CHAPTER 15

ANALYSIS OF FINANCIAL STATEMENTS



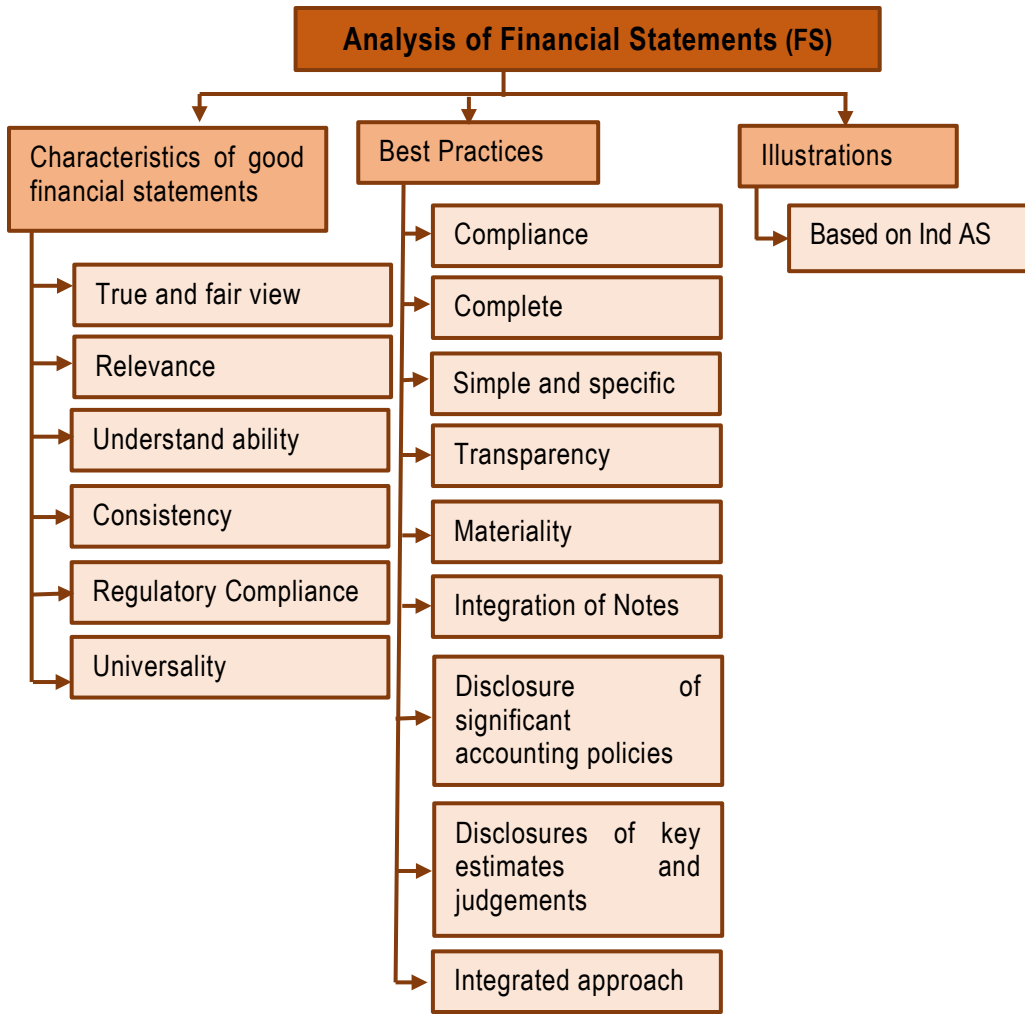
LEARNING OUTCOMES

After studying this chapter, you would be able to:

- Examine the key features of the financial statements and its relevancy for better reporting.
- Examine the key factors to be kept in mind in the preparation of financial statements.
- Follow the best practices in the preparation of financial statements.
- Analyse the common mistakes incurred by the preparers of the financial statements in the presentation of financial statements with respect to Schedule III.
- Rectify the mistakes found in the financial statements by addressing the issues and prescribing the correct presentation and disclosures.

© The Institute of Chartered Accountants of India

CHAPTER OVERVIEW



© The Institute of Chartered Accountants of India

1. INTRODUCTION

Business is important organ of society that helps in its overall development. A typical business has a variety of stakeholder that include its employees, owners, banks, trade associations, government, general public and so on. These stakeholders, particularly investors are keenly interested in knowing about the financial well-being of business organisations.

Financial reporting is an important means of communication for entities to disseminate information of its operations to various stakeholders. With the increased focus on governance the significance of financial reporting has exponentially increased. The importance of robust financial reporting cannot be emphasized enough. As India and Indian enterprises move ahead in the growth path at much faster pace and exposure of Indian entities to global environment expands, ever increasing complexities of transactions throws up newer challenges in financial reporting and related guidance. Presentation and disclosures, in this context, are assuming greater significance as enterprises aim to achieve excellence in financial reporting. Today, there are a number of requirements mandated by the regulators. It has now become imperative for entities to keep pace with the fast-evolving requirements in the area of financial reporting.

The financial statements are a source of critical communication between an entity and the investors and other stakeholders. They act as the barometer to assess the performance, both past and future, for any enterprise. Decades back when enterprises were mostly proprietary owned, the financial statements were simpler in content and were presented annually just to provide the historical data. However, with globalization and increased dependence on technology, where companies are expanding both horizontally and vertically, many even spanning across geographies; the number of stakeholders – be it be investors, suppliers, employees, or even tax authorities, have increased manifold.

The financial statements are supplemented with the disclosures which are the key source of information and help the users in interpreting the financial statements in a better manner in taking appropriate decisions. Therefore, one can say that disclosures are added for good reasons. Disclosures are not the only requirement which will make a financial statement to be a good financial statement. The presentation and the compliance of formats are also the important factors which are taken into consideration in the evaluation of a financial statement.

This chapter enumerates some of the practices currently being followed in financial reporting and sets out suggested 'best practice' to enhance the quality of financial reporting to enable preparers of financial statements in benchmarking their financial statements. It intends to bring to the notice of the preparers and reviewers of the financial statements some common errors or omissions which they shall avoid while preparing the financial statements.

© The Institute of Chartered Accountants of India

2. FINANCIAL STATEMENTS OF CORPORATE ENTITIES

The format and content of the financial statements for companies is required to be in accordance with Schedule III to the Companies Act, 2013. Further, there are several additional disclosure requirements both with respect to the balance sheet and statement of profit and loss.

Certain industries have formats specified by their industry regulators, which need to be followed by them. This fact has also been recognised in the Companies Act, 2013 in the proviso to Section 129(1) which implies that the format set out in Schedule III will not be applicable to insurance companies and banking companies. The formats for these companies are prescribed by specific regulators.

In terms of format, Schedule III only prescribes the vertical format of balance sheet and does not provide the alternative of using the horizontal format. Further, Schedule III sets out the minimum requirements for disclosure on the face of the balance sheet and the statement of profit and loss. It allows line items, sub-line items and sub-totals to be presented as an addition or substitution on the face of the financial statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Standards. Schedule III now requires all disclosures to be made as a part of the notes.

Apart from granting an overriding status to the Standards, cognizance has also been given to the requirements of Standards in the format of the balance sheet and accordingly elements such as deferred tax assets and intangible assets have been included in the balance sheet. Also, it has been clearly stated that the disclosure requirements specified in Part I and Part II or Part III of the Schedule III are in addition to and not in substitution of the disclosure requirements specified in the respective notified Standards. The terms used in Schedule III are to be considered as per the respective notified Standards.

One of the pertinent aspects which needs to be considered in the preparation of financial statements with regard to Schedule III is that it does not prescribe the accounting treatment to be adopted by the entity; it only prescribes the format and content. Consequently, the fact that a particular item has been included in the format of the balance sheet in Schedule III does not imply that the particular item can be recognized in the balance sheet. Schedule III prescribes only presentation and not treatment which is a subject matter of Standards, which has also been specifically acknowledged in Schedule III.

© The Institute of Chartered Accountants of India

3. CHARACTERISTICS OF GOOD FINANCIAL STATEMENTS

In the Indian scenario, the ICAI has been the recognized accounting body issuing generally accepted accounting policies and has made the standards mandatory for enterprises operating within India. Besides Accounting Standards, ICAI has also issued the converged set of Ind AS that is adopted and notified by MCA, and many large entities have already implemented it or are in the transition phase for adoption (depending on the net worth or other specified criteria).

The key features to any set of financial statements are:

1. **True and fair view of the affairs of the enterprise:** This is the most important feature of any set of financial statements. The user of the financial statements depends fully on the same and hence the reliability factor is supreme.

2. **Relevance:** The financial statements should provide the relevant information for the period it is presented. There is no point in presenting historical data of past several years that are redundant as of date. The key here is that the user of the financial statements should be in a position to take independent decision after reading the financial statements. This decision can be different for different users – for an investor the decision whether to hold the shares of the enterprise will stem from the set of statements, for a senior employee of the company it can be the future growth prospects of the company etc. But what is important is that the users should be empowered to make decisions through the financial statements

3. **Understandability:** For the user to make sense, the financial statements should be readable and content lucid to digest. Even a layman should be able to read the same, and understand the basic information, if not the accounting policies and procedures.

4. **Consistency:** The users of the financial statements will be benefitted only if the statements are released in periodic intervals and in standard formats. Else, the entire purpose of furnishing financials will be defeated. That is the reason that laws are prescribed for presentation formats and periodicity.

5. **Regulatory Compliance:** Needless to say, the tax authorities, market regulators etc. rely hugely on financial statements to understand and gauge the compliances met by the enterprise.

6. **Universality:** Last but not the least; the financial statements should be comparable both within the industry and outside. So financial statements by two different companies

© The Institute of Chartered Accountants of India

should look in similar lines if both are engaged in, say, manufacturing steel. Likewise, the financials of a company manufacturing steel in India should be comparable to the set of financial statements of a company based out of US engaged in the similar line of business.

The need to have the above key characteristics have brought the accounting bodies world over to come together to have a set of common standards for better integration and harmonization of accounting principles and practices.



4. BEST PRACTICES - APPLICABLE TO ALL COMPANIES

Following are some of the practices, if followed by the preparers of the financial statements, it would lead to better presentation and disclosure and will also serve the meaningful purpose for various stakeholders in understanding the functioning, financial position and financial performance of the entity and in appropriate decision making:

© The Institute of Chartered Accountants of India

1. Compliance

Financial reporting is a regulated activity and compliance with the requirements is a must. Comply with the standards and regulations but also ensure your financial statements are an effective part of your wider communication with your stakeholders. It should be simple and understandable without any change in the interpretation.

2. Complete

The information disclosed in the financial statements should be complete and should not lead to any further cross questioning in the mind of the users. Ensure consistency of disclosures across the financial statements.

Example :

Where the accounting policy states that "Balances of debtors, creditors and loans and advances are subject to reconciliations and confirmations". This indicates that these balances may or may not be appropriately stated as well as raising questions regarding the appropriateness of the audit process.

3. Simple and specific

- Draft your notes, accounting policies, commentary on more complex areas in simple and plain English. Ensuring that there are no vague or ambiguous notes.

Example :

The definition of a derivative and a hedged item and how the company uses such items:

"A derivative is a type of financial instrument the company uses to manage risk. It is something that derives its value based on an underlying asset. It's generally in the form of a contract between two parties entered into for a fixed period. Underlying variables, such as exchange rates, will cause its value to change over time. A hedge is where the company uses a derivative to manage its underlying exposure. The company's main exposure is to fluctuation in foreign exchange risk. We manage this risk by hedging forex movements, in effecting the boundaries of exchange rate changes to manageable, affordable amounts."

- Make your policies clear and specific.
- Ensure that there should not be any vague or ambiguous notes, with no further information or explanation which may lead to misinterpretation of information.

© The Institute of Chartered Accountants of India

- Reduce generic disclosures and focus on company specific disclosures that explain how the company applies the policies.

Example :

A note stated "Land not registered in the name of the company has been given for the use of group companies". However, there are no disclosures regarding such lease elsewhere in the financial statements. This leads to ambiguity regarding whether the land has been capitalized in the books of account or not.

A better disclosure would be to include this note in the note relating to 'Property, plant and Equipment' with an asterix against land and a note which states "Land includes area measuring XX acres, towards which the registration process is still in progress. This land has been given on lease to group companies."

4. Transparency

In preparation of financial statements many a times certain assumptions, or other bases are taken. Disclose those assumptions and bases transparently, so that they users are not misled. Rather such transparency shall provide useful additional information and substantiate your decision/judgement.

5. Materiality

- The lack of clarity in how to apply the concept of materiality is perceived to be one of the main drivers for overloaded financial statements. Make effective use of materiality to enhance the clarity and conciseness of your financial statements.
- Information should only be disclosed if it is material. It is material if it could influence users' decisions which are based on the financial statements.
- Your materiality assessment is the 'filter' in deciding what information to disclose and what to omit.
- Once you have determined which specific line items require disclosure, you should assess what to disclose about these items, including how much detail to provide and how best to organise the information.

Example: Capital Commitments

A company has committed to purchase several items of property, plant and equipment. Individually each purchase is immaterial. However, the total amounts to a

© The Institute of Chartered Accountants of India

material commitment for the company and therefore some disclosure should be made regarding this commitment.

Example : New Revenue Stream

A company in the software sector has communicated to its stakeholders a strategic intention to focus its new development efforts in cloud-based solutions. In a particular financial year cloud-based revenues are less than 5% of the total but have grown rapidly. The company therefore decides to provide separate disclosure about this revenue stream in accordance with Ind AS 108 'Operating Segments' even though other revenue streams of similar size are typically combined into 'other revenue.'

6. Integration of Notes

- Notes cover the largest portion of the financial statements. They are an effective tool of communication and have the greatest impact on the effectiveness of your financial statements.
- Group notes into categories, place the most critical information more prominently or a combination of both.
- Integrate your main note of a line item with its accounting policy and any relevant key estimates and judgements.

Example: Inventories

1. Accounting Policy

Inventories are stated at the lower of cost and net realisable value. Cost includes all expenses directly attributable to the manufacturing process as well as suitable portions of related production overheads, based on normal operating capacity. Costs of ordinarily interchangeable items are assigned using the first in, first out cost formula. Net realisable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

2. Significant Estimation of Uncertainty

Management estimates the net realisable values of inventories, taking into account the most reliable evidence available at each reporting date. The future realisation of these inventories may be affected by future technology or other market-driven changes that may reduce future selling prices.

© The Institute of Chartered Accountants of India

3.	Inventories consist of the following:	(₹ in crores)	
		31st March, 20X2	31st March, 20X1
	Raw materials and consumables	7,000	6,000
	Merchandise	11,000	9,000
		18,000	15,000

- Ensuring that the accounting policies are disclosed in one place and not scattered across various notes.

  For example, in one case it was observed that the policy of recognizing 100% depreciation on assets costing less than ₹ 5,000 was specified in the note on fixed assets, rather than in the accounting policy for fixed assets.

7. Disclosure of Material Accounting Policies

- The financial statements should disclose your material accounting policies. Disclose only your material accounting policies – remove your non-material disclosures that do not add any value.
- Your disclosures should be relevant, specific to your company and explain how you apply your policies.
- The aim of accounting policy disclosures is to help your investors and other stakeholders to properly understand your financial statements.
- Use judgement to determine whether your accounting policies are material, considering not only the materiality of the balances or transactions affected by the policy but also other factors including the nature of the company's operations.

Example:

Taxable temporary differences arise on certain brands and licenses that were acquired in past business combinations. Management considers that these assets have an indefinite life and are expected to be consumed by use in the business. For these assets deferred tax is recognised using the capital gains tax applicable on sale.

© The Institute of Chartered Accountants of India

8. Disclosures of Key Estimates and Judgements

- Effective disclosures about the most important estimates and judgements enable investors to understand your financial statements.
- Focus on the most difficult, subjective and complex estimates.
- Include details of how the estimate was derived, key assumptions involved, the process for reviewing and an analysis of its sensitiveness.
- Provide sufficient background information on the judgement, explain how the judgement was made and the conclusion reached.

9. Integrated Approach

- Financial statements are just one part of your communication with the stakeholders. An annual report typically includes financial statements, a management commentary and information about governance, strategy and business developments, CSR Reporting, Business Responsibility Reporting etc. There is also a growing trend towards integrated reporting.
- To ensure overall effective communication consider the annual report as a whole and deliver a consistent and coherent message throughout.
- Ind AS 1 also acknowledges that one may present, outside the financial statements, a financial review that describes and explains the main features of the company's financial performance and financial position, and the principal uncertainties it faces.
- Many companies also present, outside the financial statements, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group.
- Even though the reports and statements presented outside financial statements are outside the scope of AS / Ind AS, they are not out of the scope of regulation.

Example :

CSR disclosures, as required by the Companies Act, 2013. in section 134 and Schedule VII.

© The Institute of Chartered Accountants of India

5. CASE STUDIES BASED ON IND AS

Case Study 1

On 1 April 20X1, Star Limited has advanced a housing loan of ₹ 15 lakhs to one of its employees at an interest rate of 6% per annum which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit. The market rate of similar loan for housing finance by banks is 10% per annum.

The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. ₹ 15 lakhs. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e. ₹ 90,000 (6% of ₹ 15 lakhs).

Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 20X1-20X2 along with workings and applicable Ind AS.

You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance Sheet of Star Limited on 31 March 20X2.

Solution

The accounting treatment made by the accountant is not in compliance with Ind AS 109 'Financial Instruments'. As per Ind AS 109, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value. The fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received.

After initial recognition, an entity shall measure a financial asset either at amortised cost or at fair value through profit and loss or fair value through other comprehensive income.

Here, the loan given to employee is not at market rate. Hence, the fair value of the loan will not be equal to its initial loan proceeds. As per Ind AS 109, a financial instrument is initially measured and recorded in the books at its fair value. Further, interest income to be recognised in the Statement of Profit and Loss will be the finance income recognised at effective rate of interest i.e. @ 10% and not the rate of interest charged by the company i.e. @ 6%.

The correct accounting treatment as per Ind AS 109 will be as under:

For measuring the fair value or present value of the loan at initial recognition, market rate of interest of similar loan is considered (level 1 observable input) ie @ 10%, to discount the cash outflows.

© The Institute of Chartered Accountants of India

The fair value of the loan shall be as follows:

Date	Outstanding loan	Principal	Interest income @ 6%	Total inflow	Discount factor @ 10%	PV
31 March 20X2	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31 March 20X3	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31 March 20X4	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31 March 20X5	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31 March 20X6	3,00,000	3,00,000	18,000	3,18,000	0.621	1,97,478
Fair value of the loan						13,54,602

As per Ind AS 19, employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for termination of employment. Difference of loan proceeds and present value of the loan (fair value) will be treated as prepaid employee cost irrespective of the fact that employee is not required to give any specific performance against this benefit. This is because employee is required to be in service of the company to continue availing the benefits of concessional rate of interest on housing loan. Practically, once the employee leaves the organisation, they have to repay the outstanding loan because the company provides the loan at concessional rate of interest only to its employees.

Hence, it is an employee benefit given by the company to its employees. This deemed employee cost of ₹ 1,45,398 (15,00,000 – 13,54,602) will be deferred and amortised over the period of loan on straight line basis.

Calculation of amortised cost of loan to employees

Financial year ending on 31 March	Amortised cost (opening balance)	Interest to be recognised @ 10%	Repayment (including interest)	Amortised cost (closing balance)
20X2	13,54,602	1,35,460	3,90,000	11,00,062
20X3	11,00,062	1,10,006	3,72,000	8,38,068
20X4	8,38,068	83,807	3,54,000	5,67,875
20X5	5,67,875	56,788	3,36,000	2,88,663
20X6	2,88,663	29,337*	3,18,000	-

* 2,88,663 x 10% = ₹ 28,866. Difference of ₹ 471 (29,337 – 28,866) is due to approximation in computation.

© The Institute of Chartered Accountants of India

Journal Entries to be recorded at every period end:

1. On 1 April 20X1

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan to employee A/c	Dr.	13,54,602	
Prepaid employee cost A/c	Dr.	1,45,398	
To Bank A/c			15,00,000
(Being loan asset recorded at initial fair value)			

2. On 31 March 20X2

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	3,90,000	
To Finance income A/c (profit and loss) @10%			1,35,460
To Loan to employee A/c			2,54,540
(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate @ 10%)			
Employee benefit cost (profit and loss) A/c	Dr.	29,080	
To Prepaid employee cost A/c (1,45,398/5)			29,080
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)			

The Following housing loan balances should appear in the financial statements:

Extracts of Balance sheet of Star Ltd. as at 31 March 20X2

Non-current asset	
Financial asset	
Loan to employee (11,00,062 – 3,72,000 + 1,10,006)	8,38,068
Other non-current asset	
Prepaid employee cost	87,238
Current asset	
Financial asset	
Loan to employee (3,72,000-1,10,006)	2,61,994
Other current asset	
Prepaid employee cost	29,080

© The Institute of Chartered Accountants of India

Deferred tax on temporary differences arising on the above-mentioned account balances (appearing in the balance sheet) should be recognised. However, in the absence of any tax rate in the question no deferred tax has been recognised.

Case Study 2

Pluto Ltd. has purchased a manufacturing plant for ₹ 6 lakhs on 1st April, 20X1. The useful life of the plant is 10 years. On 30th September, 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.

Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September, 20X3 and 31st March, 20X4 was ₹ 4 lakhs and ₹ 3.5 lakhs respectively.

The accountant has performed the following working: ₹

Carrying amount on initial classification as held for sale		
Purchase Price of Plant	*6,00,000*	
Less: Accumulated dep (6,00,000/ 10 Years) x 2.5 years	*(1,50,000)*	*4,50,000*
Fair Value less cost to sell as on 30th September, 20X3		*4,00,000*
The value will be lower of the above two		*4,00,000*

Balance Sheet extracts as on 31st March, 20X4

Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	*3,50,000*

Analyse whether the above accounting treatment made by the accountant is in compliance with Ind AS. If not, advise the correct treatment alongwith the necessary workings.

Solution:

The above treatment needs to be examined in the light of the provisions given in Ind AS 16 '*Property, Plant and Equipment*' and Ind AS 105 '*Non-current Assets Held for Sale and Discontinued Operations'*.

© The Institute of Chartered Accountants of India

Para 6 of Ind AS 105 *'Non-current Assets Held for Sale and Discontinued Operations'* states that:

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

Paragraph 7 of Ind AS 105 states that:

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

Further, paragraph 8 of Ind AS 105 states that:

"For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."

Paragraph 13 of Ind AS 105 states that:

"An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use."

Paragraph 14 of Ind AS 105 states that:

"An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned."

Paragraph 55 of Ind AS 16 states that:

"Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated."

Going by the guidance given above,

© The Institute of Chartered Accountants of India

The Accountant of Pluto Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. Pluto Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet is given as below:

Calculation of carrying amount as on 31st March, 20X4	
Purchase Price of Plant	6,00,000
Less: Accumulated depreciation (6,00,000/ 10 Years) x 3 Years	(1,80,000)
	4,20,000
Less: Impairment loss	(70,000)
	3,50,000

Balance Sheet extracts as on 31st March, 20X4

Assets	
Non-Current Assets	
Property, Plant and Equipment	3,50,000

Working Note:

Fair value less cost to sell of the Plant = ₹ 3,50,000

Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. ₹ 3,50,000

Impairment loss = Carrying amount – Recoverable amount

Impairment loss = ₹ 4,20,000 - ₹ 3, 50,000 = ₹ 70,000.

© The Institute of Chartered Accountants of India

Case Study 3

On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March, 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

The accountant of Jupiter Ltd treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows: ₹ lakhs

Cost	*8.00*
Net realisable value (9.6 -2)	*7.60*
Inventories (lower of cost and net realisable value)	*7.60*

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Solution:

The above treatment needs to be examined in the light of the provisions given in Ind AS 10 *'Events after the Reporting Period'* and *Ind AS 2 'Inventories'*.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

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

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

Further, paragraph 10 of Ind AS 10 states that:

"An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period".

© The Institute of Chartered Accountants of India

Further, paragraph 6 of Ind AS 2 defines:

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

Further, paragraph 9 of Ind AS 2 states that:

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

Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 '*Events After the Reporting Date'* is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.

Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of ₹ 8 Lakhs calculated below: *₹ lakhs*

Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Case Study 4

On 1st April, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for ₹ 30 lakhs. Sun Ltd. has 3 cash-generating units A, B and C with fair value of ₹ 12 lakhs, ₹ 8 lakhs and ₹ 4 lakhs respectively. The company recognizes goodwill of Rs 6 lakhs that relates to CGU 'C' only.

During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment.

Analyse whether the view adopted by the CFO of Sun Ltd is in compliance of the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS

Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 36: Impairment of Assets.

© The Institute of Chartered Accountants of India

Para 9 of Ind AS 36 *'Impairment of Assets'* states that *"An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."*

Further, paragraph 10(b) of Ind AS 36 states that:

"Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually."

Sun Ltd has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence, the treatment made by the Company is not in accordance with Ind AS 36.

Accordingly, impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

Case Study 5

Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ₹ 30,000 for the incorporation of company and to do other necessary statuary registrations. ₹ 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 20X1.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 20X2 as follows:

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	**11,00,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000

© The Institute of Chartered Accountants of India

Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	**7,45,000**
Profit before tax (c) = (a)-(b)	**3,55,000**
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	**1,12,500**
Profit for the year (e) = (c) – (d)	**2,42,500**

Balance Sheet

Particulars	Amount (₹)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
TOTAL	**5,21,000**
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	**5,21,000**

© The Institute of Chartered Accountants of India

Additional information of Softbharti Pvt Ltd.:

i. Deferred tax liability of ₹ 6,000 is created due to following temporary difference:

Difference in depreciation amount as per Income tax and Accounting profit

ii. There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 20X2 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	₹ 1,00,000	₹ 80,000

iii. Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.

iv. Current tax is calculated at 30% on PBT - ₹ 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to ₹ 1,25,700.

v. After the reporting period, the directors have recommended dividend of ₹ 15,000 for the year ending 31st March, 20X2 which has been deducted from reserves and surplus. Dividend payable of ₹ 15,000 has been grouped under 'other current liabilities' alongwith other financial liabilities.

vi. There are 'Government statuary dues' amounting to ₹ 15,000 which are grouped under 'other current liabilities'.

vii. The capital advances amounting to ₹ 50,000 are grouped under 'Other non-current assets'.

viii. Other current assets of ₹ 51,000 comprise Interest receivable from trade receivables.

ix. Current investment of ₹ 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ₹ 50,000 as at 31st March, 20X2.

x. Actuarial gain on employee benefit measurements of ₹ 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 20X2.

The financial statements for financial year 20X1-20X2 have not been yet approved.

You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information.

© The Institute of Chartered Accountants of India

Solution

If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of set of standards on such companies.

In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly, the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. have been presented as per accounting standards (AS).

Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.

The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS
for the year ended 31st March, 20X2

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	**11,20,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses	**7,45,000**
Profit before tax	**3,75,000**
Current tax	1,25,700
Deferred tax (W.N.1)	4,800
Total tax expense	**1,30,500**
Profit for the year (A)	**2,44,500**

© The Institute of Chartered Accountants of India

OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss:	
Remeasurements of net defined benefit plans	**1,000**
Tax liabilities relating to items that will not be reclassified to Profit or Loss	
Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	**700**
Total Comprehensive Income for the period (A+B)	**2,45,200**

BALANCE SHEET

as at 31st March, 20X2

Particulars	(₹)
ASSETS	
Non-current assets	
Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans and advances)	40,000
Other non-current assets (capital advances) (refer note-2)	50,000
Current assets	
Inventories	80,000
Financial assets	
Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	**5,41,000**
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,45,200

© The Institute of Chartered Accountants of India

Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Deferred tax liabilities (4800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statuary dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	**5,41,000**

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st March, 20X2

A. EQUITY SHARE CAPITAL

	Balance (₹)
As at 31st March, 20X1	-
Changes in equity share capital during the year	1,00,000
As at 31st March, 20X2	1,00,000

B. OTHER EQUITY

	Reserves & Surplus Retained Earnings (₹)
As at 31st March, 20X1	-
Profit for the year	2,44,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,45,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31st March, 20X2	2,45,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (refer note 4)

© The Institute of Chartered Accountants of India

Notes:

1. Current investment are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, ₹ 20,000 (₹ 50,000 – ₹ 30,000) increase in fair value of financial asset will be recognised in profit and loss. However, it will attract deferred tax liability on increased value (Refer W.N).
2. Assets 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.
3. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.
4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.
5. Other current financial liabilities:

	(₹)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 20X1 – 20X2 (Note – 4)	(15,000)
Reclassification of government statuary dues payable to 'other current liabilities'	(15,000)
Closing balance	15,000

Working Note:

Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 20X1 – 20X2

Item	Carrying amount (₹)	Tax base (₹)	Difference (₹)	DTA / DTL @ 30% (₹)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
Current Investment	50,000	30,000	20,000	6,000-DTL
			Net DTL	4,800-DTL

© The Institute of Chartered Accountants of India

Case Study 6

Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31 March 20X2.

(a) Owing to the proposed schedules of Indian Hockey League as well as Cricket Premier Tournament, Mumbai Challengers Ltd. needs a new stadium to host the sporting events. This stadium will form a part of the Property, Plant and Equipment of the company. Mumbai Challengers Ltd. began the construction of the stadium on 1 December, 20X1. The construction of the stadium was completed in 20X2-20X3. Costs directly related to the construction amounted to ₹ 140 crores in December 20X1. Thereafter, ₹ 350 crores have been incurred per month until the end of the financial year. The company has not taken any specific borrowings to finance the construction of the stadium, although it has incurred finance costs on its regular overdraft during the period, which were avoidable had the stadium not been constructed. Mumbai Challengers Ltd. has calculated that the weighted average cost of the borrowings for the period 1 December 20X1 to 31 March 20X2 amounted to 15% per annum on an annualized basis.

The company seeks advice on the treatment of borrowing costs in its financial statements for the year ending 31 March 20X2.

(b) Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.

At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of ₹ 49 crores.

© The Institute of Chartered Accountants of India

Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above.

(c) Mumbai Challengers Ltd. measures its stadiums in accordance with the revaluation model. An airline company has approached the directors offering ₹ 700 crores for the property naming rights of all the stadiums for five years. Three directors are on the management boards of both Mumbai Challengers Ltd. and the airline. Additionally, statutory legislations regulate the financing of both the cricket and hockey clubs. These regulations prevent contributions to the capital from a related party which 'increases equity without repayment in return'. Failure to adhere to these legislations could lead to imposition of fines and withholding of prize money.

Mumbai Challengers Ltd. wants to know how to take account of the naming rights in the valuations of the stadium and the potential implications of the financial regulations imposed by the legislations.

Solution:

(a) Borrowing Costs

As per Ind AS 23 *Borrowing Costs*, an entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e. an asset that necessarily takes a substantial period of time to get ready for its intended use or sale) as part of the cost of that asset. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period.

The capitalization rate of the borrowings of Mumbai Challengers Ltd. during the period of construction is 15% per annum (as given in the question), and therefore, the total amount of borrowing costs to be capitalized is the expenditures incurred on the asset multiplied by the capitalization rate, which is as under:

Particulars	₹ in crores
Costs incurred in December 20X1: (₹ 140 crores x 15% x 4/12)	7.000
Costs incurred in January 20X2: (₹ 350 crores x 15% x 3/12)	13.125

© The Institute of Chartered Accountants of India

Costs incurred in February 20X2: (₹ 350 crores x 15% x 2/12)	8.750
Costs incurred in March 20X2: (₹ 350 crores x 15% x 1/12)	4.375
Borrowing Costs to be capitalized in 20X1-X2	**33.250**

OR

Weighted average carrying amount of the stadium during 20X1-X2 is:

₹ (140 + 490 + 840 + 1,190) crores/4 = ₹ 665 crores

Applying the weighted average rate of borrowings of 15% per annum, the borrowing cost to be capitalized is computed as:

₹ 665 crores x (15% x 4/12) = ₹ 33.25 crores

(b) Players' Registrations

Acquisition

As per Ind AS 38 *Intangible Assets*, an entity should recognize an intangible asset where it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably. Accordingly, the **costs** associated with the acquisition of players' registrations would need to be **capitalized which would be the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire such registrations**. In line with Ind AS 38 *Intangible Assets*, costs would include transfer fees, league levy fees, and player agents' fees incurred by the club, along with other directly attributable costs, if any. Amounts capitalized would be fully amortized over the period covered by the player's contract.

Sale of registrations

Player registrations would be classified as assets held for sale under Ind AS 105 *Non-Current Assets Held for Sale and Discontinued Operations* when their carrying amount is expected to be recovered principally through a sale transaction and a sale is considered to be highly probable. To consider a sale to be 'highly probable', the assets (in this case, player registrations) should be actively marketed for sale at a price that is reasonable in relation to its current fair value. In the given case, it would appear that the management is committed to a plan to sell the registration, that the asset is available for immediate sale and that an active plan to locate a buyer is already in place by circulating clubs. Ind AS 105 stipulates that it should be unlikely that the plan to sell the registrations would be significantly changed or withdrawn. To fulfil this requirement, it would be prudent if only

© The Institute of Chartered Accountants of India

those registrations are classified as held for sale where unconditional offers have been received prior to the reporting date.

Once the conditions for classifying assets as held for sale in accordance with Ind AS 105 have been fulfilled, the player registrations would be stated at lower of carrying amount and fair value less costs to sell, with the carrying amount stated in accordance with Ind AS 38 prior to application of Ind AS 105, subjected to impairment, if any.

Profits and losses on sale of players' registrations would be computed by deducting the carrying amount of the players' registrations from the fair value of the consideration receivable, net of transactions costs. In case a portion of the consideration is receivable on the occurrence of a future performance condition (i.e. contingent consideration), this amount would be recognized in the Statement of Profit and Loss only when the conditions are met.

The players registrations disposed of, subsequent to the year end, for ₹ 175 crores, having a corresponding book value of ₹ 49 crores would be disclosed as a non-adjusting event in accordance with Ind AS 10 *Events after the Reporting Period*.

Impairment review

Ind AS 36 *Impairment of Assets* requires companies to **annually test their assets for impairment**. An asset is said to be impaired if the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is higher of the asset's fair value less costs to sell and its value in use (which is the present value of future cash flows expected to arise from the use of the asset). In the given scenario, it is not easy to determine the value in use of any player in isolation as that player cannot generate cash flows on his/her own unless via a sale transaction or an insurance recovery. Whilst any individual player cannot really be separated from the single cash-generating unit (CGU), being a cricket team or a hockey team in the instant case, there may be certain instances where a player is taken out of the CGU when it becomes clear that he/she will not play for the club again. If such circumstances arise, the **carrying amount of the player should be assessed against the best estimate of the player's fair value less any costs to sell and an impairment charge should be recognized in the profit or loss**, which reflects any loss arising.

(c) Valuation of stadiums

In terms of Ind AS 113 *Fair Value Measurement*, stadiums would be valued at the **price which would be received to sell the asset in an orderly transaction between market participants** at the measurement date (i.e. exit price). The price would be the one which

© The Institute of Chartered Accountants of India

maximizes the value of the asset or the group of assets using the principle of the highest and best use. The price would essentially use Level 2 inputs which are inputs other than quoted market prices included within Level 1 which are observable for the asset or liability, either directly or indirectly. Property naming rights present complications when valuing property. The status of the property indicates its suitability for inviting sponsorship attached to its name. It has nothing to do with the property itself but this can be worth a significant amount. Therefore, Mumbai Challengers Ltd. could include the property naming rights in the valuation of the stadium and write it off over three years.

Ind AS 24 *Related Party Disclosures* lists the criteria for two entities to be treated as related parties. Such criteria include being members of the same group or where a person or a close member of that person's family is related to a reporting entity if that person has control or joint control over the reporting entity. Ind AS 24 deems that parties are not related simply because they have a director or a key manager in common. In this case, there are three directors in common and in the absence of any information to the contrary, it appears as though the entities are not related. However, the regulator will need to establish whether the sponsorship deal is a related party transaction for the purpose of the financial control provisions. There would need to be demonstrated that the airline may be expected to influence, or be influenced by, the club or a related party of the club. If the deal is deemed to be a related party transaction, the regulator will evaluate whether the sponsorship is at fair value or not.

*****

Case Study 7

(a) Neelanchal Gas Refinery Ltd. (hereinafter referred to as Neelanchal), a listed company, is involved in the production and trading of natural gas and oil. Neelanchal jointly owns an underground storage facility with another entity, Seemanchal Refineries Ltd. (hereinafter referred to as Seemanchal). Both the companies are engaged in extraction of gas from offshore gas fields, which they own and operate independently of each other. Neelanchal owns 60% of the underground facility and Seemanchal owns 40%. Both the companies have agreed to share services and costs accordingly, with decisions relating to the storage facility requiring unanimous agreement of the parties. The underground facility is pressurised so that the gas is pushed out when extracted. When the gas pressure is reduced to a certain level, the remaining gas is irrecoverable and remains in the underground storage facility until it is decommissioned. As per the laws in force, the storage facility should be decommissioned at the end of its useful life.

© The Institute of Chartered Accountants of India

Neelanchal seeks your advice on the treatment of the agreement with Seemanchal as well as the accounting for the irrecoverable gas.

(b) Neelanchal has entered into a ten-year contract with Uttaranchal Refineries Pvt. Ltd. (hereinafter referred to as Uttaranchal) for purchase of natural gas. Neelanchal has paid an advance to Uttaranchal equivalent to the total quantity of gas contracted for ten years based on the forecasted price of gas. This advanced amount carries interest at the rate of 12.5% per annum, which is settled by Uttaranchal way of supply of extra gas. The contract requires fixed quantities of gas to be supplied each month. Additionally, there is a price adjustment mechanism in the contract whereby the difference between the forecasted price of gas and the prevailing market price is settled in cash on a quarterly basis. If Uttaranchal does not deliver the gas as agreed, Neelanchal has the right to claim compensation computed at the current market price of the gas.

Neelanchal wants to account for the contract with Uttaranchal in accordance with Ind AS 109 *Financial Instruments* and seeks your inputs in this regard.

Solution

(a) Joint Arrangement

As per Ind AS 111 *Joint Arrangements*, a joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The structure and form of the arrangement determines the nature of the relationship. However, irrespective of the purpose, structure or form of the arrangement, the classification of joint arrangements depends upon the parties' rights and obligations arising from the arrangement. Accordingly, a joint arrangement could be classified as a joint operation or as a joint venture. A joint arrangement which is NOT structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights and obligations. A joint operator accounts for the assets, liabilities, revenues and expenses relating to its involvement in a joint operation in accordance with the relevant Ind AS. Based on the information provided, the arrangement with Seemanchal Refineries Ltd. is a joint operation as no separate vehicle is formed and the companies have agreed to share services and costs with decisions regarding the storage facility requiring unanimous agreement of the parties. Neelanchal Gas Refinery Ltd. should recognize its share of the asset as Property, Plant and Equipment.

© The Institute of Chartered Accountants of India

As per Para 16 of Ind AS 16 Property, Plant and Equipment, the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides guidance on measuring decommissioning, restoration and similar liabilities. Para 45 of Ind AS 37 provides that where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. Thus, costs incurred by an entity in respect of obligations for dismantling, removing and restoring the site on which an item of property, plant and equipment is situated are recognized and measured in accordance with Ind AS 16 and Ind AS 37, with the journal entry being as under:

Property, Plant and Equipment	Dr.	xxx	
To Provision for Dismantling, Removal and Restoration			xxx

Neelanchal Gas Refinery Ltd. should recognize 60% of the cost of decommissioning of the underground storage facility. However, in line Para 29 of Ind AS 37 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**. Accordingly, Neelanchal Gas Refinery Ltd. should also disclose 40% of the cost of decommissioning of the underground facility as a contingent liability, should there arise future events that prevent Seemanchal Refineries Ltd. from fulfilling its obligations under the arrangement.

As per Ind AS 16, Property, Plant and Equipment are tangible items that:

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

(b) are expected to be used during more than one period.

Thus, Neelanchal Gas Refinery Ltd. should classify and account for its share of irrecoverable gas as property, plant and equipment, as the irrecoverable gas is necessary for the storage facility to perform its function. Therefore, the **irrecoverable gas, being a part of the storage facility, should be capitalized as a component of the storage facility asset**, and should be depreciated to its residual value over the life of the storage facility. However, if the gas is recoverable in full upon decommissioning of the storage facility, then depreciation against the irrecoverable gas component will be recorded only if the estimated residual value of the gas decreases below cost during the life of the facility. Upon decommissioning of the storage facility, when the cushion gas is extracted and sold, the sale of irrecoverable gas is accounted as a disposal of an item of property, plant and

© The Institute of Chartered Accountants of India

equipment in accordance with Ind AS 16 and the resulting gain or loss is recognized in the Statement of Profit and Loss. The natural gas in excess of the irrecoverable gas which is injected into the facility would be treated as inventory in accordance with Ind AS 2 *Inventories*.

(b) Contract with Uttaranchal Refineries Pvt. Ltd.

As per para 2.4 of Ind AS 109 *Financial Instruments,* this standard applies to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, **with the exception** of contracts that were 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 (i.e. own use contracts). This contract will result in physical delivery of the commodity i.e. extra gas.

Para 2.5 of Ind AS 109 further provides that a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through profit or loss 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. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard.

There are various 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. These include:

(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) 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 net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

© The Institute of Chartered Accountants of India

(c) when, for similar contracts, the entity has a 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; and

(d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A written option to buy or sell a non-financial item, such as a commodity, that can be settled net in cash or another financial instrument, or by exchanging financial instruments, is within the scope of Ind AS 109. Such a contract is accounted as a derivative. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements. Judgment would be required in this area as net settlements caused by unique events beyond management's control may not necessarily prevent the entity from applying the 'own use' exemption to all similar contracts.

In the given case, the contract with Uttaranchal Refineries Pvt. Ltd. will result in physical delivery of extra gas (which is a commodity and not cash, or a financial instrument) for the use of Neelanchal Gas Refinery Ltd. Accordingly, it appears that this contract would be an own use contract falling outside the scope of Ind AS 109 and therefore, would be treated as an executory contract. However, arguments could be placed that the contract is net settled due to the penalty mechanism requiring Uttaranchal Refineries Pvt. Ltd. to compensate Neelanchal Gas Refinery Ltd. at the current prevailing market price. Further, if natural gas is readily convertible into cash at the location of delivery, the contract could be considered net settled. Additionally, if there is volume flexibility, the contract could be regarded as a written option which falls within the scope of Ind AS 109.

However, the contract will probably continue to be regarded as 'own use' as long as it has been entered into and continues to be held for expected counterparties' sale / usage requirements. Additionally, the entity has not irrevocably designated the contract as measured at fair value through profit or loss, thus emphasizing the 'own use' designation.

*****

© The Institute of Chartered Accountants of India

TEST YOUR KNOWLEDGE

Questions

1. Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

Particulars	Property 1	Property 2	Property 3
	Factory	Factory	Let-Out
Purchase price	15,000	10,000	12,000
Market value 31.03.20X2	16,000	11,000	13,500
Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:

Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment alongwith working for the same.

2. On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of ₹ 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ₹ 12 lakhs to the customer on

© The Institute of Chartered Accountants of India

15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

3. Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for ₹ 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. Eucalyptus trees are not considered as bearer plant in this case.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss as income following the principles laid down under *Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance*.

Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

4. Mercury Ltd. has sold goods to Mars Ltd. at a consideration of ₹ 10 lakhs, the receipt of which receivable in three equal installments of ₹ 3,33,333 over a two year period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5 % (i.e. ₹ 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at ₹ 10 Lakhs and hence, the management has recognised the revenue from sale of goods for ₹ 10 lakhs.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

5. Master Creator Private Limited (a subsidiary of listed company) is an Indian company to whom Ind AS are applicable. Following draft balance sheet is prepared by the accountant for year ending 31st March 20X2.

© The Institute of Chartered Accountants of India

Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	₹
ASSETS	
Non-current assets	
Property, plant and equipment	85,37,500
Financial assets	
Other financial assets (Security deposits)	4,62,500
Other non-current assets (capital advances)	17,33,480
Deferred tax assets	2,54,150
Current assets	
Trade receivables	7,25,000
Inventories	5,98,050
Financial assets	
Investments	55,000
Other financial assets	2,17,370
Cash and cash equivalents	1,16,950
TOTAL ASSETS	**1,27,00,000**
EQUITY AND LIABILITIES	
Equity share capital	10,00,000
Non-current liabilities	
Other Equity	25,00,150
Deferred tax liability	4,74,850
Borrowings	64,00,000
Long term provisions	5,24,436
Current liabilities	
Financial liabilities	
Other financial liabilities	2,00,564
Trade payables	6,69,180
Current tax liabilities	9,30,820
TOTAL EQUITY AND LIABILITIES	**1,27,00,000**

© The Institute of Chartered Accountants of India

Additional Information:

1. On 1st April 20X1, 8% convertible loan with a nominal value of ₹ 64,00,000 was issued by the entity. It is redeemable on 31st March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ₹ 200 worth of loan.

   An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 5,12,000 has already been paid and included as a finance cost.

   Present Value (PV) rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

2. After the reporting period, the board of directors have recommended dividend of ₹ 50,000 for the year ending 31st March, 20X1. However, the same has not been yet accounted by the company in its financials.

3. 'Other current financial liabilities' consists of the following:

Particulars	Amount (₹)
Wages payable	21,890
Salary payable	61,845
TDS payable	81,265
Interest accrued on trade payables	35,564

4. Property, Plant and Equipment consists following items:

Particulars	Amount (₹)	Remarks
Building	37,50,250	It is held for administration purposes
Land	15,48,150	It is held for capital appreciation
Vehicles	12,37,500	These are used as the conveyance for employees
Factory premises	20,01,600	The construction was started on 31st March 20X2 and consequently no depreciation has been charged on it. The construction activities will continue to happen, and it will take 2 years to complete and be available for use.

© The Institute of Chartered Accountants of India

5. The composition of 'other current financial assets' is as follows:

Particulars	Amount (Rs.)
Interest accrued on bank deposits	57,720
Prepaid expenses	90,000
Royalty receivable from dealers	69,650

6. Current Investments consist of securities held for trading which are carried at fair value through profit & loss. Investments were purchased on 1st January,20X2 at ₹ 55,000 and accordingly are shown at cost as at 31st March 20X2. The fair value of said investments as on 31st March 20X2 is ₹ 60,000.

7. Trade payables and Trade receivables are due within 12 months.

8. There has been no changes in equity share capital during the year.

9. Entity has the intention to set off a deferred tax asset against a deferred tax liability as they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off taxes.

10. Other Equity consists retained earnings only. The opening balance of retained earnings was ₹ 21,25,975 as at 1st April 20X1.

11. No dividend has been actually paid by company during the year.

12. Assume that the deferred tax impact, if any on account of above adjustments is correctly calculated in financials.

Being Finance & Accounts manager, you are required to identify the errors and misstatements if any in the balance sheet of Master Creator Private Limited and prepare corrected balance sheet with details on the face of the balance sheet i.e. no need to prepare notes to accounts, after considering the additional information. Provide necessary explanations/workings for the treated items, wherever necessary.

6. HIM Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1st April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

© The Institute of Chartered Accountants of India

Issue 1 : As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was ₹ 5,00,000. The land was acquired for a consideration of ₹ 5,00,000. However, the fair value of land as on the date of transition was ₹ 8,00,000.

Issue 2 : Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was ₹ 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was ₹ 5,00,000.

Issue 3 : Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 1,80,000 as against the carrying amount of loan which at present equals ₹ 2,00,000.

Issue 4 : The company has declared dividend of ₹ 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Issue 5 : The company had acquired intangible assets as trademarks amounting to ₹ 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was ₹ 3,00,000. However, the company wants to carry the intangible assets at ₹ 2,50,000 only.

Issue 6 : After consideration of possible effects as per Ind AS, the deferred tax impact is computed as ₹ 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue.

© The Institute of Chartered Accountants of India

Answers

1. The above issue needs to be examined in the umbrella of the provisions given in Ind AS 1 '*Presentation of Financial Statements',* Ind AS 16 *'Property, Plant and Equipment'* in relation to property '1' and '2' and *Ind AS 40 'Investment Property'* in relation to property '3'.

Property '1' and '2'

Para 6 of Ind AS 16 '*Property, Plant and Equipment'* defines:

"Property, plant and equipment are tangible items that:

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

(b) are expected to be used during more than one period."

Paragraph 29 of Ind AS 16 states that:

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

Further, paragraph 36 of Ind AS 16 states that:

"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".

Further, paragraph 39 of Ind AS 16 states that:

"If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss".

Further, paragraph 52 of Ind AS 16 states that:

"Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount".

Property '3'

Para 6 of Ind AS 40 '*Investment property'* defines:

"Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

© The Institute of Chartered Accountants of India

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

(b) sale in the ordinary course of business".

Further, paragraph 30 of Ind AS 40 states that:

"An entity shall adopt as its accounting policy the cost model to all of its investment property".

Further, paragraph 79 (e) of Ind AS 40 requires that:

"An entity shall disclose the fair value of investment property".

Further, paragraph 54 (2) of Ind AS 1 '*Presentation of Financial Statements'* requires that:

"As a minimum, the balance sheet shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

As per the facts given in the question, Venus Ltd. has

(a) presented all three properties in balance sheet as 'property, plant and equipment';

(b) applied different accounting policies to Property '1' and '2';

(c) revaluation is charged in statement of profit and loss as profit; and

(d) applied revaluation model to Property '3' being classified as Investment Property.

These accounting treatment is neither correct nor in accordance with provision of Ind AS 1, Ind AS 16 and Ind AS 40.

Accordingly, Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2". It also required to depreciate these properties irrespective of that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Venus ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.

© The Institute of Chartered Accountants of India

Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet is as follows:

Case 1: Venus Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	9,000	22,500
Investment Properties		
Property '3'		10,800

Case 2: Venus Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	11,000	27,000
Investment Properties		
Property '3'		10,800
Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property '1' [16,000 – (15,000 – 1,500)]	2,500	
Property '2' [11,000 – (10,000 – 1,000)]	2,000	4,500

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and shown in a separate column under Statement of Changes in Equity.

© The Institute of Chartered Accountants of India

2. The above treatment needs to be examined in the light of the provisions given in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' and Ind AS 10 'Events After the Reporting Period'.

Para 10 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' defines:

"Provision is a liability of uncertain timing or amount.

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

Further, paragraph 14 of Ind AS 37, states:

"A provision shall be recognised when:

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

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

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

Further, paragraph 36 of Ind AS 37, states:

"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period".

Further, paragraph 3 of Ind AS 10 *'Events after the Reporting Period'* defines:

"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

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

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

Further, paragraph 8 of Ind AS 10 states that:

"An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period."

© The Institute of Chartered Accountants of India

The Accountant of Sun Ltd. has not recognised the provision and accordingly not adjusted the amounts recognised in its financial statements to reflect adjusting events after the reporting period is not correct and nor in accordance with provision of Ind AS 37 and Ind AS 10.

As per given facts, the potential payment of damages to the customer is an obligation arising out of a past event which can be reliably estimated. Therefore, following the provision of Ind AS 37 '*Provisions, Contingent Liabilities and Contingent Assets'* – a provision is required. The provision should be for the best estimate of the expenditure required to settle the obligation at 31st March, 20X2 which comes to ₹ 7.5 lakhs (₹ 10 lakhs x 75%).

Further, following the principles of Ind AS 10 '*Events After the Reporting Period'* evidence of the settlement amount is an adjusting event. Therefore, the amount of provision created shall be increased to ₹ 12 lakhs and accordingly be recognised as a current liability.

3. As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.

The above facts need to be examined in the light of the provisions given in *Ind AS 20* '*Accounting for Government Grants and Disclosure of Government Assistance'* and *Ind AS 41 'Agriculture'.*

Para 2(d) of Ind AS 20 *'Accounting for Government Grants and Disclosure of Government Assistance'* states:

"This Standard does not deal with government grants covered by Ind AS 41, Agriculture".

Further, paragraph 1 (c) of Ind AS 41 *'Agriculture'*, states:

"This Standard shall be applied to account for the government grants covered by paragraphs 34 and 35 when they relate to agricultural activity".

Further, paragraph 1 (c) of Ind AS 41 *'Agriculture'*, states:

"If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met".

© The Institute of Chartered Accountants of India

Understanding of the given facts, The Company has recognised the proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss before the conditions attaching to government grant are met which is not correct and nor in accordance with provision of Ind AS 41 *'Agriculture'*.

Accordingly, the accounting treatment of government grant received by the Mercury Ltd. is governed by the provision of Ind AS 41 *'Agriculture'* rather Ind AS 20 *'Accounting for Government Grants and Disclosure of Government Assistance'.*

Government grant for ₹ 10 lakhs shall be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e. after the expiry of specified period of five years of continuing engagement in the plantation of eucalyptus tree.

Balance Sheet extracts showing the presentation of Government Grant as on 31st March, 20X2 ₹

Liabilities	
Non-Current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

4. The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue.

The fair value of consideration (cash price equivalent) of the sale of goods is calculated as follows: ₹

Year	**Consideration (Installment)**	**Present value factor**	**Present value of consideration**
Time of sale	3,33,333	-	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		**9,50,000**

© The Institute of Chartered Accountants of India

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		₹	₹
Cash	Dr.	3,33,333	
Trade Receivable	Dr.	6,16,667	
To Sale			9,50,000
Recognition of interest expense and receipt of second installment			
Cash	Dr.	3,33,333	
To Interest Income			33,053
To Trade Receivable			3,00,280
Recognition of interest expense and payment of final installment			
Cash	Dr.	3,33,334	
To Interest Income (Balancing figure)			16,947
To Trade Receivable			3,16,387

Statement of Profit and Loss (extracts)
for the year ended 31st March, 20X2 and 31st March, 20X3

₹

	As at 31st March, 20X2	As at 31st March, 20X3
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3

₹

	As at 31st March, 20X2	As at 31st March, 20X3
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	XXX

© The Institute of Chartered Accountants of India

5. Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	Working Note reference	(₹)
ASSETS		
Non-current assets		
Property, plant and equipment	1	49,87,750
Capital work-in-progress	2	20,01,600
investment Property	3	15,48,150
Financial assets		
Other financial assets (Security deposits)		4,62,500
Other non-current assets (capital advances)	4	17,33,480
Current assets		
Inventories		5,98,050
Financial assets		
Investments (55,000 + 5,000)	5	60,000
Trade receivables	6	7,25,000
Cash and cash equivalents	7	1,16,950
Other financial assets	8	1,27,370
Other current assets (Prepaid expenses)	8	90,000
TOTAL ASSETS		**1,24,50,850**
EQUITY AND LIABILITIES		
Equity		
Equity share capital	A	10,00,000
Other equity	B	28,44,606
Non-current liabilities		
Financial liabilities		
8% Convertible loan	11	60,60,544
Long term provisions		5,24,436
Deferred tax liability	12	2,20,700

© The Institute of Chartered Accountants of India

Current liabilities		
Financial liabilities		
Trade payables	13	6,69,180
Other financial liabilities	14	1,19,299
Other current liabilities (TDS payable)	15	81,265
Current tax liabilities		9,30,820
TOTAL EQUITY AND LIABILITIES		**1,24,50,850**

Statement of changes in equity
For the year ended 31st March, 20X2

A. Equity Share Capital

	Balance (₹)
As at 31st March, 20X1	10,00,000
Changes in equity share capital during the year	-
As at 31st March, 20X2	10,00,000

B. Other Equity

	Retained Earnings (₹)	Equity component of Compound Financial Instrument (₹)	Total (₹)
As at 31st March, 20X1	21,25,975	-	21,25,975
Total comprehensive income for the year (25,00,150 + 5,000 - 85,504- 21,25,975)	2,93,671	-	2,93,671
Issue of compound financial instrument during the year	-	4,24,960	4,24,960
As at 31st March, 20X2	**24,19,646**	**4,24,960**	**28,44,606**

Disclosure forming part of Financial Statements:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (Note 9)

© The Institute of Chartered Accountants of India

Notes/ Workings: (for adjustments/ explanations)

1. Property, plant and equipment are tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period. Therefore, the items of PPE are Buildings (₹ 37,50,250) and Vehicles (₹ 12,37,500), since those assets are held for administrative purposes.

2. Property, plant and equipment which are not ready for intended use as on the date of Balance Sheet are disclosed as "Capital work-in-progress". It would be classified from PPE to Capital work-in-progress.

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

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

   (b) sale in the ordinary course of business.

   Therefore, Land held for capital appreciation should be classified as Investment property rather than PPE.

4. Assets 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.

5. Current investments here are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, ₹ 5,000 (60,000 – 55,000) increase in fair value of financial asset will be recognised in profit and loss.

6. A contractual right to receive cash or another financial asset from another entity is a financial asset. Trade receivables is a financial asset in this case and hence should be reclassified.

7. Cash is a financial asset. Hence it should be reclassified.

8. Other current financial assets:

Particulars	Amount (₹)
Interest accrued on bank deposits	57,720
Royalty receivable from dealers	69,650
Total	1,27,370

© The Institute of Chartered Accountants of India

Prepaid expenses does not result into receipt of any cash or financial asset. However, it results into future goods or services. Hence, it is not a financial asset.

9. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.

10. 'Other Equity' cannot be shown under 'Non-current liabilities'. Accordingly, it is reclassified under 'Equity'.

11. There are both 'equity' and 'debt' features in the instrument. An obligation to pay cash i.e. interest at 8% per annum and a redemption amount will be treated as 'financial liability' while option to convert the loan into equity shares is the equity element in the instrument. Therefore, convertible loan is a compound financial instrument.

Calculation of debt and equity component and amount to be recognised in the books:

S. No	Year	Interest amount @ 8%	Discounting factor @ 10%	Amount
Year 1	20X2	5,12,000	0.91	4,65,920
Year 2	20X3	5,12,000	0.83	4,24,960
Year 3	20X4	5,12,000	0.75	3,84,000
Year 4	20X5	69,12,000	0.68	47,00,160
Amount to be recognised as a liability				59,75,040
Initial proceeds				(64,00,000)
Amount to be recognised as equity				4,24,960

* In year 4, the loan note will be redeemed; therefore, the cash outflow would be ₹ 69,12,000 (₹ 64,00,000 + ₹ 5,12,000).

Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 20X2

Finance cost to be recognised in the Statement of Profit and Loss (59,75,040 x 10%)	₹ 5,97,504
Less: Already charged to the Statement of Profit and	(₹ 5,12,000)

© The Institute of Chartered Accountants of India

Loss	
Additional finance charge required to be recognised in the Statement of Profit and Loss	₹ 85,504

In Balance Sheet as at 31 March 20X2

Equity and Liabilities	
Equity	
Other Equity (8% convertible loan)	4,24,960
Non-current liability	
Financial liability [8% convertible loan – [(59,75,040+ 5,97,504– 5,12,000)]	60,60,544

12. Since entity has the intention to set off deferred tax asset against deferred tax liability and the entity has a legally enforceable right to set off taxes, hence their balance on net basis should be shown as:

Particulars	Amount (₹)
Deferred tax liability	4,74,850
Deferred tax asset	(2,54,150)
Deferred tax liability (net)	2,20,700

13. A liability that is a contractual obligation to deliver cash or another financial asset to another entity is a financial liability. Trade payables is a financial liability in this case.

14. 'Other current financial liabilities':

Particulars	Amount (₹)
Wages payable	21,890
Salary payable	61,845
Interest accrued on trade payables	35,564
Total	1,19,299

15. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities. Hence, TDS payable should be reclassified from 'Other current financial liabilities' to 'Other current liabilities' since it is not a contractual obligation.

© The Institute of Chartered Accountants of India

6. Assessment of Preliminary Impact Assessment of Transition to Ind AS on Him Limited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value. The resulting impact of fair valuation of land ₹ 3,00,000 should be adjusted in other equity.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Property Plant and Equipment	Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)			3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments are measured at lower of cost and fair value.	On transition, financial assets including investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	All financial assets (other than Investment in subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics.

© The Institute of Chartered Accountants of India

		Since investment in mutual fund are designated at FVTPL, increase of ₹ 1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Investment in mutual funds	Dr.	1,00,000	
To Retained earnings			1,00,000

Issue 3: Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised as the case may be	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is ₹ 1,80,000 as against its book value of ₹ 2,00,000. Accordingly, the difference of ₹ 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Borrowings / Loan payable	Dr.	20,000	
To Retained earnings			20,000

Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, provision for proposed divided is	As per Ind AS, liability for proposed	Since dividend should be deducted from retained earnings during the

© The Institute of Chartered Accountants of India

made in the year when it has been declared and approved.	dividend is recognised in the year in which it has been declared and approved.	year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Provisions	Dr.	30,000	
To Retained earnings			30,000

Issue 5 : Intangible assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by ₹ 25,000.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Retained earnings	Dr.	25,000	
To Deferred tax liability			25,000

© The Institute of Chartered Accountants of India