • How to run the cable? • Through which routes the data will be delivered?

Specifying the output of an asset before the period of use
• If a customer can only specify the output from an asset before the beginning of the period of use and cannot change that output throughout the period of use, the customer does **not have the right to direct the use of that asset unless** it designed the asset, ***OR*** specific aspects of the asset.
• If the customer did not design the asset or aspects of it, the customer's ability to specify the output in a contract that does not give it any other relevant decision-making rights relating to the use of the asset (***for e.g.***, the ability to change when, whether and what output is produced) gives the customer the same rights as any customer that purchases goods or services in an arrangement (i.e., a contract that does not contain a lease).

Protective rights
• A supplier's protective rights, **in isolation, do not prevent the customer from having the right to direct the use** of an identified asset.
• Protective rights typically define the scope of the customer's right to use the asset without removing the customer's right to direct the use of the asset. Protective rights are intended to protect a supplier's interests.
• Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.

Separation of Lease and Non-Lease Components

Identifying and separating lease components of a contract

↓

The right to use each asset is considered as a 'separate' lease component

ONLY IF BOTH the following conditions are satisfied

- The lessee can benefit from the use of the asset either on its own ***OR*** together with other resources that are readily available to the lessee
- The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract

Note: If one or both criteria are not met then, the right to use multiple assets is considered as a 'single' lease component, i.e., not a 'separate' lease component

1.	**Separating lease components from non-lease components**	Only items that **contribute to securing the output** of the asset **are lease components**.
		Costs incurred by a supplier to provide maintenance on an underlying asset, as well as the materials and supplies consumed as a result of the use of the asset, **are not lease components**.
		The **non-lease components are identified and accounted for separately** from the lease component in accordance with other standards. ***For e.g.***, the non-lease components may be accounted for as executory arrangements by lessees (customers) or as contracts subject to Ind AS 115 by lessors (suppliers).
		Costs related to **property taxes and insurance** that do not involve the transfer of a good or service, are fixed in the contract. Hence, they should be **included in the overall contract consideration to be allocated to the lease and non-lease components**.
2.	**Lessee reimbursements – whether a separate component of a contract?**	**Reimbursements (or certain payments on behalf of lessor) *by lessee*** that do not transfer a good or service to the lessee are **not separate components of the contract**. Such items are considered as part of the total consideration which is allocated to the separately identified components of the contract (i.e., the lease and non-lease components, if any).
3.	**Optional exemption of using Practical Expedient-not to separate non-lease component**	Ind AS 116 provides a practical expedient that permits lessees to make an **accounting policy election**, by **CLASS OF UNDERLYING ASSET**, to account for each separate lease component of a contract and any associated non-lease components as a **SINGLE LEASE COMPONENT**.
		This practical expedient is **not permissible for lessor**.
		Lessees that make the **policy election** to account for each separate lease component of a contract and any associated non-lease components as a **SINGLE LEASE COMPONENT, allocate ALL of the contract consideration to the lease component**.
		Practical expedient does not allow lessees to account for multiple lease components of a contract as a single lease component, if it meets the conditions given in point 1 above.
4.	**Determining and allocating the consideration in the contract – Lessee**	Lessees that do not use the practical expedient, are required to **allocate** the consideration in the contract to the lease and non-lease components on a **RELATIVE STAND-ALONE PRICE BASIS**. If observable stand-alone prices are not readily available, lessees **estimate** stand-alone prices, maximising the use of observable information.
5.	**Determining and allocating the consideration in the contract – Lessors**	Lessor are required to **allocate** the consideration in the contract to the lease and any associated non-lease components as per **paragraphs 73 – 90 of** Ind AS 115 *Revenue from Contracts with Customers.*

Contract Combinations

Ind AS 116 requires that two or more contracts entered into at or near the **same time** with the **same counterparty (or related parties of the counterparty)** be considered a **'single' contract IF ANY ONE** of the following criteria is met:

The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together

Or

The amount of consideration to be paid in one contract depends on the price or performance of the other contract

Or

The rights to use the underlying assets conveyed in the contracts (or some of the rights to use underlying assets conveyed in each of the contracts) are a single lease component

Portfolio Application

- Ind AS 116 **includes a practical expedient** that allows entities to use a portfolio approach for **leases with similar characteristics** if the entity reasonably expects that the **effects on the financial statements would not differ materially** from the application of the standard to the individual leases in that portfolio.
- If accounting for a portfolio, an entity uses estimates and assumptions that reflect the size and composition of the portfolio.
- A decision to use the portfolio approach would be similar to a **decision some entities make today to expense, rather capitalise, certain assets** when the accounting difference is, and would continue to be, immaterial to the financial statements.

Determination of contract that whether it contains a lease is done at the **inception of the contract**.

Date of a lease agreement

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

Whichever date is earlier → **Inception date of a lease**

Commencement date of a lease

The **commencement date** is the date on which a lessor makes an **underlying asset* available for use** by a lessee

On this date

a lessee initially recognises
- a lease liability and
- related Right of Use Asset (ROU Asset)*

a lessor (for finance leases) initially recognizes
- its net investment in the lease

*The **'underlying asset'** is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee

***'ROU Asset'** represents a lessee's right to use an **underlying asset** for the **lease term**

Note:
- In certain cases, the commencement date of the lease may be before the date stipulated in the lease agreement.
- The timing of when lease payments begin under the contract **does not affect** the commencement date of the lease.

Lease Term

The assessment of the lease term is a critical estimate and a key input to the amount of the lease liability.

	Particulars	**Years**
1	Rent free period	XXX
2	Non-cancellable period	XXX
3	Optional renewable periods (where lessee is reasonably certain to extend the lease)	XXX
4	Periods covered by option to terminate the lease (where lessee is reasonably certain not to terminate early)	XXX
	Total Lease terms	**XXXX**

Notes:

- Lease term begins **at the commencement date** and include any rent-free period.
- Termination options held **by the lessor are not considered** when determining the lease term.
- The assessment of whether it is reasonably certain that a lessee will exercise an extension or termination option **should be done on lease commencement date**.

An entity should consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option.

Example of relevant factors to consider are:

Contractual terms vis-a vis market rates		**Asset related factors**	
1.	Lease rentals in optional period, ex. Termination penalties and residual value guarantees	1.	Specialised asset
2.	Variable or contingent payment	2.	Location of underlying asset
3.	Terms and condition after initial optional period. Example: Purchase option	3.	Availability of suitable alternatives
4.	Cost relating to the termination of the lease and signing of new replacement lease	4.	Existence of significant leasehold improvement

Cancellable leases

In assessing the length of the non-cancellable period of a lease, determine the period for which the contract is **enforceable**

An arrangement is **not enforceable** if

both the lessor and lessee each have the right to terminate the lease **without permission from the other party** + with no more than an insignificant penalty

Any non-cancellable periods are **considered part of the lease term**

If **only the lessor** has the right to terminate a lease → the period covered by the option to terminate the lease **is included** in the non-cancellable period of the lease

If **only the lessee** has the right to terminate a lease → the right is a termination option which **is included** in determining the lease term

If **both the lessee and the lessor** can terminate the contract without more than an insignificant penalty → there are **no enforceable rights and obligations** beyond the non-cancellable term
Hence, the lease term is limited to the non-cancellable term

Explained through an example:

Suppose the term of a contract is 10 years and the non-cancellable / lock-in period is 6 years. The lease term shall be as follows:

If the termination option is with 'Lessor'	If the termination option is with 'Lessee'	If the termination option is with 'Both' (i.e., any party can terminate)
The lease term shall be **10 years**. *Because even after 6^{th} year, the lessee would be contractually bound until 10^{th} year i.e. lessee cannot refuse to make the payment till the expiry of the contract and also, has the right to use the asset until 10^{th} year, unless lessor terminates the contract.*	The lease term shall be **10 years** assuming reasonable certainty. *Because after the expiry of 6^{th} year, though the lessee is not contractually bound till 10^{th} year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate. Hence, though there is no enforceable obligation from lessee's point of view beyond 6^{th} year but, basis the said assumption, the lease term shall be 10 years.*	The lease term shall be **6 years**. *Because after 6^{th} year, either party can terminate the contract without the consent of the other party and hence, the contract is not enforceable after 6^{th} year ONLY IF there is insignificant penalty for termination.*

Reassessment of lease term and purchase options

A. For lessees

Lessees are required to **reassess** the lease term upon the occurrence of either a **significant event** ***OR*** a **significant change** in the circumstances that:

Is within the control of the lessee + Affects whether the lessee is reasonably certain to exercise / not to exercise renewal, termination and / or purchase option, not previously included in its determination of the lease term

Following are some of the examples of significant events or significant changes in circumstances within the lessee's control:

1) Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable

2) Making significant modifications or customisations to the underlying asset

3) Making a business decision that is directly relevant to the lessee's ability to exercise, or not to exercise, an option (e.g., extending the lease of a complementary asset or disposing of an alternative asset)

4) Subleasing the underlying asset for a period beyond the exercise date of the option

Note: Changes in market-based factors (***for e.g.***, a change in market rates to lease or purchase a comparable asset) are not within the lessee's control, and therefore, they **do not trigger a reassessment by themselves**.

Revision of Lease Term

Lessees are required to revise the lease term if there is change in the non-cancellable period of lease. Following are the example which leads to change in non-cancellable period of a lease:

Change in non-cancellable lease period

If the lessee **exercises an option** not previously included in the entity's determination of the lease term	If the lessee **does not exercise an option** previously included in the entity's determination of the lease term
An event occurs that **contractually obliges the lessee** to exercise an option not previously included in the entity's determination of the lease term	An event occurs that **contractually prohibits** the lessee from exercising an option previously included in the entity's determination of the lease term

B. For lessors

Lessor revises the lease term to account for the lessee's exercise of an option to extend or terminate the lease or purchase the underlying asset when exercise of such options was not already included in the lease term.

Lease Payments

Lease payment for the Lessors

Lease payment for the Lessees

- Fixed payments (including in-substance fixed payments), **less** any lease incentives*
- Variable lease payments that depend on an index or a rate measured using the prevailing rate at the measurement date**
- Exercise price of a purchase option if the lessee is reasonably certain to exercise that option
- Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease
- Expected residual value guarantees payable by the lessee
- Residual value guarantees provided by the lessee or a third party related to the lessee or unrelated to the lessor

It includes any **in-substance fixed lease payments** which are the payments that may, **in form, contain variability but in substance, are unavoidable**

***Lease incentives**

- **For lessee** - lease incentives that are paid or payable to lessee by the lessor are deductible from lease payments and reduce the initial measurement of lessee' ROU asset.
- **For lessors** - lease incentives are also deducted from lease payments and affect the lease classification test.
  - **For finance leases**
    - lease incentives reduce the expected lease receivables at the commencement date and thereby the initial measurement of the lessor's net investment in the lease.
    - selling profit or loss is not affected.
  - **For operating leases**
    - defer the cost of any lease incentives paid or payable to the lessee and recognise that cost as a reduction to lease income over the lease term.

**Lessees subsequently remeasure the lease liability if there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect) for future payments resulting from a change in index or rate used to determine lease payments.

Exclusion of payments for calculating lease liability:

a. **Lease payments allocated to non-lease components of a contract**, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.

b. Variable lease payments that **do not** depend on index or rate. They are recognised in profit or loss in the period in which the event that triggers the payment occurs.

Lessee Involvement before Commencement Date

The lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee

Whether the lessee obtains control of the underlying asset before that asset is transferred to the lessor?

- Yes → The transaction is a 'sale and leaseback transaction'
- No → The transaction is accounted as a lease

Initial Direct Costs

- **Definition** → 'Initial direct costs' are **the incremental costs of obtaining a lease** that would not have been incurred if the lease had not been obtained, **except for such costs incurred by a manufacturer or dealer lessor** in connection with a finance lease
- **Accounting by lessee** → It is included in his initial measurement of the right-of-use asset
- **Accounting by lessor** →
  - Initial direct costs, **other than those incurred by manufacturer or dealer lessors,** are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term
  - The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease and there is no need to add them separately
- **Note** → Lessees and lessors apply the same definition of initial direct costs
- **Examples** → Costs included and excluded from initial direct costs

Inclusion	Exclusion
Commission (including payments to employees acting as selling agents)	Employee salaries
Legal fees resulting from the execution of the lease	Legal fees for services rendered before the execution of the lease
Lease document preparation costs incurred after the execution of the lease	Negotiating lease term and conditions
Certain payments to existing tenants to move out	Advertising
Consideration paid for a guarantee of a residual asset by an unrelated third party	Depreciation and amortization

Discount Rates

Discount rates are used to determine the present value of the lease payments, which are used to determine **Right-of Use asset and Lease liability in case of a lessee** and **to measure a lessor's net investment** in the lease.

For a Lessee

Discount rate to be used should be:

THE INTEREST RATE IMPLICIT IN THE LEASE, if that rate can be readily determined

OR

If not, then the lessee shall use **THE LESSEE'S INCREMENTAL BORROWING RATE**

Where,

'Interest rate implicit in the lease' is defined as the rate of interest that causes the following:

The present value of lease payments made by the lessee for the right to use the underlying asset + The unguaranteed residual value = The fair value of the underlying asset + Any initial direct costs of the lessor

- Lessee's **incremental borrowing rate** is the rate of interest that
  - the lessee would have to pay to borrow over a **similar term**
  - and with a **similar security**
  - the funds necessary to obtain an asset of a **similar value** to the Right of use Asset
  - in a **similar economic environment**.
- In determining the incremental borrowing rate, the lessee considers borrowings with a similar term and security to the ROU Asset (**NOT the underlying asset**).
- If the contract requires lease payments to be made in a foreign currency then, the incremental borrowing rate of the lessee should be determined based on a borrowing of a similar amount in that foreign currency.

For a Lessor:

Lessor to use the interest rate implicit in the lease.

Fair Value

The fair value for the purposes of applying the lessor accounting requirements in Ind AS 116 is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Note: For the purposes of determination of fair value under Ind AS 116, above stated definition is to be considered, hence Ind AS 113 "Fair Value Measurement" is not applicable for determination of fair value.

Accounting in the Books of Lessee

- A **'lessee'** is defined as an entity that obtains the right to use an **underlying asset** for a period of time in exchange for consideration.
- **At the commencement date,** a lessee shall recognise a ROU Asset and a Lease Liability.
- A lessee initially measures the ROU Asset at **COST**, which consists of ***ALL*** of the following:

Initial Measurement of Right-of Use Asset (ROU Asset)

Present Value of Lease Liability (Refer Chart on 'Lessee Payments')

+

Initial direct costs

+

Estimated cost to dismantle, remove or restore, measured as per Ind AS 37

+

Prepaid lease payments (example- deposits)

−

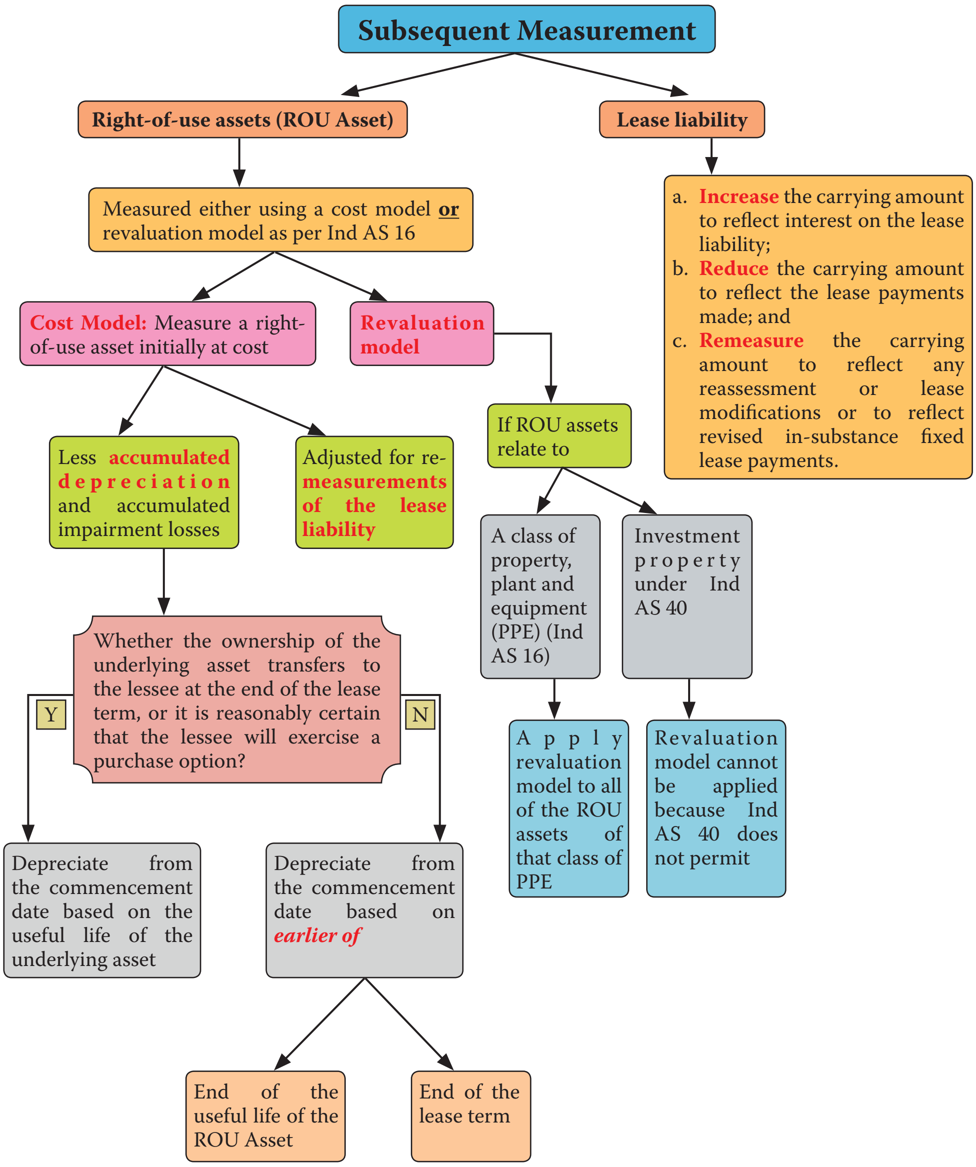
Lease incentives received

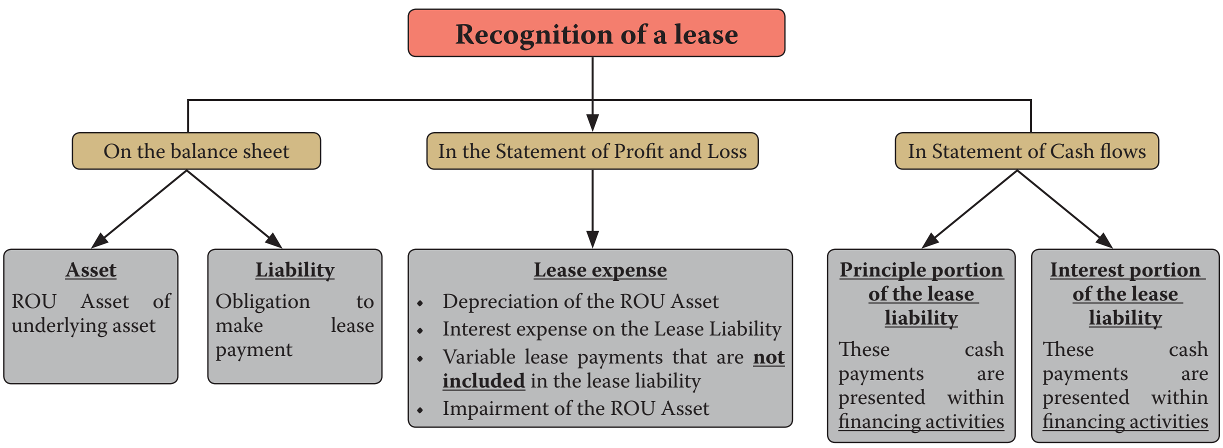
=

Right-of use asset

Journal entry in the books of lessee

ROU Asset	**Dr.**	**Sum total of all below items**
To Lease liability	Cr.	Present Value of outstanding lease payments by lessee using interest rate implicit in lease
To Lessor / Supplier	Cr.	Any lease payment made on or before the commencement date ***less*** lease incentives received
To Bank / Creditor	Cr.	Initial direct costs incurred by lessee
To Provision for dismantling / removing the underlying asset	Cr.	Estimate of costs to be recognised only when lessee incurs an obligation for these costs (Ind AS 37)


Subsequent Measurement
Right-of-use assets (ROU Asset)
Lease liability
Measured either using a cost model or revaluation model as per Ind AS 16
a. Increase the carrying amount to reflect interest on the lease liability;
b. Reduce the carrying amount to reflect the lease payments made; and
c. Remeasure the carrying amount to reflect any reassessment or lease modifications or to reflect revised in-substance fixed lease payments.
Cost Model: Measure a right-of-use asset initially at cost
Revaluation model
If ROU assets relate to
Less accumulated depreciation and accumulated impairment losses
Adjusted for re-measurements of the lease liability
A class of property, plant and equipment (PPE) (Ind AS 16)
Investment property under Ind AS 40
Whether the ownership of the underlying asset transfers to the lessee at the end of the lease term, or it is reasonably certain that the lessee will exercise a purchase option?
Y
N
Apply revaluation model to all of the ROU assets of that class of PPE
Revaluation model cannot be applied because Ind AS 40 does not permit
Depreciate from the commencement date based on the useful life of the underlying asset
Depreciate from the commencement date based on earlier of
End of the useful life of the ROU Asset
End of the lease term


Recognition of a lease
On the balance sheet
In the Statement of Profit and Loss
In Statement of Cash flows
Asset
ROU Asset of underlying asset
Liability
Obligation to make lease payment
Lease expense
• Depreciation of the ROU Asset
• Interest expense on the Lease Liability
• Variable lease payments that are not included in the lease liability
• Impairment of the ROU Asset
Principle portion of the lease liability
These cash payments are presented within financing activities
Interest portion of the lease liability
These cash payments are presented within financing activities

Leases denominated in a foreign currency

Lease Liability	Applying Ind AS 21, Lessees remeasure the foreign currency-denominated lease liability using the exchange rate at each reporting date, **like they do for other monetary liabilities**.
	Any **changes** to the lease liability due to exchange rate changes are **recognised in profit or loss**.
ROU Asset	Since **ROU Asset is a non-monetary asset** measured at historical cost, it is **not affected by changes in the exchange rate**.

Remeasurement

Remeasure lease liabilities upon a change in lease payments on account of **ANY** of the following:

- The reassessment of lease term on account of reasonable certainty to exercise/not exercise of extension and/or termination option
- The reassessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset
- In-substance fixed lease payments
- The amounts expected to be payable under residual value guarantees
- Future lease payments resulting from a change in an index or rate

When to use the 'original' and a 'revised' discount rate?

Revised Discount Rate	Original Discount Rate
Lessees use a **revised** discount rate when lease payments are updated for - reassessment of the lease term ***OR*** - a reassessment of a purchase option. The revised discount rate is based on the interest rate implicit in the lease for the **REMAINDER** of the lease term. If that rate cannot be readily determined, the lessee uses its incremental borrowing rate.	Lessees use the **original** discount rate when lease payments are updated for - a change in expected amounts for residual value guarantees ***AND*** - payments dependent on an index or rate, **unless** the rate is a floating interest rate. - the variability of payments is resolved so that they become in-substance fixed payments.

Note: A lessee recognises the amount of the remeasurement of the lease liability as an adjustment to the ROU Asset. However, if the carrying amount of the ROU Asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee recognises any remaining amount of the remeasurement in profit or loss.

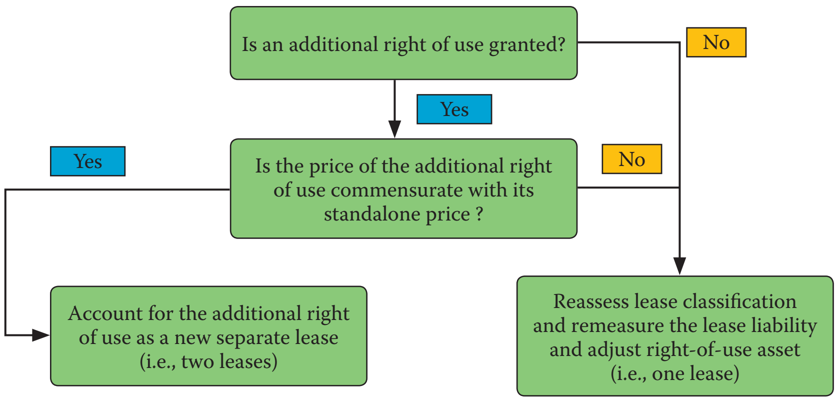
A 'lease modification' is a **change** in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease.

Examples of lease modifications that may be negotiated after the lease commencement date:

Lease Modifications in the Books of Leassee

- A lease extension
- Early termination of the lease
- A change in the timing of lease payments
- Leasing additional space in the same building
- Surrendering a part of the underlying asset

Lessee's Analysis of a Change in Lease



The exercise of an existing purchase or renewal option or a change in the assessment of whether such options are reasonably certain to be exercised are **not lease modifications but can result in the remeasurement** of Lease Liabilities and ROU Assets.

Accounting Treatment for Lease Modifications that are not Accounted for as Separate Leases

Decrease in scope

- Remeasure lease liability using revised discount rate * (1)
- Decrease right-of-use asset by its relative scope compared to the original lease (2)
- Difference between (1) and (2) recognised in P&L

All other lease modification

- Remeasure lease liability using revised discount rate*
- Remeasure right-of-use asset by same amount

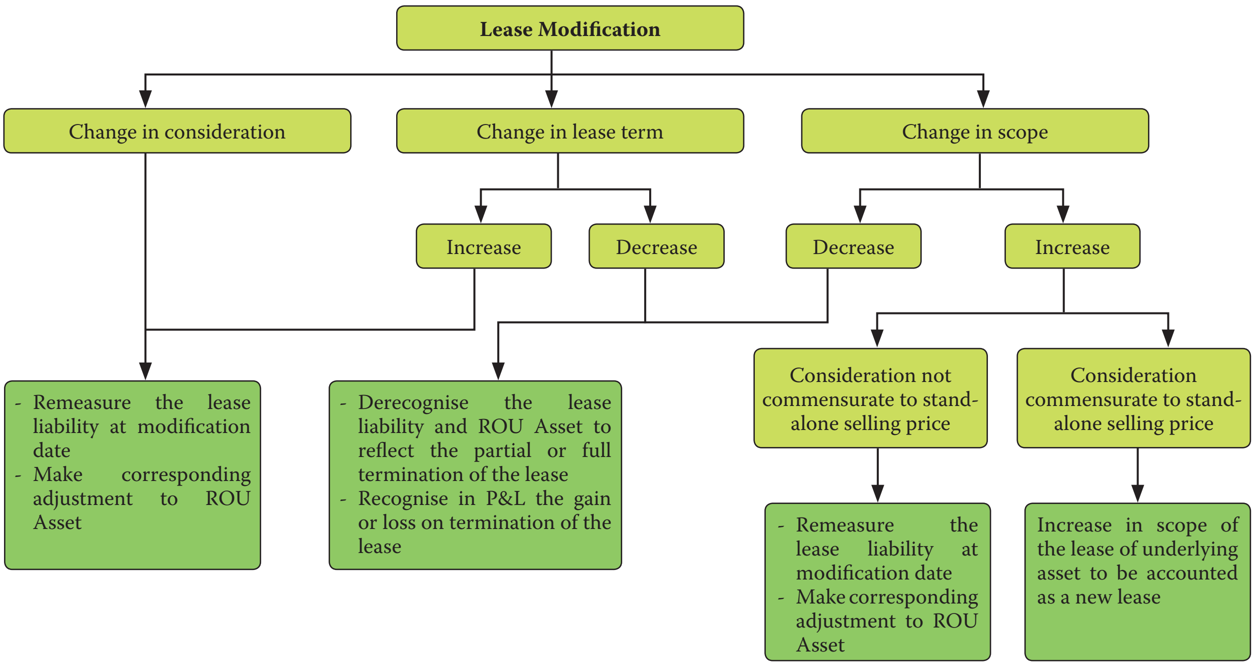
* The implicit rate in the lease is to be used. If it cannot be readily determined, the incremental rate of borrowing is to be used.

- The re-measurements occur as of the effective date of the lease modification on a prospective basis.
- In some cases, the lessee and lessor may agree to a modification to the lease contract that starts at a later date (i.e., the terms of the modification take effect at a date later than the date when both parties agreed to the modification). This can be understood with the help of a following example:

Case study: A lessee enters into a lease arrangement with a lessor to lease an asset for 10 years. At the beginning of year 8, the lessee and lessor agree to a modification to the contract that will take effect from the beginning of year 9.

Scenario 1 (Increase in scope – Not a Separate Lease)	Scenario 2 (Increase in scope – Separate Lease)	Scenario 3 (Decrease in scope)
Lessee will re-allocate the consideration in the modified contract to each of the existing lease and non-lease components and Remeasure the lease liability **at the date both parties agreed to the modification** (the beginning of year 8).	Lessee will **allocate the consideration** in the modified contract **to each of the existing and new lease and non-lease components** at the date both parties agreed to the modification (the beginning of year 8). The lessee will **remeasure the lease liability for the existing lease components** at that date as well. However, **recognition of the lease liability and ROU Asset for any new lease component occurs at the commencement date of the new lease component** (the beginning of year 9).	Lessee will **re-allocate the consideration** in the modified contract **to each existing lease and non-lease component** and **remeasure the lease liability and ROU Asset at the effective date of the modification** (the beginning of year 8).

Summarised Flowchart for Lease Modification in the Books of Lessee:



Presentation in the Books of Lessee

Balance Sheet	*Statement of profit and loss*	*Statement of cash flows*
ROU Assets: They are presented either: - Separately from other assets (e.g., owned assets) ***OR*** - Together with other assets as if they were owned, with disclosures of the balance sheet line items that include ROU Assets and their amounts ROU Assets that meet the definition of investment property are presented as investment property **Lease Liabilities:** They are presented either: - Separately from other liabilities ***OR*** - Together with other liabilities with disclosure of the balance sheet line items that includes lease liabilities and their amounts	**Depreciation and Interest:** Depreciation on Right of use asset and interest expense accreted on lease liabilities are presented **separately** (i.e., they **CANNOT** be combined). This is because interest expense on the lease liability is a component of **finance costs**	**Principal portion of the lease liability:** - These cash payments are presented within financing activities **Interest portion of the lease liability:** - These cash payments are presented within financing activities **Short-term leases and leases of low-value assets:** - Lease payments pertaining to them (i.e., not recognised on the balance sheet as per Ind AS 116) are presented within operating activities **Variable lease payments not included in the lease liability:** - These are also presented within operating activities **Non-cash activity:** Such activity is disclosed as a supplemental non-cash item (e.g., the initial recognition of the lease at commencement)

Disclosures in the Books of Lessee

Ind AS 116 requires lessees to present all disclosures in:
- a single note ***OR***
- separate section in the financial statements.

Quantitative Disclosure Requirement		
Balance Sheet	*Statement of profit and loss*	*Statement of cash flows*
– Additions to right-of-use assets – Carrying value of right-of-use assets at the end of the reporting period by class – Maturity analysis of lease liabilities separately from other liabilities based on Ind AS 107 requirements	– Depreciation for assets by class – Interest expense on lease liabilities – Short-term leases expensed* – Low-value leases expensed* – Variable lease payments expensed – Income from subleasing – Gains or losses arising from sale and leaseback transactions	– Total cash outflow for leases

* These disclosures need not include leases with lease terms of one month or less.

- All of the above disclosures are required to be presented in tabular format, unless another format is more appropriate.
- The amounts disclosed include costs that a lessee has included in the carrying amount of another asset during the reporting period.
- Other disclosure requirements also include:
  - Commitments for short-term leases if the current period expense is dissimilar to future commitments.
  - For right-of-use assets that meet the definition of investment property, the disclosure requirements of Ind AS 40, *Investment Property*, with a few exclusions.
  - For right-of-use assets where the revaluation model has been applied, the disclosure requirements of Ind AS 16, *Property, Plant and Equipment.*
  - Entities applying the short-term and / or low-value lease exemptions are required to disclose that fact.

Qualitative Disclosure Requirements
– A summary of the nature of the entity's leasing activities; – Potential cash outflows the entity is exposed to that are not included in the measured lease liability: • Variable lease payments; • Extension options and termination options; • Residual value guarantees; • Leases not yet commenced to which the lessee is committed; • Restrictions or covenants imposed by leases; • Sale and leaseback transaction information.

In providing additional information, lessees are required to consider:

(a) Whether that information is relevant to the users of the financial statements. The additional information is included **ONLY IF** that information is **expected to be relevant** to users of financial statements. For e.g., this is likely to be relevant if it helps those users to understand:

The flexibility provided by leases	*for e.g., a lessee can reduce its exposure by exercising termination options or renewing leases with favourable terms and conditions*
Restrictions imposed by leases	*for e.g., by requiring the lessee to maintain particular financial ratios*
Sensitivity of reported information to key variables	*for e.g., future variable lease payments*
Deviations from industry practice	*for e.g., unusual or unique lease terms and conditions that affect a lessee's lease portfolio*
Exposure to other risks arising from leases	

(b) Whether that information is apparent from information either presented in the primary financial statements or disclosed in the notes.

Note: A lessee need not duplicate information that is already presented elsewhere in the financial statements.

Accounting in the Books of Lessor

Classification of Lease at Inception

- **Operating Lease** → a **lease** that **does not** transfer substantially all the risks and rewards incidental to ownership of an **underlying asset**
- **Finance Lease** → a **lease** that transfers substantially all the risks and rewards incidental to ownership of an **underlying asset**

Examples that Individually, or in Combination, would normally Lead to a Lease being Classified as a FINANCE LEASE

Ownership	The lease transfers ownership of the asset to the lessee by the end of the lease term
Purchase option	The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised
Lease term	The lease term is for the major part of the economic life of the asset even if title is not transferred
PV of Minimum Lease Payments	At the inception date, the present value of the lease payments amounts to at least **substantially all*** of the fair value of the asset
Specialised Nature	The asset is of such a specialised nature that only the lessee can use it without major modifications

*The term "substantially all" is not defined in Ind AS 116.

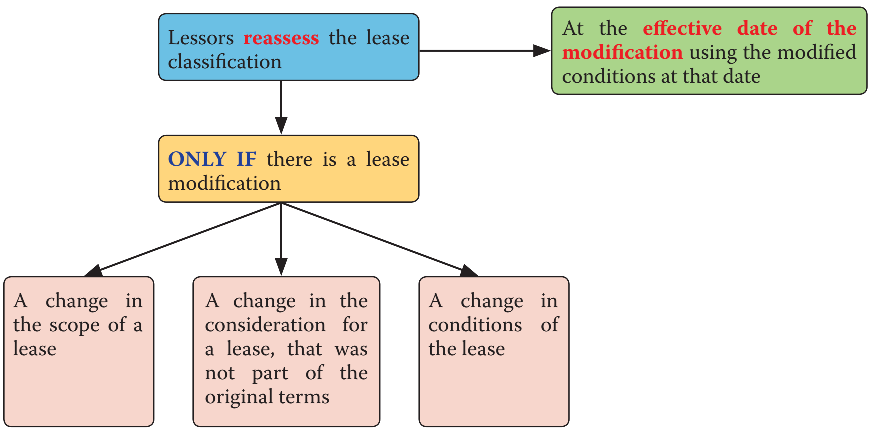
Additionally, Ind AS 116 lists the following indicators of situations that, individually or in combination, could also lead to a lease being classified as a **FINANCE LEASE**

Loss on cancellation	If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
Risk of fair value of the residual asset	Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (e.g., in the form of a rent rebate that is equal to most of the sale proceeds at the end of the lease)
Option to extend lease	The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

Lease Classification Test for Land and Buildings by the Lessor

Classification assessment	• Lessor **separately assesses** the classification of each element as a finance lease or an operating lease, **having fact that land normally has an indefinite economic life** • If the lease payments **cannot be allocated reliably** between the land and the buildings elements, the **entire lease is classified as a finance lease** • If **both elements** (land and building) of the lease payments **are operating leases, the entire lease is classified as an operating lease**
Allocation of lease payments	• Allocate lease payments between the land and the buildings elements **in proportion to the relative fair values** of the leasehold interests in the land element and buildings element of the lease **at the inception date**
Single unit - Economic life	• When the amount for the land element is **immaterial** to the lease, the lessor may treat the land and buildings as a **single unit** for the purpose of lease classification and classify it as a finance lease or an operating lease. • In such a case, the lessor regards the economic life of the buildings as the economic life of the **entire** underlying asset

Reassessment of Lease Classification by the Lessor



Note: If a lease modification results in a separate new lease, that new lease would be classified in the **same manner** as any new lease.

Gross investment in the lease = The lease payments (refer chart on Lease Payments given in Part I of Ind AS 116 capsule) receivable by a lessor under a finance lease + Any **unguaranteed residual value** accruing to the lessor

Portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor

Net investment in the lease = Gross investment in the lease → Discounted at the interest rate implicit in the lease

Accounting for Initial Direct Costs

By Lessor
Finance Lease: • **Lessors *(other than manufacturer or dealer lessors)*** are required to include initial direct costs in the initial measurement of their net investment in finance leases and reduce the amount of income recognised over the lease term. • The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease and they are **not added separately**. • Initial direct costs related to finance leases incurred **by manufacturer or dealer lessors are expensed at lease commencement.** **Operating Lease:** • Ind AS 116 requires lessors **to include initial direct costs in the carrying amount of the underlying asset in an operating lease.** • These initial direct costs are **recognised as an expense over the lease term** on the same basis as lease income.

Finance Leases- Recognition by the Lessor

At the commencement date, a lessor shall recognise assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the **net investment in the lease.**

Initial Measurement by the Lessor

Journal entry for finance lease

Finance lease receivable	Dr.	Net investment
To Underlying asset		Carrying amount

(Balancing figure is profit or loss)

For finance leases (other than those involving manufacturer and dealer lessors), initial direct costs are included in the initial measurement of the finance lease receivable, hence are **not added separately to the net investment in lease**.

Selling profit or loss = [Fair value of the underlying asset / Fair value of the lease receivable — Whichever is lower] − Carrying amount of the underlying asset, net of any unguaranteed residual asset

Initial Measurement – Manufacturer or Dealer Lessors

- At the commencement date, a manufacturer or dealer lessor recognises selling profit or loss in accordance with its policy for outright sales to which Ind AS 115 applies.
- Therefore, at lease commencement, a manufacturer or dealer lessor recognises the following:

The fair value of the underlying asset as revenue ***OR*** the present value of the lease payments discounted using a market rate of interest, whichever is ***lower***.

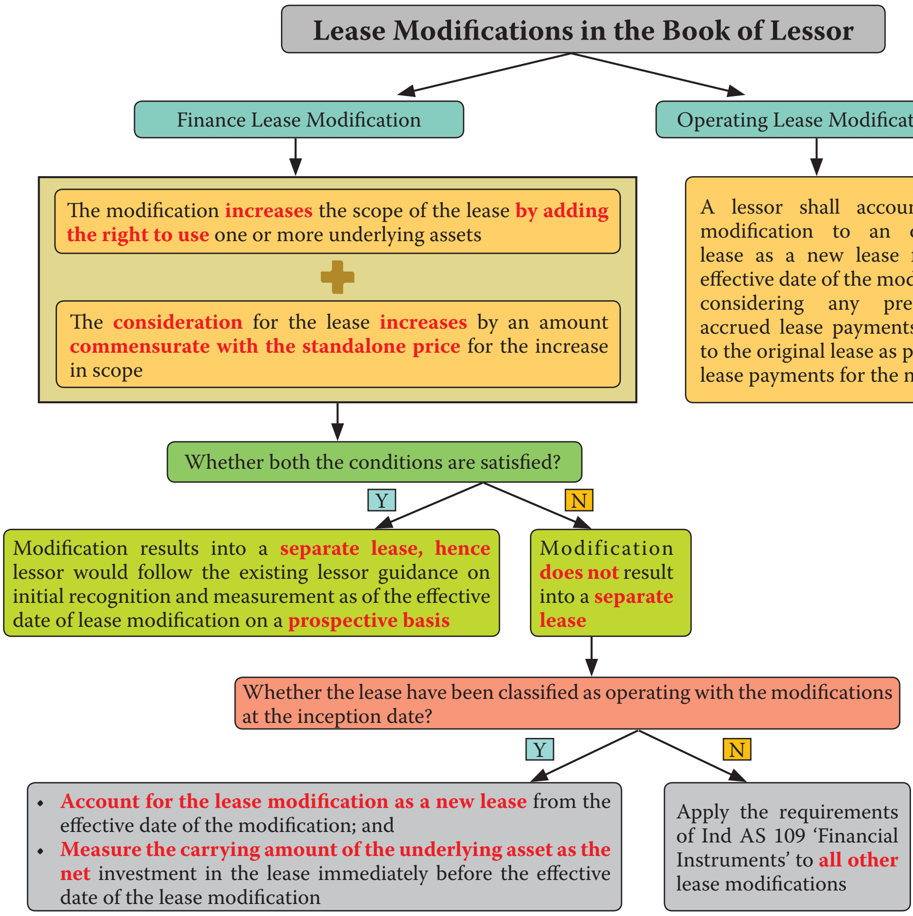
The cost (or carrying amount) of the asset (less) the present value of the unguaranteed residual value, as cost of sale.

The selling profit or loss in accordance with the policy for outright sales.

- At the commencement date, a manufacturer or dealer lessor recognises selling profit or loss on a **finance lease,** regardless of whether the lessor transfers the underlying asset as described under Ind AS 115.
- Costs incurred by a manufacturer or dealer lessor in connection with **obtaining a finance lease are recognised as an expense at the commencement date** and are **excluded** from the net investment in the lease.

Summary-Accounting Treatment in the Books of a Lessor

Particulars	Finance Leases	Operating Leases
Initial measurement		
Balance sheet	• **Derecognise the carrying amount** of the underlying asset • **Recognise the net investment** in the lease i.e. a finance lease receivable (equal to the present value of the lease payments to be received)	• **Continue to present** the underlying asset • **Add any initial direct costs** incurred in connection with obtaining the lease to the carrying amount of the underlying asset • A **manufacturer or dealer lessor does not recognise any selling profit** on entering into an operating lease because it is not equivalent of a sale
Statement of Profit and loss	• Recognise in profit or loss, any **selling profit or selling loss**	
Subsequent measurement		
Balance sheet	• **Reduce the net investment** in the lease for lease payments received (net of finance income calculated above) • **After** lease commencement, the net investment in a lease is **NOT REMEASURED UNLESS** either: ▪ The lease is modified and the modified lease is not accounted for as a separate contract *OR* ▪ The lease term is revised when there is a change in the non-cancellable period of the lease • Recognise any impairment of the net investment in the lease, if there has been a **reduction in the estimated unguaranteed residual value**	• **Calculate depreciation** in accordance with Ind AS 16 and Ind AS 38 • **Apply Ind AS 36** to determine whether an underlying asset is impaired and to account for any impairment loss identified
Statement of Profit and loss	• **Apportion the amount received** between the finance income and reduction in receivable • Finance income will be computed to give a constant periodic rate of return • **Separately recognises income** from variable lease payments that are not included in the net investment in the lease in the period in which that income is earned • **Revise the income allocation** over the lease term and recognise immediately any reduction in respect of amounts accrued, if there has been a **reduction in the estimated unguaranteed residual value**	• **Recognise lease income** over the lease term, typically on a straight line basis • **Recognise depreciation** expense related to the underlying asset • **Recognise variable lease payments** that do not depend on an index or rate (e.g., performance- or usage- based payments) **as they are earned**



Presentation in the Books of Lessor

Finance Leases	*Operating Leases*
• **Recognise assets in the balance sheet** and present them as a receivable at an amount equal to the net investment in the lease • Net investment in the lease is subject to the **same considerations** as other assets in classification as current or non-current assets in a balance sheet.	**Present underlying assets** according to the nature of that asset in the balance sheet

Disclosure in the Books of Lessor

The lessor disclosure requirements are more extensive to enable users of financial statements to better evaluate the amount, timing and uncertainty of cash flows arising from a lessor's leasing activities.

Quantitative Disclosure Requirements	
Finance Leases	– Selling profit or loss; – Finance income on the net investment; – Income from variable lease payments; – Qualitative and quantitative explanation of changes in the net investment; and – Maturity analysis of lease payments receivable.
Operating Leases	– Lease income, separately disclosing variable lease payments; – Disclosure requirements of Ind AS 16 for leased assets, separating leased assets from non-leased assets; – Other applicable disclosure requirements based on the nature of the underlying asset (eg. Ind AS 36, Ind AS 38, Ind AS 40 and Ind AS 41); and – Maturity analysis of lease payments.

Note: The standard prescribes that the quantitative disclosures should be presented in a tabular format, unless another format is more appropriate to be presented.

Qualitative Disclosure Requirements
This disclosure include the nature of the lessor's leasing activities and how the lessee manages risks associated with those activities, including risk management on rights retained in underlying assets and risk management strategies including: – Buy-back agreements; – Residual value guarantees; – Variable lease payments for excess use; and – Any other risk management strategies.

Sub-Leases

Sub Lease { Lessor → Original Lessee / Intermediate Lessor / Sub-lessor } Head Lease

Original Lessee / Intermediate Lessor / Sub-lessor → Ultimate Lessee / Sub-lessee

Definition	A 'Sub-lease' is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor' or 'sub-lessor') to a third party, and the original lease ('head lease') between the head lessor and lessee remains in effect.
Treatment	In some cases, the sublease is a separate lease agreement while, in other cases, though the third party assumes the original lease, yet the original lessee remains the primary obligor under the original lease.
Recognition and Measurement	**Intermediate Lessor (sub-lessor)** • The sublease is classified using the classification criteria **BUT**, it should be by reference to the 'ROU Asset' in the head lease (and **NOT** the 'underlying asset' of the head lease).

	Sublease is a 'Finance Lease'	*Sublease is an 'Operating Lease'*
Balance sheet	• **Derecognise the ROU Asset on the head lease** at the sub-lease commencement date • **Continue to account for the original lease liability** in accordance with the lessee accounting model • **Recognise a net investment in the sublease** and evaluate it for impairment	• **Continue** to account for the **lease liability and ROU asset on the head lease** • If the total remaining carrying amount of the ROU asset on the head lease exceeds the anticipated sublease income, this may indicate that the ROU asset associated with the head lease is impaired (as per Ind AS 36)
Statement of Profit and Loss	• Recognise finance income from sub-lease • Charge interest expense on head lease	• Recognise finance income from sub-lease • Charge depreciation and interest expense on lease liability

- However, when the head lease is a short-term lease, the sublease is classified as an operating lease.
- Lessor may use the discount rate for the head lease (**adjusted for initial direct costs, if any, associated with the sublease**) to measure the net investment in the sublease, if the interest rate implicit in the lease cannot be readily determined.
- When contracts are entered into at or near the same time, an intermediate lessor is required to consider the criteria for **combining contracts**. If the contracts are required to be combined, the intermediate lessor accounts for the head lease and sublease as a **single combined transaction**.
- An intermediate lessor who subleases, or expects to sublease an asset, **CANNOT** account for the head lease as a lease of a low-value asset **even when** the required criteria w.r.t. 'leases of low-value assets' are satisfied.

Sub-lessee Accounting

A sub-lessee accounts for its lease as a new lease following Ind AS 116's recognition and measurement provisions for accounting in the books of lessee.

Presentation	Intermediate lessors are **not permitted** to offset • lease liabilities and lease assets that arise from a head lease and a sublease, respectively, **unless** those liabilities and assets meet the requirements in Ind AS 1 for offsetting. • depreciation and interest expenses and lease income relating to a head lease and a sublease of the same underlying asset, respectively, **unless** the requirements for offsetting in Ind AS 1 are met.
Disclosure	Entities **(including intermediate lessors)** are required to disclose **qualitative** and **quantitative** information which gives a **basis** for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor (refer the disclosures for 'lessors' and 'lessees')

Sale and Leaseback Transactions

A sale and leaseback transaction involves two transactions:
- the transfer (sale) of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and
- the leaseback of the same asset by the seller-lessee.

How to determine whether the transfer of an asset is a sale:

When determining whether the transfer of an asset should be accounted for as a sale or purchase, both the seller-lessee and the buyer-lessor shall apply the requirements of Ind AS 115 on when an entity satisfies a performance obligation by transferring **'control'** of an asset.

If Control is passed	*If Control is NOT passed*
If the control of an underlying asset is **passed** to the buyer-lessor, the transaction is accounted for as a **'sale or purchase'** of the asset and a **'lease'**.	If the control of an underlying asset is **NOT passed** to the buyer-lessor, both the seller-lessee and the buyer-lessor account for the transaction as a **'financing transaction'**.

Note: If the seller-lessee has a **'substantive repurchase option'** for the underlying asset (i.e., a right to repurchase the asset), **'NO sale'** has occurred because the buyer-lessor has **NOT** obtained control of the asset.

Accounting Treatment for Sale and Leaseback Transaction

Particulars	Seller-lessee	Buyer-lessor
Transfer of asset is a sale	**Apply accounting for sale** • Recognise the cash received • Derecognise the underlying asset **Apply ROU Accounting** • Apply the lessee accounting model to the leaseback asset • Measure the ROU asset at the retained portion of the previous carrying amount • Recognise a gain or loss related to the portion of the assets transferred to the buyer-lessor	• Recognise the underlying asset based on the nature of the asset • Apply the lessor accounting model to leaseback asset
Transfer of asset is not a sale	• Continue to recognise the underlying asset • Account for the transaction as financing transaction • Recognise a financial liability under Ind AS 109 for any amount received from the buyer-lessor • Decrease the financial liability by the payments made (as and when) less the portion considered as interest expense	• Do not recognise the underlying asset • Recognise a financial asset under Ind AS 109 for any amount paid to the seller-lessee i.e. account for the amount paid as a receivable

Note:
- When a sale occurs, both the seller-lessee and the buyer-lessor account for the leaseback in the same manner as any other lease (**with adjustments for any off-market terms**).
- A seller-lessee recognises a lease liability and ROU asset for the leaseback (**subject to the optional exemptions** for short-term leases and leases of low-value assets).

An entity shall make the following adjustments to measure the sale proceeds at fair value if:
- the fair value of the consideration for the sale of an asset does not equal the fair value of the asset ***OR***
- the payments for the lease are not at market rates

Following are the two possibilities of the sale price ***OR*** the present value of the lease payments being 'less' or 'greater' than the fair value of the asset ***OR*** present value of the market lease payments:

When Sale Price or Present Value is LESS	*When Sale Price or Present Value is GREATER*
Using the more readily determinable basis: • When the sale price is **LESS** than the underlying asset's fair value ***OR*** • The present value of the lease payments is **LESS** than the present value of the market lease payments, A seller-lessee recognises the difference as an **increase** to the sales price and the initial measurement of the ROU asset as a **'lease prepayment'**.	Using the more readily determinable basis: • When the sale price is **GREATER** than the underlying asset's fair value ***OR*** • The present value of the lease payments is **GREATER** than the present value of the market lease payments, A seller-lessee recognises the difference as a **reduction** in the sales price and an **'additional financing received'** from the buyer-lessor.
Buyer-lessors are also required to **adjust the purchase price** of the underlying asset for any off-market terms. Such adjustments are recognised as: - **'lease prepayments'** made by the seller-lessee ***OR*** - **'additional financing provided'** to the seller-lessee.	

Disclosure

A seller-lessee is also required to disclose any gains and losses arising from sale and leaseback transaction separately from gains and losses on disposals of other assets under Ind AS 116.

Additional information relating to sale and leaseback transactions depending on the circumstances, may need disclosure that helps users of financial statements to assess, *for e.g.*:

(a) The lessee's reasons for sale and leaseback transactions and the prevalence of those transactions

(b) Key terms and conditions of individual sale and leaseback transactions

(c) Payments not included in the measurement of lease liabilities

(d) The cash flow effect of sale and leaseback transactions in the reporting period

Transition Approach

Transition exemption on lease definition

- Either: Apply the new definition to **all contracts**
- Or: Apply practical expedients and grandfather assessment for existing contracts and apply the new definition **only to new contracts**

Practical Expedient

- This exemption must be applied either for all contracts or none **i.e. cherry picking is not permitted**
- This exemption does not mean that previously identified operating leases can remain off-balance sheet for lessee (unless qualify for a recognition exemption). It merely saves the entity the costs and effort of reassessing)
- If the exemption is elected, the new definition of a lease is applied only to contracts entered into or changed on or after initial application
- Disclosure is required if a practical expedient is elected

Transition Options for Lessees

Retrospective approach

Restate comparatives as if Ind AS 116 has always been applied

Modified approach (Do not change comparative financial statements

- Recognise difference between asset and liability in opening Retained Earnings at transition date
- Calculate present value of remaining lease payments for existing operating leases using incremental borrowing rate at date of transition
- Choose how to measure ROU asset on **lease by lease basis**

Operating lease under previous GAAP

- **ROU ≠ Lease liability**
  - Measure asset as if Ind AS 116 had been applied from lease commencement (but using incremental borrowing rate at date of transition)
- **ROU = Lease liability**
  - Measure asset at amount equal to liability (adjusted for accruals and prepayments)

Finance lease under previous GAAP

- ROU = Carrying value of previous GAAP
- Lease liability = Carrying value of previous GAAP

Note:

- A lessee applies Ind AS 36 to ROU assets at the date of initial application, unless the lessee applies the practical expedient for onerous leases.
- A lessee is not required to make adjustments on transition for 'leases of low-value assets' (which is one of the recognition exemptions under Ind AS 116)

Additionally, a lessee is also permitted to apply the following practical expedients to leases previously classified as operating leases (when applying modified retrospective approach), on a **lease-by-lease basis:**

Discount rate	Apply a single discount rate to a portfolio of leases with reasonably similar characteristics
Onerous contracts	Rely on its assessment of whether leases are onerous by applying Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets as opposed to performing an impairment review
Short term leases	Not recognise leases whose term ends within 12 months of the date of initial application of Ind AS 116. If this election is taken, these leases are accounted for as short-term leases
Initial direct cost	Exclude initial direct costs from the measurement of right-of-use assets at the date of initial application
Hindsight	Use hindsight, such as in determining the lease term for leases that contain options

Disclosures

Disclosure requirements vary in accordance with the Transition Approach opted. The lessee shall disclose the following as required by Ind AS 8 (except that it is impracticable to determine the amount of the adjustment):

Full Retrospective Approach	***Modified Retrospective Approach***
(a) the title of the Ind AS;	(a) the title of the Ind AS;
(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;	(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
(c) the nature of the change in accounting policy;	(c) the nature of the change in accounting policy;
(d) when applicable, a description of the transitional provisions;	(d) when applicable, a description of the transitional provisions;
(e) when applicable, the transitional provisions that might have an effect on future periods;	(e) when applicable, the transitional provisions that might have an effect on future periods;
(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment: (i) for each financial statement line item affected; and (ii) if Ind AS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;	(f) the weighted average lessee's incremental borrowing rate applied to lease liabilities recognised in the balance sheet at the date of initial application; and an explanation of any difference between: (i) operating lease commitments disclosed applying Ind AS 17 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application; and (ii) lease liabilities recognised in the balance sheet at the date of initial application.
(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and	(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
(h) if retrospective application required by Ind AS 8 is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.	(h) if retrospective application required by Ind AS 8 is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied. Further, if a lessee uses one or more of the practical expedients (already discussed above), it shall disclose that fact.

Transition Options for Lessors

- A lessor is **not required** to make any adjustments on transition for leases in which it is a lessor and account for those leases applying Ind AS 116 from the date of initial application.
- However, in case of an ***'Intermediate Lessor',*** the entity shall:
  - (a) **reassess subleases that were classified as operating leases applying Ind AS 17 and are ongoing at the date of initial application,** to determine whether each sublease should be classified as an operating lease or a finance lease applying Ind AS 116. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date with reference to the ROU Asset associated with the head lease and not the underlying asset.
  - (b) **for subleases that were classified as operating leases applying Ind AS 17 but, finance leases applying Ind AS 116,** account for the **sublease as a new finance lease** entered into at the date of initial application. Any gain or loss arising on the sublease arrangement is included in the cumulative catch-up adjustment to retained earnings at the date of initial application.

Sale and Leaseback Transactions before the date of Initial Application

- An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements under Ind AS 115 to be accounted for as a sale.
- Leaseback is accounted for on transition in the following manner, depending on the classification:

Finance Lease	*Operating Lease*
If a sale and leaseback transaction was accounted for as a sale and a **finance lease** applying Ind AS 17, the seller-lessee shall: (a) account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application ***AND*** (b) continue to amortise any gain on sale over the lease term.	If a sale and leaseback transaction was accounted for as a sale and **operating lease** applying Ind AS 17, the seller-lessee shall: (a) account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; ***AND*** (b) adjust the leaseback ROU asset for any deferred gains or losses that relate to off-market terms recognised in the balance sheet immediately before the date of initial application.

Amounts Previously Recognised in respect of Business Combinations

The lessee shall
- Derecognise the acquired asset or liability and
- Adjust the carrying amount of the ROU asset by a corresponding amount at the date of initial application.

Amendment in Accounting of Rent Concessions arising due to COVID-19 Pandemic

Following amendments have been made with respect to accounting of COVID-19 related rent concessions such as rent holidays and temporary rent reductions:

As a practical expedient, a lessee **may elect not to assess** a rent concession as a lease modification **only** if **ALL** of the following conditions are met:

a) the change in lease payments results in revised consideration for the lease that is **substantially the same as, or less** than, the consideration for the **lease immediately preceding the change;**

b) any reduction in **lease payments affects only payments originally due on or before the 30th June, 2022*** (for example, a rent concession would meet this condition if it results in **reduced lease payments on or before the 30th June, 2022* and increased** lease payments that **extend beyond the 30th June, 2022***); and

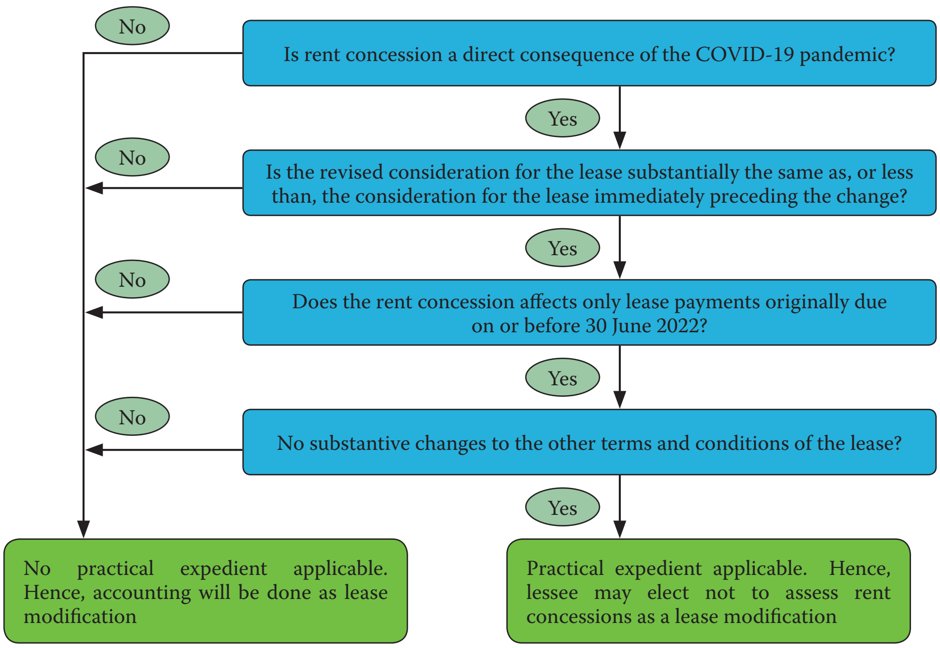
c) there is **no substantive change** to other terms and conditions of the lease.

A lessee that makes this election shall account for any change in lease payments resulting from the rent concession as if the change were not a lease modification.

Note: The above practical expedient **applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic.**

*As per the amendment made by the MCA on 18th June, 2021.

The key conditions for applying the practical expedient are as follows:



Disclosures

Lessees applying practical expedient are required to disclose:

a. The fact that if they have applied the practical expedient to all eligible rent concessions and, if not, the nature of contracts to which they have applied the practical expedient and

b. The amount recognized in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.

Note: The disclosure requirements of paragraph 28(f) of Ind AS 8 do not apply on initial application of these amendments.

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