

PAPER

1

**FINAL COURSE
STUDY MATERIAL
GROUP-I
FINANCIAL
REPORTING
MODULE 1 OF 4**



Board of Studies (Academic)
**The Institute of Chartered
Accountants of India**

(Set up by an Act of Parliament)



www.icai.org



<https://boslive.icai.org>

This Study Material has been prepared by the faculty of the Board of Studies (Academic). The objective of the Study Material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarification or have any suggestion for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the Study Material has not been specifically discussed by the Council of the Institute or any of its committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Basic draft of this publication was prepared by CA. Vandana D Nagpal

Edition	:	April, 2023
Committee/Department	:	Board of Studies (Academic)
E-mail	:	bosnoida@icai.in
Website	:	www.icai.org
Price	:	₹ /- (For All Modules)
ISBN No.	:	978-81-19472-10-9
Published by	:	The Publication & CDS Directorate on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002 (India)
Printed by	:	

BEFORE WE BEGIN ...

The role of a chartered accountant is evolving continually to assume newer responsibilities in a dynamic environment. There has been a notable shift towards strategic decision making and entrepreneurial roles that add value beyond traditional accounting and auditing. The causative factors for the change include globalisation leading to increase in cross border transactions and consequent business complexities, significant developments in information and technology and financial scams underlining the need for a stringent regulatory set up. These factors necessitate an increase in the competence level of chartered accountants to bridge the gap in competence acquired and competence expected from stakeholders. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being stepped up to enable aspiring chartered accountants to acquire the requisite professional competence to take on new roles.

Concurrent Practical Training along with academic education: Key to achieving the desired level of Professional Competence

Under the Revised Scheme of Education and Training, at the Final Level, you are expected to apply the professional knowledge acquired through academic education and the practical exposure gained during articleship training in addressing issues and solving practical problems. The integrated process of learning through academic education and practical training should also help you inculcate the requisite technical competence, professional skills and professional values, ethics and attitudes necessary for achieving the desired level of professional competence.

Indian Accounting Standards (Ind AS): High Standards of Financial Reporting

Consistent, comparable and understandable financial reporting is essential to develop a robust economy. High standards of financial reporting underpin the trust investors place in financial and non-financial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of our national accounting standards (I GAAP) with IFRS.

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the

detailed analysis of IFRS requirements and extensive discussion with various stakeholders. Accordingly, while formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as, various terminology related changes have been made to make it consistent with the terminology used in law, e.g., 'statement of profit and loss' in place of 'statement of comprehensive income' and 'balance sheet' in place of 'statement of financial position'. Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS.

Thereafter, the Ministry of Corporate Affairs (MCA) had notified IFRS-converged Indian Accounting Standards (Ind AS) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and also the roadmap for the applicability of Ind AS for certain class of companies from financial year 2016-17. With the financial year 2016-17, the era of implementation of Ind AS in India had begun for the listed and unlisted companies as per the MCA roadmap for implementation of Ind AS. The MCA has also laid down roadmap for implementation of Ind AS for NBFCs. These developments are a significant step in achieving international benchmarks of financial reporting.

Ind AS, at the Final level, involves understanding, application and analysing of the concepts and testing of the same. The nitty-gritties of this new standard coupled with its inherent dynamism, makes the learning, understanding and application of the standards in problem solving very interesting and challenging.

Know your Syllabus

Accounts being the core competence areas of chartered accountants, at Final level, the syllabus of Financial Reporting covers Indian Accounting Standards alongwith Ethics and Technology integrated with the profession and accounting. However, for understanding the coverage of syllabus, it is important to read the Study Material as the content therein has been developed keeping in mind the extent of coverage of various topics in commensuration with 100 marks allotted to the paper. Certain Ind AS / portion of Ind AS are excluded from the study material, keeping in view the relevancy of the content in the Indian scenario and also to avoid the volume of the study material.

For understanding the coverage of syllabus, it is important to read the Study Material along with the reference to Study Guidelines. The Study Guidelines specify the topic-wise exclusions from the syllabus.

Know your Study Material

Efforts have been made to present the multifaceted Ind AS in a lucid manner. The Study Material carries 17 chapters. Care has been taken to present the chapters in a logical sequence to facilitate easy understanding by the students. Ind AS have been grouped under various categories to make you understand the areas of relevancy and application of Ind AS. The chapters have been numbered based on those categories and Ind AS falling in the same category are included in that chapter. Therefore, certain chapters on Ind AS, contain several units each unit dedicated to one Ind AS. However, for bare text of Indian Accounting standards, students are advised to refer the notified Indian Accounting Standards uploaded on the website at the link https://www.icai.org/post.html?post_id=15365

The various chapters/units of this subject have been structured uniformly and comprise of the following components:

	Components of each Chapter	About the component
1.	Learning Outcomes	Learning outcomes which you need to demonstrate after learning each topic have been detailed in the first page of each chapter/unit. Demonstration of these learning outcomes will help you to achieve the desired level of technical competence.
2.	Chapter / Unit Overview	As the name suggests, the flow chart/table/diagram given at the beginning of each chapter will give a broad outline of the contents covered in the chapter.
3.	Content	Ind AS have been explained by following a systematic approach of first discussing the objective, then the scope of the pronouncement and then extracting the underlying concepts. The concepts and provisions of Ind AS are explained in student-friendly manner with the aid of examples / illustrations / diagrams / flow charts. Diagrams and flow charts will help you understand and retain the

		concept / provision learnt in a better manner. Examples and illustrations will help you understand the application of concepts/provisions. Later, in the topics of Ind AS, the significant differences vis-à-vis AS has also been incorporated so that students appreciate and recapitulate their learning done at Intermediate level. These value additions will, thus, help you develop conceptual clarity and get a good grasp of the topic.
4.	Illustrations involving conceptual understanding	Illustrations would help the students to understand the application of concepts / provisions of Indian Accounting Standards. In effect, it would test understanding of concepts / provisions as well as ability to apply the concepts / provisions learnt in solving problems and addressing issues.
5.	Summary of Ind AS	The summary of each Ind AS has been linked through a QR Code in the respective chapter/unit dedicated to that Ind AS. The QR Code has been given at the end of the chapter discussion i.e. before 'Test Your Knowledge' section
6.	Test Your Knowledge	Questions This section comprises of variety of questions which will help you to apply what you have learnt in problem solving, and, thus, sharpen your application skills. In effect, it will test your understanding of concepts as well as your ability to apply the concepts learnt in solving problems and addressing issues. Answers After you work out the problems / questions given under the section "Test Your Knowledge", you can verify your answers with the answers given under this section. This way you can self-assess your level of understanding of the concepts of a chapter.

A new feature has been added at the end of each Module of Financial Reporting namely '**Ind AS Puzzlers: Test Your Accounting Acumen**'. Under the title there is a crossword puzzle

Crossword Puzzle	After going through the chapters of a Module, you can test your Ind AS acumen by solving a crossword puzzle. The crossword puzzle has been given at the end of every module with respect to the chapters dealt with in that module. These crossword puzzles will be a fun for you to solve by going through the clues, recall the concepts and review your understanding and knowledge acquired. You are advised to solve the puzzle earnestly after going through the chapters of the Module thoroughly. Answer of the Ind AS Crossword puzzle is again linked through a QR Code. You can scan the QR Code to match your filled crossword with the answer given therein.

Though all efforts have been taken in developing this Study Material, the possibilities of errors / omissions cannot be ruled out. You may bring such errors / omissions, if any, to our notice so that the necessary corrective action can be taken.

We hope that the student-friendly features in the Study Material makes your learning process more enjoyable, enriches your knowledge and sharpens your application skills.

Happy Reading and Best Wishes!

SYLLABUS

PAPER – 1: FINANCIAL REPORTING

(One paper – Three hours – 100 Marks)

Objectives:

- (a) To acquire the ability to integrate and solve problems in practical scenarios on Indian Accounting Standards (Ind AS) for deciding the appropriate accounting treatment and formulating suitable accounting policies.
- (b) To gain the prowess to recognize and apply disclosure requirements specified in Indian Accounting Standards (Ind AS) while preparing and presenting the financial statements.
- (c) To develop the expertise to prepare financial statements of group entities which includes subsidiaries, associates and joint arrangements based on Indian Accounting Standards (Ind AS).
- (d) To develop understanding of certain Accounting Standards and solve problems in practical scenarios where treatment is different in both the standards.

Contents:

- 1. **Introduction to General Purpose Financial Statements as per Indian Accounting Standard (Ind AS)**
- 2. **Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)**
- 3. **Application of Ind AS with reference to General Purpose Financial Statements**
 - (i) Ind AS on Presentation of Items in the Financial Statements
 - (ii) Ind AS on Measurement based on Accounting Policies
 - (iii) Ind AS on Income Statement
 - (iv) Ind AS on Assets and Liabilities of the Financial Statements

- (v) Ind AS on Items impacting the Financial Statements
- (vi) Ind AS on Disclosures in the Financial Statements
- (vii) Other Ind AS
- (viii) Ind AS on Financial Instruments (it includes Ind AS 32, Ind AS 109, Ind AS 107)

4. Ind AS on Group Accounting

5. First time adoption of Indian Accounting Standards (Ind AS 101)

6. Analysis of financial statements (as per Ind AS)

7. Ethics with Accounting Concepts

Identify and explain the key ethical issues

8. Technology and Accounting

Evolution of Accounting in the technological environment

Notes:

1. Discussion on AS 7, AS 9, AS 19 and AS 22 will be given along with corresponding Ind AS 115, Ind AS 116 and Ind AS 12.
2. If either a new Ind AS or Announcements and Limited Revisions to Ind AS are issued or the earlier one is withdrawn or new Ind AS, Announcements and Limited Revisions to Ind AS are issued in place of existing Ind AS, the syllabus will accordingly include / exclude such new developments in the place of the existing ones with effect from the date to be notified as decided by the Institute.
3. The specific inclusions / exclusions in any topic covered in the syllabus will be affected every year by way of Study Guidelines.

CONTENTS

MODULE – 1**Chapter 1: Introduction to Indian Accounting Standards****Chapter 2: Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)****Chapter 3: Ind AS on Presentation of Items in the Financial Statements**

Unit 1: Ind AS 1 “Presentation of Financial Statements”

Unit 2: Ind AS 34 “Interim Financial Reporting”

Unit 3: Ind AS 7 “Statement of Cash Flows”

Chapter 4: Ind AS on Measurement based on Accounting Policies

Unit 1: Ind AS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”

Unit 2: Ind AS 10 “Events after the Reporting Period”

Unit 3: Ind AS 113 “Fair Value Measurement”

Chapter 5: Ind AS 115 “Revenue from Contracts with Customers”

Annexure: Division II of Schedule III to the Companies Act, 2013

Ind AS Puzzlers: Test Your Accounting Acumen

MODULE – 2**Chapter 6: Ind AS on Assets of the Financial Statements**

Unit 1: Ind AS 2 “Inventories”

Unit 2: Ind AS 16 “Property, Plant and Equipment”

Unit 3: Ind AS 23 “Borrowing Costs”

Unit 4: Ind AS 36 “Impairment of Assets”

Unit 5: Ind AS 38 “Intangible Assets”

Unit 6: Ind AS 40 “Investment Property”

Unit 7: Ind AS 105 “Non-current Assets Held for Sale and Discontinued Operations”

Unit 8: Ind AS 116 “Leases”

Chapter 7: Other Indian Accounting Standards

Unit 1: Ind AS 41 “Agriculture”

Unit 2: Ind AS 20 “Accounting for Government Grants and Disclosure of Government Assistance”

Unit 3: Ind AS 102 “Share Based Payment”

Ind AS Puzzlers: Test Your Accounting Acumen

MODULE – 3

Chapter 8: Ind AS on Liabilities of the Financial Statements

Unit 1: Ind AS 19 “Employee Benefits”

Unit 2: Ind AS 37 “Provisions, Contingent Liabilities and Contingent Assets”

Chapter 9: Ind AS on Items impacting the Financial Statements

Unit 1: Ind AS 12 “Income Taxes”

Unit 2: Ind AS 21 “The Effects of Changes in Foreign Exchange Rates”

Chapter 10: Ind AS on Disclosures in the Financial Statements

Unit 1: Ind AS 24 “Related Party Disclosures”

Unit 2: Ind AS 33 “Earnings per Share”

Unit 3: Ind AS 108 “Operating Segments”

Chapter 11: Accounting and Reporting of Financial Instruments

Unit 1: Financial Instruments: Scope and Definitions

Unit 2: Classification and Measurement of Financial Assets and Financial Liabilities

Unit 3: Financial Instruments: Equity and Financial Liabilities

Unit 4 : Derivatives and Embedded Derivatives

Unit 5: Recognition and Derecognition of Financial Instruments

Unit 6: Hedge Accounting

Unit 7: Disclosures

Comprehensive Illustrations

Ind AS Puzzlers: Test Your Accounting Acumen

MODULE – 4**Chapter 12: Ind AS 103 “Business Combinations”****Chapter 13: Consolidated and Separate Financial Statements of Group Entities**

Unit 1 : Introduction to Consolidated and Separate Financial Statements

Unit 2 : Important Definitions

Unit 3 : Consolidated Financial Statements

Unit 4 : Ind AS 110: Consolidation Procedure for Subsidiaries

Unit 5 : Ind AS 111: Joint Arrangements

Unit 6 : Ind AS 28: Investment in Associates & Joint Ventures

Unit 7 : Ind AS 27: Separate Financial Statements

Unit 8 : Disclosures

Chapter 14: Ind AS 101 “First-time Adoption of Indian Accounting Standards”**Chapter 15: Analysis of Financial Statements****Chapter 16: Professional and Ethical Duty of a Chartered Accountant****Chapter 17: Accounting and Technology****Ind AS Puzzlers: Test Your Accounting Acumen**

DETAILED CONTENTS: MODULE – 1

CHAPTER 1: INTRODUCTION TO INDIAN ACCOUNTING STANDARDS (IND AS)

Learning Outcomes..... 1.1

Chapter Overview 1.2

Contents:

1.	Introduction	1.3
2.	Indian Scenario prior to introduction of Ind AS in India	1.4
3.	Limitations of Accounting Standards	1.7
4.	Emergence of Global Accounting Standards	1.7
5.	Need for Global Accounting standards in India	1.9
6.	Benefits of Global Accounting Standards	1.10
7.	Convergence vs Adoption of IFRS	1.10
8.	Process of development and finalisation of Indian Accounting Standards	1.11
9.	Transition from AS to Ind AS	1.12
9.1	About Indian Accounting Standards	1.13
9.2	How Ind AS have been numbered?	1.15
9.3	How Ind AS have been structured?	1.16
10.	Roadmap for applicability of Ind AS	1.18
10.1	For Listed Entities	1.18
10.2	Ind AS Roadmap for Non -Banking Financial Companies (NBFC)	1.27
10.3	Ind AS Roadmap for Banking and Insurance Companies	1.30
10.4	Ind AS Roadmap for Mutual Funds	1.30
11.	Ind AS relevant Statutory Provisions	1.31
11.1	Relevant Sections referring to Ind AS in the Companies Act, 2013 and Rules	1.31
11.2	Relevant SEBI Rules and Regulations	1.32
12.	Format of Division II to Schedule III to the Companies Act – Structure	1.33

12.1	Introduction	1.33
12.2	Applicability	1.33
13.	Guidance Note on Division II to Schedule III to the Companies Act, 2013	1.34
	Summary	1.40

CHAPTER 2: CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING UNDER INDIAN ACCOUNTING STANDARDS (IND AS)

Learning Outcomes.....	2.1
Chapter Overview	2.2

Contents:

Unit 1 : Introduction	2.4
Unit 2 : Objective of General Purpose Financial Reporting	2.6
2.1 Objectives and usefulness of general -purpose financial reporting	2.6
2.2 Limitations of general-purpose financial reporting	2.6
2.3 Information provided by general purpose financial reports	2.7
2.3.1 Economic resources and claims	2.7
2.3.2 Changes in economic resources and claims	2.8
Unit 3 : Qualitative Characteristics of Useful Financial Information	2.10
3.1 Qualitative characteristics of useful financial information	2.10
3.1.1 Relevance	2.10
3.1.2 Faithful representation	2.11
3.1.3 Applying the fundamental qualitative characteristics	2.12
3.1.4 Enhancing qualitative characteristics	2.13
3.1.5 Applying the enhancing qualitative characteristics	2.14
3.2 The cost constraint on useful financial information	2.14
Unit 4 : Financial Statements and the Reporting Entity	2.16
4.1 Objective and scope of financial statements	2.16
4.1.1 Reporting period	2.17

4.1.2	Perspective adopted in financial statements	2.17
4.1.3	Going concern assumption	2.17
4.2	The reporting entity	2.18
4.2.1	Consolidated and unconsolidated financial statements	2.18
Unit 5 : The Elements of Financial Statements		2.20
5.1	Link between information in general purpose financial reports as per conceptual framework and elements of financial statements	2.20
5.2	Definition of an asset	2.21
5.2.1	Right	2.21
5.2.2	Potential to produce economic benefits	2.23
5.2.3	Control	2.24
5.3	Definition of a liability	2.25
5.3.1	Obligation	2.26
5.3.2	Transfer of an economic resource	2.26
5.3.3	Present obligation as a result of past events	2.27
5.4	Aspects which are common to assets and liabilities	2.28
5.4.1	Unit of account	2.28
5.4.2	Executory contracts	2.29
5.4.3	Substance of contractual rights and contractual obligations	2.29
5.5	Definition of equity	2.30
5.6	Definition of income and expenses	2.30
Unit 6 : Recognition and Derecognition		2.32
6.1	The recognition process	2.32
6.2	Recognition criteria	2.33
6.2.1	Relevance	2.34
6.2.2	Faithful representation	2.36
6.3	Derecognition	2.38
Unit 7 : Measurement		2.40

7.1	Measurement bases of an asset or a liability	2.40
7.1.1	Historical cost	2.41
7.1.2	Current value	2.42
7.2	Information provided by particular measurement bases	2.43
7.2.1	Assets	2.44
7.2.2	Liabilities	2.46
7.3	Factors to consider when selecting a measurement basis for initial recognition and subsequent measurement of an asset or a liability	2.48
7.3.1	Relevance	2.49
7.3.2	Faithful representation	2.50
7.3.3	Implications of enhancing qualitative characteristics for the selection of measurement basis	2.56
7.4	Factors specific to initial measurement of an asset or a liability	2.57
7.4.1	Transactions on market terms	2.57
7.4.2	Transactions not on market terms (or off-market transactions)	2.58
7.5	More than one measurement basis	2.58
7.6	Measurement of equity	2.60
Unit 8 : Presentation and Disclosure		2.61
8.1	Presentation and disclosure objectives and principles	2.61
8.2	Classification	2.61
8.2.1	Classification of assets and liabilities	2.61
8.2.2	Offsetting	2.62
8.2.3	Classification of equity	2.62
8.2.4	Classification of income and expenses	2.62
8.2.5	Profit or loss and other comprehensive income	2.62
8.3	Aggregation	2.63

Unit 9 : Concepts of Capital and Capital Maintenance.....	2.66
9.1 Concepts of capital	2.66
9.2 Concepts of capital maintenance and the determination of profit	2.66
9.3 Capital maintenance adjustments	2.67
Test Your Knowledge.....	2.70
Question.....	2.70
Answer	2.70

CHAPTER-3: IND AS ON PRESENTATION OF GENERAL PURPOSE FINANCIAL STATEMENTS

Unit 1: Indian Accounting Standard 1: Presentation of Financial Statements

Learning Outcomes.....	3.1
Unit Overview	3.2

Contents:

1.1 Ind AS 1 'Presentation of Financial Statements' – Introduction	3.3
1.2 Objective	3.3
1.3 Scope.....	3.3
1.4 Definitions	3.4
1.5 Purpose of financial statements.....	3.7
1.6 Complete set of financial statements	3.7
1.7 General features of financial statements.....	3.10
1.7.1 Presentation of True and Fair View and compliance with Ind AS	3.10
1.7.2 Going concern	3.14
1.7.3 Accrual basis of accounting.....	3.17
1.7.4 Materiality and aggregation	3.17
1.7.5 Offsetting.....	3.18
1.7.6 Frequency of reporting.....	3.19
1.7.7 Comparative information	3.20
1.7.8 Consistency of presentation	3.22

1.8	Structure and content.....	3.23
1.8.1	Identification of Financial Statements	3.23
1.8.2	Balance sheet.....	3.24
1.8.3	Statement of profit and loss.....	3.41
1.8.4	Statement of changes in equity	3.49
1.8.5	Statement of cash flows	3.51
1.8.6	Notes	3.52
1.9	Significant differences in Ind AS 1 vis-à-vis AS 1	3.62
1.10	Carve out in Ind AS 1 from IAS 1.....	3.66
	Shortcut to Ind AS Wisdom	3.68
	Test Your Knowledge.....	3.68
	Questions	3.68
	Answers	3.72
	Unit 2: Indian Accounting Standard 34: Interim Financial Reporting	
	Learning Outcomes.....	3.77
	Unit Overview	3.78
	Contents:	
2.1	Introduction	3.79
2.2	Objective	3.79
2.3	Scope.....	3.79
2.4	Definitions	3.79
2.5	Contents of an interim financial report	3.80
2.5.1	Form and content of interim financial report.....	3.81
2.5.2	Significant events and transactions	3.81
2.5.3	Other disclosures.....	3.83
2.5.4	Periods for which interim financial statements are required to be presented	3.86
2.5.5	Materiality.....	3.88

2.6	Disclosure in annual financial statements	3.89
2.7	Recognition and measurement	3.89
2.8	Restatement of previously reported interim periods	3.99
2.9	Interim financial reporting and impairment	3.100
2.10	Significant differences in Ind AS 34 vis-à-vis AS 25	3.102
Shortcut to Ind AS Wisdom		3.105
Test Your Knowledge		3.105
Questions		3.105
Answers		3.106

Unit 3: Indian Accounting Standard 7: Statement of Cash Flows

Learning Outcomes	3.111
Unit Overview	3.112

Contents:

3.1	Introduction	3.113
3.2	Meaning of statement of cash flows	3.113
3.3	Objective	3.114
3.3.1	To provide information about historical changes in cash and cash equivalents	3.114
3.3.2	To assess the ability to generate cash and cash equivalents	3.114
3.3.3	To understand the timing and certainty of their generation	3.115
3.4	Benefits of cash flow information	3.115
3.4.1	Provides information enabling evaluation of changes in net assets and financial structure (Liquidity and solvency)	3.115
3.4.2	Assesses the ability to manage the cash	3.115
3.4.3	Assess and compare the present value of future cash flows	3.116
3.4.4	Compares the efficiency of different entities	3.116
3.5	Scope	3.116
3.6	Definitions	3.116
3.7	Cash and Cash Equivalents	3.117

3.8	Presentation of Statement of cash flows	3.119
3.8.1	Operating activities	3.119
3.8.2	Investing activities	3.121
3.8.3	Financing activities	3.124
3.9	Reporting cash flows from operating activities	3.126
3.10	Reporting cash flows from investing and financing activities.....	3.130
3.11	Reporting cash flows on a net basis	3.131
3.12	Foreign currency cash flows.....	3.132
3.13	Interest and dividends.....	3.133
3.14	Taxes on income	3.135
3.15	Investments in subsidiaries, associates and joint ventures	3.136
3.16	Changes in ownerships interests in subsidiaries and other businesses.....	3.136
3.16.1	Classification of cash flows as investing activity.....	3.136
3.16.2	Classification of cash flows as financing activity	3.137
3.17	Non-cash transactions	3.138
3.17.1	Changes in liabilities arising from financing activities	3.139
3.18	Components of cash and cash equivalents	3.140
3.19	Other disclosures.....	3.141
3.20	Extracts of financial statements of listed entity.....	3.149
3.21	Significant differences in Ind AS 7 vis-à-vis AS 3	3.152
	Quick Recap	3.155
	Shortcut to Ind AS Wisdom	3.156
	Test Your Knowledge	3.156
	Questions	3.156
	Answers	3.161

CHAPTER 4: IND AS ON MEASUREMENT BASED ON ACCOUNTING POLICIES

Unit 1 : Indian Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors

Learning Outcomes.....	4.1
Unit Overview	4.2
Contents:	
1.1 Introduction	4.3
1.2 Objective	4.3
1.2.1 To prescribe the criteria for selecting and changing accounting policies	4.3
1.2.2 To prescribe the accounting treatment and disclosure of changes in accounting policies	4.4
1.2.3 To prescribe the accounting treatment and disclosure of changes in accounting estimates.....	4.4
1.2.4 To prescribe the accounting treatment and disclosure of corrections of errors	4.4
1.2.5 To provide better base of inter-firm and intra-firm comparison.....	4.4
1.3 Scope.....	4.5
1.4 Definitions	4.5
1.5 Accounting policies	4.8
1.5.1 Selection and application of accounting policies	4.8
1.5.2 Is it Compulsory to follow the accounting policies?.....	4.8
1.5.3 How to select and apply an accounting policy when specific Ind AS is not available on the particular transaction/condition/ event?	4.9
1.5.4 Consistency of accounting policies	4.11
1.5.5 Changes in accounting policies	4.12
1.5.6 Disclosure regarding the Changes in Accounting Policies	4.23
1.6 Change in accounting estimates.....	4.25
1.6.1 Meaning	4.25
1.6.2 Can changes in estimates be related to prior periods?	4.26
1.6.3 Change in the basis of measurement – Whether a change in accounting policy or change in estimate?	4.26
1.6.4 Accounting treatment for applying changes in accounting estimates.....	4.27

1.6.5	Disclosure of changes in estimates	4.29
1.7	Errors	4.29
1.7.1	Meaning	4.29
1.7.2	Common types of errors.....	4.30
1.7.3	Treatment of errors	4.30
1.7.4	Limitations on retrospective restatement	4.35
1.8	Disclosure of prior period errors	4.36
1.9	Impracticability in respect of retrospective application and retrospective restatement	4.36
1.10	Significant differences in Ind AS 8 and AS 5	4.37
	Shortcut to Ind AS Wisdom	4.41
	Test Your Knowledge	4.41
	Questions	4.41
	Answers	4.45
	Unit 2 : Ind AS 10: “Events after the Reporting Period”	
	Learning Outcomes.....	4.51
	Unit Overview	4.52
	Contents:	
2.1	Introduction	4.53
2.2	Objective	4.53
2.3	Scope.....	4.54
2.4	Definitions and explanations	4.54
2.4.1	Events after the Reporting Period.....	4.55
2.4.2	Approval of Financial Statements	4.55
2.4.3	When date of approval is after the public announcement of some other financial information	4.57
2.4.4	Should the company report only unfavourable events?	4.59
2.5	Type of Events.....	4.59

2.6	Recognition and measurement of adjusting events	4.60
2.7	Accounting treatment and disclosure of Non-adjusting events after the reporting period.....	4.65
2.8	Special cases	4.66
2.8.1	Long-term Loan Arrangements	4.66
2.8.2	Going concern	4.67
2.9	Dividends	4.70
2.10	Disclosure required under Ind AS 10	4.71
2.10.1	Date of approval for issue	4.71
2.10.2	Updating disclosure about conditions at the end of the reporting period	4.71
2.10.3	Disclosure of Non-adjusting events after the reporting period	4.72
2.11	Distribution of non cash assets to owners	4.74
2.11.1	Applicability	4.75
2.11.2	Non-applicability	4.75
2.11.3	Issues addressed by Appendix A to AS 10	4.76
2.11.4	Accounting principles enunciated by Appendix A to Ind As 10	4.76
2.12	Extracts of financial statements of listed entity	4.77
2.13	Significant differences between Ind AS 10 and AS 4	4.78
2.14	Carve out in Ind AS 10 from IAS 10	4.79
	Shortcut to Ind AS Wisdom	4.80
	Test Your Knowledge.....	4.80
	Questions	4.80
	Answers	4.82
	Unit 3- Indian Accounting Standard 113 : Fair Value Measurement	
	Learning Outcomes.....	4.86
	Unit Overview	4.87
	Contents:	
3.1	What is fair value?	4.88

3.2	Objective	4.88
3.3	Scope	4.89
3.3.1	What is not covered?	4.90
3.4	Definition	4.90
3.5	Asset or liability specific fair value	4.91
3.6	Unit of Account	4.92
3.7	The transaction	4.93
3.7.1	Principal market	4.93
3.7.2	Most advantageous market	4.94
3.8	Market participants	4.94
3.8.1	What are market participants?	4.95
3.9	The price	4.95
3.9.1	Transaction cost	4.96
3.9.2	Transport cost	4.96
3.10	Applying fair value rules on non-financial assets	4.98
3.10.1	Highest and best use	4.98
3.10.2	Valuation premise	4.100
3.11	Applying fair value rules to liabilities and an entity's own equity instruments	4.101
3.11.1	When liability and equity instruments are held by other parties as assets	4.102
3.11.2	When liability and equity Instruments are not held by other parties as assets	4.102
3.12	Applying fair value rules to financial asset & financial liability with offsetting position in market risk or counterparty risk	4.102
3.13	Fair value at initial recognition	4.104
3.14	Valuation techniques	4.105
3.15	Inputs to valuation techniques	4.108
3.15.1	Level 1 Inputs	4.109
3.15.2	Level 2 Inputs	4.111

3.15.3 Level 3 Inputs	4.112
3.16 Disclosures	4.113
3.17 Extracts of financial statements of listed entity	4.115
Shortcut to Ind AS Wisdom	4.117
Test Your Knowledge	4.117
Questions	4.117
Answers	4.121

CHAPTER 5: IND AS 115 “REVENUE FROM CONTRACTS WITH CUSTOMERS”

Learning Outcomes	5.1
Chapter Overview	5.2

Contents:

1. Scope	5.3
2. Definitions	5.4
3. Overview	5.5
4. Transition	5.6
5. Step 1: Identifying the contract	5.7
5.1 Criteria for recognizing a contract	5.7
5.2 Contracts that do not pass Step 1: Reassessing the Step 1 criteria	5.11
5.3 Contract term	5.12
5.4 Combining contracts	5.13
5.5 Contract Modifications	5.15
6. Step 2: Identifying performance obligations	5.20
6.1 Criteria for identifying performance obligation	5.20
6.2 Multiple Element Arrangements/Goods and services that are not distinct	5.29
6.3 Customer options for additional goods or services	5.34
6.4 Long term arrangements	5.38
6.5 Consignment Arrangements	5.38
6.6 Principal vs agent consideration	5.40

6.7	Non-refundable upfront fees	5.44
7.	Step 3: Determining the transaction price	5.45
7.1	Variable consideration	5.46
7.2	Significant financing component	5.64
7.3	Non-cash consideration	5.75
7.4	Consideration payable to a customer.....	5.78
8.	Step 4: Allocating the transaction price to performance obligations	5.82
8.1	Determining stand-alone selling price	5.82
8.2	Changes in the transaction price	5.92
9.	Step 5: Satisfying performance obligation	5.95
9.1	What does transfer of control mean?	5.96
9.2	Does the customer acquire control over a period of time or at a point in time?	5.97
9.3	Repurchase agreements	5.112
9.4	Bill-and-hold	5.117
9.5	Licences of intellectual property	5.119
10.	Contract Costs	5.124
10.1	Costs to obtain a contract (contract acquisition costs)	5.124
10.2	Costs to fulfil a contract (contract fulfilment costs)	5.126
10.3	Amortisation and impairment.....	5.128
11.	Presentation & disclosure.....	5.129
11.1	Presentation	5.129
11.2	Disclosure	5.129
12.	Service Concession Arrangements	5.131
12.1	About Arrangement.....	5.131
12.2	Accounting Principles.....	5.132
12.3	Service Concession Arrangements: Disclosures	5.136
13.	Extracts of financial statements of listed entity	5.140

14. Significant Differences in Ind AS 115 vis-à-vis AS 7 and AS 9.....	5.143
Shortcut to Ind AS Wisdom	5.146
Test your knowledge.....	5.146
Questions	5.146
Answers	5.149
 ANNEXURE: DIVISION II OF SCHEDULE III TO THE COMPANIES ACT, 2013	A.1 – A.37
 Ind AS Puzzlers: Test Your Accounting Acumen	(1)-(4)

INTRODUCTION TO INDIAN ACCOUNTING STANDARDS



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ Appreciate the concept of Accounting Standards
- ☐ Grasp the Indian scenario prior to Ind AS and the need of time leading to emergence of global accounting standards
- ☐ Acknowledge the benefits of global accounting standards
- ☐ Distinguish between convergence and adoption of global accounting standards
- ☐ Discuss about Ind AS transition in India and benefits thereof
- ☐ Recognise the process of development and finalisation of Ind AS (IASB to ICAI to MCA)
- ☐ Describe India's roadmap for applicability of Ind AS for listed and unlisted entities, NBFCs, banking and insurance sector
- ☐ Illustrate the salient features of Ind AS like numbering, flow and structure
- ☐ Tabulate the important statutory provisions under the Companies Act and SEBI regulations involving Ind AS
- ☐ Identify the format of balance sheet, statement of changes in equity, profit and loss and significant notes related to them as given in Division II to Schedule III to the Companies Act, 2013
- ☐ Analyse key takeaways from guidance note on Division II to Schedule III to the Companies Act, 2013

UNIT OVERVIEW



Introduction to Indian Accounting Standards	Introduction	
	Indian Scenario prior to introduction of Ind AS in India	
	Limitations of AS	
	Emergence of Global Standards	
	Need for Global standard in India	
	Benefits of Global Accounting Standards	
	Convergence vs Adoption of IFRS	
	Process of development and finalisation of Ind AS	
	Transition from AS to Ind AS	About Indian Accounting Standards How Ind AS has been numbered How Ind AS has been structured
	Roadmap for applicability of Ind AS	For listed entities Ind AS Roadmap for Non -Banking Financial Companies (NBFC) Ind AS Roadmap for Banking and Insurance Companies Ind AS Roadmap for Mutual Funds
	Ind AS relevant Statutory Provisions	Relevant Sections referring Ind AS in the Companies Act, 2013 and Rules Relevant SEBI Rules and Regulations
	Format of Division II to Schedule III to the Companies Act - Structure	Part I - Format of Balance Sheet and Statement of Changes in Equity Part II – Statement of Profit and Loss
	Guidance Note on Division II to Schedule III to the Companies Act, 2013	



1. INTRODUCTION

A set of financial statements are a key tool of communication about the financial position, performance and changes in financial position of an entity that is useful to a wide range of stakeholders in making economic decisions. Accounting Standards is an essential building block in the financial reporting world. These Accounting Standards provide principles and rules that must be followed to ensure accuracy, consistency and comparability of financial statements. These accounting guidelines also ensure that financial statements should be understandable, relevant, reliable and comparable.

Accounting Standards are a set of documents that lay down the principles covering various aspects, such as, recognition, measurement, presentation & disclosure of accounting transaction in the financial statements. Objective of accounting standards is to standardize the diverse accounting policies & practices with a view to eliminate the non-comparability of financial statements to the extent possible and also to enhance the reliability to the financial statements. Accounting standards play a very significant role in enabling the stakeholders to get the reliable and comparable accounting data and investors to make more informed economic decisions.

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (The ICAI), since its establishment way back in 1977, has been involved in the formulation of Accounting Standards and standard setting process of the country. ASB has been relentlessly working to ensure that the world's fastest growing emerging economy of India is equipped with high quality Accounting Standards (AS) comparable to the best in the world. The ICAI also issued Accounting Standards which are applicable to the entities other than companies and are aligned with Accounting Standards notified by the Ministry of Corporate Affairs (MCA) with certain differences.

ASB is an Accounting Standards-Setting arm of the ICAI, which formulates Accounting Standards through a process that is robust, comprehensive, and inclusive with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards to discharge its role of national standard-setter. Once the ASB finalises the draft of AS post incorporating the public comments on exposure draft, ASB recommends such approved draft of AS to National Financial Reporting Authority (NFRA)¹ and then Government of India, through MCA notifies AS or Ind-AS for corporate entities under Companies Act and ICAI issues AS for non-corporate entities.

¹ NFRA was constituted under the Companies Act, 2013 which replaced National Advisory Committee On Accounting Standards (NACAS) which was constituted under Companies Act, 1956.



2. INDIAN SCENARIO PRIOR TO INTRODUCTION OF IND AS IN INDIA

Prior to introduction of Indian Accounting Standards (Ind AS) which are Accounting Standards duly converged with International Financial Reporting Standards (IFRS), ASB has issued various AS to deal with various reporting matters. As on February 2002, ICAI has issued 27 AS, the list thereof with their respective applicability is as under². These AS are applicable to

- (a) companies other than those following Ind AS,
- (b) SMCs and also
- (c) non-corporate entities.

AS No.	Name of AS	Applicable to all Companies Other than those following Ind AS	Applicable to Small and Medium Sized Companies (SMCs) ³	Applicable to Non-Corporate Entities ⁴			
				Level I	Level II	Level III	Level IV
1	Disclosure of Accounting Policies	Yes	Yes	Yes	Yes	Yes	Yes
2	Valuation of Inventories (Revised)	Yes	Yes	Yes	Yes	Yes	Yes
3	Cash Flow Statement	Yes	Yes	Yes	NA	NA	NA
4	Contingencies and Events occurring after the Balance Sheet Date	Yes	Yes	Yes	Yes	Yes	Yes

² This table should be read in conjunction of Appendix 1 to Compendium of Accounting Standards (as on 1st February, 2022)

³ SMCs are defined under Notification dated 23rd June, 2021, issued by the Ministry of Corporate Affairs, Government of India

⁴ Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants of India should be referred back from Appendix 1 to Compendium of Accounting Standards (as on 1st February, 2022)

	(Revised 2016)						
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Yes	Yes	Yes	Yes	Yes	Yes
7	Construction Contracts	Yes	Yes	Yes	Yes	Yes	Yes
9	Revenue Recognition	Yes	Yes	Yes	Yes	Yes	Yes
10	Property, Plant and Equipment (Revised)	Yes	Yes	Yes	Yes	Yes (with disclosure exemption)	Yes (with disclosure exemption)
11	The Effects of Changes in Foreign Exchange Rates	Yes	Yes	Yes	Yes	Yes (with disclosure exemption)	Yes (with disclosure exemption)
12	Accounting for Government Grants	Yes	Yes	Yes	Yes	Yes	Yes
13	Accounting for Investments (Revised)	Yes	Yes	Yes	Yes	Yes	) Yes (with disclosure exemption)
14	Accounting for Amalgamation (Revised)	Yes	Yes	Yes	Yes	Yes	NA
15	Employee Benefits	No	Applicable with some exemptions	Yes	Yes (With certain exemptions)		
16	Borrowing Costs	Yes	Yes	Yes	Yes	Yes	Yes
17	Segment Reporting	No	No	Yes	No	No	No
18	Related Party Disclosure	Yes		Yes	Yes	No	No
19	Leases	No	Applicable	Yes	Yes (with disclosure exemption)		

			with some exemptions				
20	Earnings per share	No	Applicable with some exemptions	Yes	No	No	No
21	Consolidated Financial Statements (Revised)	Yes	Yes	Yes	No	No	No
22	Accounting for Taxes on Income	Yes	Yes	Yes	Yes	Yes	Yes (only related to current tax provisions)
23	Accounting for Investments in Associates in Consolidated Financial Statements	Yes	Yes	Yes	No	No	No
24	Discontinuing Operations	Yes	Yes	Yes	Yes	No	No
25	Interim Financial Reporting	No	Applicable with some exemptions	Yes	No	No	No
26	Intangible Assets	Yes	Yes	Yes	Yes	Yes	Yes (with disclosure exemption)
27	Financial Reporting of Interests in Joint Ventures	Yes	Yes	Yes	No	No	No
28	Impairment of Assets	No	Applicable with some exemptions	Yes	Yes (with disclosure exemption)		NA
29	Provisions, Contingent Liabilities and Contingent Assets (Revised)	No	Applicable with some exemptions	Yes	Yes (with disclosure exemption)		



3. LIMITATIONS OF ACCOUNTING STANDARDS

With the increasing flow of foreign funds, following were few of the rising complexities which were not explicitly and comprehensive dealt by AS and it was needed to have guidance around the same to witness consistent accounting treatments by entities.

- a) Capital being raised in the form of complex financial instruments like optionally convertible / compulsorily convertible shares / debentures etc.
- b) Various derivative instruments embedded in the foreign currency bonds / equity instruments, commodity derivatives etc.
- c) Group restructuring, business acquisitions, mergers, demergers, slump sale etc.
- d) Complex revenue arrangements and business models with innovating emerging digital economy
- e) Diverse stock-based compensation with innovative remuneration models for C-suite
- f) Complex tax provisions and impact thereof in determination of current and deferred tax
- g) Different ways to provide shareholders' return and various modes of shareholder's investments in kind in the event of group reorganisation.

Further, a need was felt to have comprehensive disclosures in the financial statements so as to enable the investors to have a complete overview of business background, risks involved and other important aspects. The disclosure requirements in ASs are limited and the need was felt to improve those disclosures especially about aspects like revenue, related party transactions, segment reporting, business combinations etc. so as to improve the quality of financial reporting and enable investors to take an informed decision.



4. EMERGENCE OF GLOBAL ACCOUNTING STANDARDS

In 1973, International Accounting Standards Committee (IASC) was formed through an agreement made by professional accountancy bodies from Canada, Australia, France, Germany, Japan, Mexico, the Netherlands, the UK and Ireland, and the United States of America. The main goal of the committee was to harmonize different financial reporting practices. The standard setting board of the IASC was known as the IASC Board. The IASC Board promoted various standards, conceptual Framework, which was directly adopted by many countries and many national accounting standards setters were referring to the same to govern the standard setting process in their countries.

Nearly after 25 years of its operations, IASC felt a need to change its structure in order to effectively converge national accounting standards to lead to one set of Global Accounting

Standards. As a result, International Accounting Standards Board (IASB) was formed on 1st July 2000. It was further decided that it would operate under a new International Accounting Standards Committee Foundation (IASCF, now known as IFRS Foundation). IASB members are responsible for the development and publication of International Financial Accounting Standards (IFRS). For IFRS to be truly global standards, consistent application and interpretation is required. The Interpretations Committee assists the IASB in improving financial reporting through timely assessment, discussion and resolution of financial reporting issues identified within the IFRS framework.

As early as 1989 the International Organisation of Securities Commissions (IOSCO), the world's primary forum for co-operation among securities regulators, prepared a paper noting that cross border security offerings would be facilitated by the development of internationally accepted standards. For preparers, greater comparability in financial reporting with their global peers had obvious attractions. In May 2000 IOSCO announced that it had completed its assessment of 30 accounting standards of the International Accounting Standards Committee (IASC 2000 standards). As a result, the IOSCO Presidents' Committee recommended that its members permit incoming multinational issuers to use the 30 IASC 2000 standards to prepare their financial statements for cross-border offerings and listings, as supplemented by reconciliation, disclosure and interpretation where necessary to address substantive outstanding issues at a national or regional level.

On 19th July 2002, a regulation was passed by the European Parliament and the European Council of Ministers requiring the adoption of IFRS. As a result of the Regulation, all EU listed companies were required to prepare their financial statements following IFRS from 2005. This has led to IFRS being considered as one of the major unified GAAP in the world.

So with this, two prominent and widely adopted accounting standards have emerged:

- 1) Accounting Standards set up by US Financial Accounting Standards Board (FASB) (widely known as "US GAAP") and
- 2) IFRS

The "Group of 20" (G20) is made up of the finance ministers and central bank governors of 19 countries and the European Union: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, United Kingdom and United States of America. The G20 meets regularly to discuss matters of common interest. As a result of the global financial crisis, the G20 began to explore ways to improve the global financial system, including regulations related to financial reporting and institutions. The G20 has for some time called for the global convergence of accounting standards and has supported the IASB-FASB convergence process.

The joint convergence project was launched in 2002 by the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB). The objective of this project is to eliminate a variety of differences between International Financial Reporting Standards and US GAAP. The project, which is being done jointly by FASB and IASB, grew out of an agreement reached by the two boards in October 2002 (the 'Norwalk Agreement'). The scope of the overall IASB-FASB convergence project has evolved over time and is currently under progress.

So, IFRS is now, together with US GAAP, one of the two globally recognised financial reporting frameworks. Although the goal of a single set of high-quality global accounting standards has not been fulfilled, as per IASB research, presently, 167 jurisdictions require the use of IFRS Accounting Standards for all or most publicly listed companies, whilst a further 12 jurisdictions permit its use.



5. NEED FOR GLOBAL ACCOUNTING STANDARDS IN INDIA

Modern economies rely on cross-border transactions and the free flow of international capital. Investors seek diversification and investment opportunities across the world, while companies raise capital, undertake transactions or have international operations and subsidiaries in multiple countries.

In the past, such cross-border activities were complicated to be followed by Indian Companies due to increased compliance costs of maintaining multiple sets of financial books following varied national accounting standards. This reworking of accounting requirements often added cost, complexity and ultimately risk both to companies preparing financial statements and investors and others using those financial statements to make economic decisions.

Applying local accounting standards led to a totally different basis for amounts appearing in financial statements. Solving this complexity involved studying the details of national accounting standards, because even a small difference in requirements could have a major impact on a company's reported financial performance and financial position — for example, a company may recognise profits under one set of national accounting standards and losses under another. For e.g.: A company has made non-current investments in equity instruments and there is a temporary decline in the value of investments. As per AS, it may be required to report the investment at cost but may have to fair value the same as per IFRS. Hence this may lead to recognizing losses as per IFRS.

With this emerging need to move AS to comparable Global Standards and also considering the limitations of AS to deal with emerging business transactions and structure, need to revamp current AS was felt inevitably. International investors were apprehensive to rely on the financial

information of Indian Companies due to their limited understanding of accounting framework in India and often sought companies to produce such financial information under IFRS.

Considering above, India made a commitment towards the convergence of Indian accounting standards with IFRS at the G20 summit in 2009.



6. BENEFITS OF GLOBAL ACCOUNTING STANDARDS

Global Accounting Standards address above challenges by providing a high-quality, internationally recognised set of accounting standards that bring transparency, accountability and efficiency to financial markets around the world. Global Standards bring transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.

Further, Global Standards strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. As a source of globally comparable information, Global Accounting Standards are also of vital importance to regulators around the world.

Global Accounting Standards also contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs. This also resulted into increased investment in jurisdictions adopting IFRS. Also for a Company which has operations in multiple countries, it became easy for them to consolidate their operations, track operational key performance indicators, and reduce the number of different reporting systems.

These advantages of global standards have been accepted by various jurisdictions, resulting into many countries following the path of adoption or convergence with IFRS with minimal carve outs.



7. CONVERGENCE VS ADOPTION OF IFRS

In common parlance, many users refer Convergence to IFRS and Adoption of IFRS interchangeably. However, there exists a significant difference between the two

Adoption of IFRS, in simple terms, means that the Country applying IFRS would be implementing IFRS in the same manner as issued by the IASB and would be 100% compliant with the guidelines issued by IASB.

The dictionary definition of Convergence states that *“to move towards each other or meet at the same point from different directions”*. Hence convergence with IFRS means the national accounting standards setter would work with IASB to develop high quality Accounting Standards over the time. Hence the national accounting standard setter is said to have “Converged with

IFRS” if it has adopted IFRS with some exceptions, and work with IASB towards those exceptions to reach at a point wherein there are no differences left.

An entity is required to apply IFRS 1 First-time Adoption of International Financial Reporting Standards – when it first asserts compliance with IFRS. The IASB has, therefore, established unambiguously the principle that full application of its standards and related interpretations is necessary for an entity to be able to assert that its financial statements comply with IFRS (as issued by the IASB). Consequently, it is necessary for countries that align their national standards with IFRS to require the application of IFRS 1 so that entities reporting under those standards can assert compliance with IFRS. In addition, an entity that applies IFRS as amended by a local authority cannot assert compliance with IFRS.

It is merely impossible for IASB to consider the individual factors of each country. Hence, such countries decide to converge to IFRS with limited exceptions. These exceptions are regularly looked upon and in order to meet at a point where no exceptions are left.

Countries like Canada, Bahrain, Cambodia etc have adopted IFRS while countries like India, China, Hongkong etc have converged with IFRS.



8. PROCESS OF DEVELOPMENT AND FINALISATION OF INDIAN ACCOUNTING STANDARDS

As discussed above, accounting standards in India are formulated by the ASB of ICAI. The central government prescribes the standards of accounting, or any addendum thereto, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the NFRA. The Ministry of Corporate Affairs (MCA) notifies the standards under the Companies Act by publishing them in the Gazette of India. Notified standards are authoritative under Indian law.

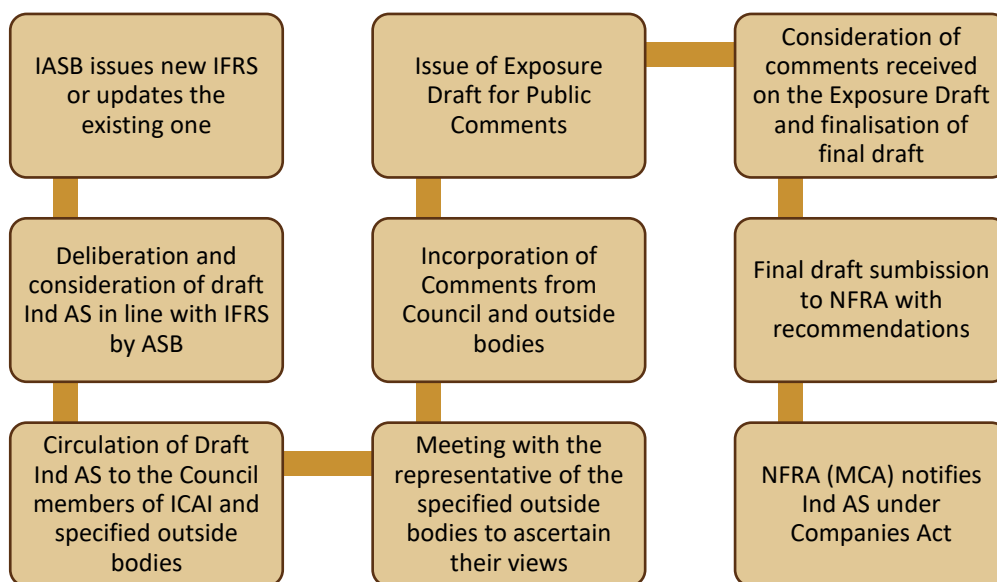
It may be noted that IFRS are being issued / revised by the IASB from time to time. As a part of convergence with IFRS, the Ind AS may be issued/revised corresponding to the IFRS. Accordingly, whenever IASB issues any new IFRS or update the current one, ASB of ICAI considers the convergence thereof under Ind AS. While doing so ASB provides considerations to local regulatory landscape, business practices, tax and other relevant provisions to develop exposure draft with proposed carve in or carve out from IFRS.

The Ind-AS setting process can be briefly outlined as follows:

- Consideration of preliminary draft prepared (with requisite carve in and carve out) by ASB and revision thereof, as need be.
- Circulation of Draft Ind AS to the Council members of ICAI and specified outside bodies such as MCA, Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT) etc.
- Meeting with the representative of the specified outside bodies to ascertain their views on the Draft Ind AS

- Finalisation of Exposure Draft of Ind AS and its issuance for inviting public comments
- Consideration of comments received on the Exposure Draft and finalisation of Ind AS by ASB for submission to the Council of ICAI for its consideration and approval for issuance.
- Consideration of the final draft of proposed Ind AS by the Council of the ICAI, and if found necessary, modification of the draft in consultation with the ASB
- Final draft Ind AS to be submitted to NFRA with ICAI recommendations for notification
- NFRAs reviews and provides inputs, if any, to ICAI before finalising. Post that, MCA notifies the Ind AS under Companies Act for Companies to follow with announcement of applicability date.

To summarise,



9. TRANSITION FROM AS TO IND AS

India made a commitment towards the convergence of Indian accounting standards with IFRS at the G20 summit in 2009. In line with this, MCA issued a roadmap for implementation of Ind AS converged with IFRS beginning April 2011. However, this plan was suspended due to unresolved tax and other issues. In the presentation of the Union Budget 2014–15, the Honourable Minister for Finance, Corporate Affairs and Information and Broadcasting proposed the adoption of Ind AS. The Minister clarified that the respective regulators will separately notify the date of implementation for banks and insurance companies. Also, standards for tax computation would be notified separately. In accordance with the Budget statement, the MCA has notified the Companies (Indian Accounting Standards) Rules 2015 vide its G.S.R dated 16th February 2015.

Accordingly, it has notified 39 Ind AS and has laid down Ind AS transition roadmap for companies and non-banking finance companies excluding banking companies and insurance companies.

The implementation of Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) by Indian Companies is a monumental step in the accounting history of India. It was possible due to the relentless and collective efforts of regulators and accounting professionals of this large growing economy aspiring to be economic superpower in the coming decades. ICAI believes that Ind AS implementation has provided better insights into the financial affairs of the companies and Ind AS based financial statements reflect the underlying economics of the transactions/events in a transparent and unbiased manner. It has also improved the comparability and benchmarking of the financials of Indian Companies with Global Peers, thereby improving the accessibility of Indian Companies to Global Capital Markets.

IFRS convergence is an ongoing initiative, and the process of issuing IFRS is dynamic. The IASB issues new/revised IFRS on a regular basis. To avoid significant changes in Ind AS for a period post its transition in India, it was decided to keep the applicability date of some of the IFRS earlier than its applicability date announced by IASB.

Example 1

IFRS 15 Revenue from Contracts with Customers is effective for annual periods beginning on or after 1st January 2017, while in India Ind AS 115 was applicable from 1st April 2018. Hence, it wasn't implemented in advance of IFRS 15. Another example is that of IFRS 16 Leases, which was issued in 2016 and made effective for annual reporting periods beginning on or after 1st January 2019, while in India Ind AS 116 was applicable from 1st April 2019.

9.1 About Indian Accounting Standards

Ind AS are the IFRS converged standards. Similar to IFRS they are principles-based standards, but substantially different from Indian GAAP. Ind AS is not the same as IFRS. It is a separate accounting framework based on IFRS as created by the MCA and has certain carve-outs to accommodate Indian business nuances.

As on date, 39 Ind AS are notified by Ministry of Corporate Affairs, which are as under:

IND AS	Description
Ind AS 101	First-time Adoption of Indian Accounting Standard
Ind AS 102	Share-based Payment
Ind AS 103	Business Combinations

Ind AS 104	Insurance Contracts
Ind AS 105	Non-current Assets Held for Sale and Discontinued Operations
Ind AS 106	Exploration for and Evaluation of Mineral Resources
Ind AS 107	Financial Instruments: Disclosures
Ind AS 108	Operating Segments
Ind AS 109	Financial Instruments
Ind AS 110	Consolidated Financial Statements
Ind AS 111	Joint Arrangements
Ind AS 112	Disclosure of Interests in Other Entities
Ind AS 113	Fair Value Measurement
Ind AS 114	Regulatory Deferral Accounts
Ind AS 115	Revenue from Contracts with Customers
Ind AS 116	Leases
Ind AS 1	Presentation of Financial Statements
Ind AS 2	Inventories
Ind AS 7	Statement of Cash Flows
Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors
Ind AS 10	Events after the Reporting Period
Ind AS 12	Income Taxes
Ind AS 16	Property, Plant and Equipment
Ind AS 19	Employee Benefits
Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance
Ind AS 21	The Effects of Changes in Foreign Exchange Rates

Ind AS 23	Borrowing Costs
Ind AS 24	Related Party Disclosures
Ind AS 27	Separate Financial Statements
Ind AS 28	Investments in Associates and Joint Ventures
Ind AS 29	Financial Reporting in Hyperinflationary Economies
Ind AS 32	Financial Instruments: Presentation
Ind AS 33	Earnings per Share
Ind AS 34	Interim Financial Reporting
Ind AS 36	Impairment of Assets
Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets
Ind AS 38	Intangible Assets
Ind AS 40	Investment Property
Ind AS 41	Agriculture

9.2 How Ind AS have been numbered?

Ind AS are numbered in a similar manner as compared to IFRS. So in order to understand how Ind AS are numbered, it is important to understand how IFRS are numbered. Ind AS differ from the IFRS, as they contain certain carve outs and carve ins for making them contextually relevant to the Indian economic and legal environment.

International Accounting Standard Committee (IASB) was formed in 1973 and its main objective was to harmonize different financial reporting practices. It continued issuing standards under heading "International Accounting standards" (IAS) and they were numbered chronologically from 1. Eg: IAS 1, IAS 2 etc. Till 2000, it had notified 41 IAS (some of them are now repealed or omitted). Post incorporation of IASB on 1st July 2000., standards issued are known as IFRS and a new numerical series was started i.e. IFRS 1, IFRS 2 etc

In Indian context, numbers for IAS are retained. For e.g.: For IAS 1 – Presentation of Financial Statements, corresponding standard in Ind AS is Ind AS 1 – Presentation of Financial statements. For IFRS, a new series starting after 100 was used. For e.g.: For IFRS 1 – First time adoption of International Financial Reporting Standards, corresponding Ind AS is Ind AS 101 - First time adoption of Indian Accounting Standards.

Further, IFRS Interpretations Committee (IFRIC) is the interpretative body of the IASB. Its main work is to address application issues and suggest official IFRS Interpretations, which are eventually approved by the IASB. These interpretations are titled 'IFRIC' and numbered as IFRIC 1,2 etc. Interpretations issued before 2003 were titled 'SIC' and some of them are still in force today. IFRIC and SICs are included in Ind AS as part of Appendix in relevant Ind AS.

- Total reporting standards issued under IFRS are 41. Total reporting standards issued under Ind AS are 39. IFRS 17 Insurance Contracts and IAS 26 Accounting and Reporting by Retirement Benefit Plans are yet not notified in India as Ind AS.
- Total interpretations under IFRS (IFRIC + SIC) are 18. Total interpretation included under Ind AS (Appendix to relevant standards) are 17. IFRIC 2 – Members' Shares in Co-operative Entities and Similar Instruments and SIC -7 Introduction of the Euro are neither included under Ind AS nor notified. However, Appendix C to Ind AS 103 – Business Combinations was developed and additionally included in India for which no corresponding IFRIC or SIC is available.

9.3 How Ind AS have been structured?

Ind AS have followed the structure of IFRS and IAS and have not changed the same. Ind AS retained the paragraph numbers of IFRS and IAS too to allow readers to refer back similar guidance under IFRS and IAS while also appreciating the carve out and carve in. For ex. If Ind AS do not contain corresponding paragraph of IFRS, the same number had been kept blank with a note mentioned referring to Appendix – Comparison with IFRS.

Ind AS have following components and they are generally structured as follows:

- 1) **Objective** – What is the main purpose for which the Ind AS is formed is mentioned in this heading. On a bird's eye view, it mentions the issues dealt by it and what objective it seeks to achieve from laying the principles in it.

Example 2

Following is Ind AS 2's objective:

"The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories."

- 2) **Scope** – What the standard intends to cover in its ambit is mentioned in the scope heading. In many cases, it defines specifically what it intends not to cover. For e.g.: Para 2 of Ind AS 2 states that it applies to all inventories except financial instruments and biological assets related to agricultural activity and agricultural produce at the point of harvest.
- 3) **Definitions** – It includes definitions of various terms used in the standards. For standards which are converged from International Accounting standards, definition is a part of structure while for standards which are converged from International Financial Reporting standards (Ind AS 101 onwards), the definitions are included in appendices.
- 4) **Content of the Standard** – This includes the main principles of the standard. It generally contains principle of recognition, measurement, subsequent measurement along with any other standard specific contents grouped in appropriate headings.
- 5) **Disclosure** – This section covers what qualitative / quantitative information required to be disclosed in financial statements pertaining to the matter covered in the standard. Wherever applicable, it also contains how a particular asset / liability / income / expense should be presented in financial statements.
- 6) **Transitional provisions and effective date** – For any Ind AS notified, it mentions effective date and transitional provisions from which it would be applicable. Under Ind AS, transitional provisions are mentioned mainly at two places. Firstly, it is broadly mentioned in Ind AS 101 - First-time Adoption of Indian Accounting Standard and secondly in the individual Ind AS wherever applicable. The transitional provisions mentioned in Ind AS 101 are applicable to first time adopter of Ind AS. The transitional provisions mentioned in individual standards are applicable to entities that have already applied Ind AS. In many standards, transitional provisions and effective date are mentioned in Appendices
- 7) **Appendices** – As and where applicable, the Ind AS also has appendices which are integral part of the standard. They mainly consist of:
 - a. Explanation on industry specific issues which require detailed guidance. For e.g.: Appendix to Ind AS 16 contains treatment of stripping costs in the production phase of a surface mine
 - b. Application Guidance – These are mainly in standards which are converged from International Financial Reporting Standards (Ind AS 101 and onwards). It contains detailed guidance in applying the principles mentioned in the standard
 - c. Defined terms – It mentions definition of terms mentioned in the standard
 - d. References to matters contained in other Ind AS - It lists the appendix which is a part of another Indian Accounting Standard and makes reference to the particular standard.

- e. Comparison with IFRS – Differences with IFRS are explained in this section
- f. IFRIC and SIC applicable and relevant for the respective Ind AS

In each Ind AS, certain texts are highlighted in bold while certain are in plain. The text in bold mentions the principle while the text in plain mentions its application guidance / other explanation. Paragraphs set in bold type and plain type, have equal authority. In Ind AS 101, principles are numbered in chronological order while detailed explanation or guidance applicable to these principles are included in the respective Appendices, as applicable.



10. ROADMAP FOR APPLICABILITY OF IND AS

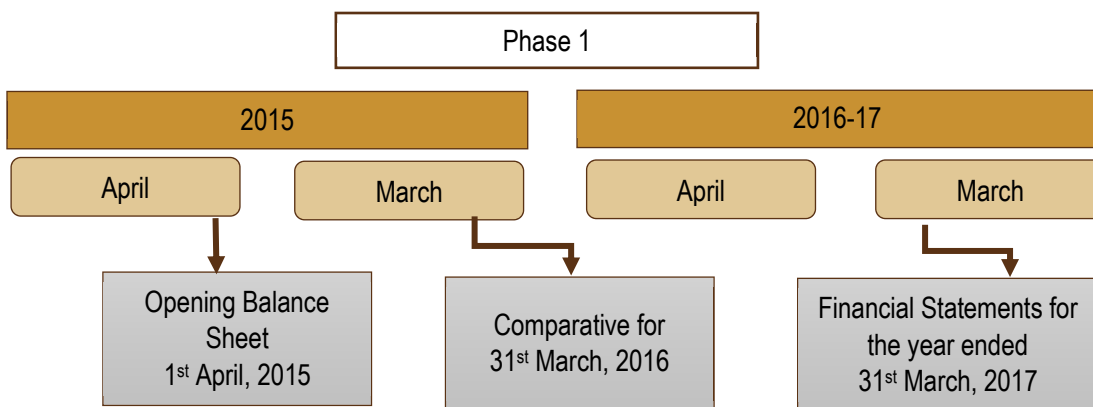
MCA has notified the Companies (Indian Accounting Standards) Rules, 2015 vide its G.S.R dated 16 February 2015. Accordingly, it has notified 39 Ind AS and has laid down an Ind AS transition roadmap for companies and non-banking finance companies excluding banking companies and insurance companies. MCA has proposed phase-wise approach for mandatory transition to Ind AS.

10.1 For Listed Entities

Phase I

As per the Companies (Indian Accounting Standards) Rules, 2015, following companies were covered under Phase I for accounting periods beginning on or after 1st April 2016, with the comparatives for the periods ending on 31st March 2016:

- a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;
- b) companies other than those covered by sub-clause (a) above and having net worth of rupees five hundred crore or more;
- c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) and sub-clause (b) as mentioned above

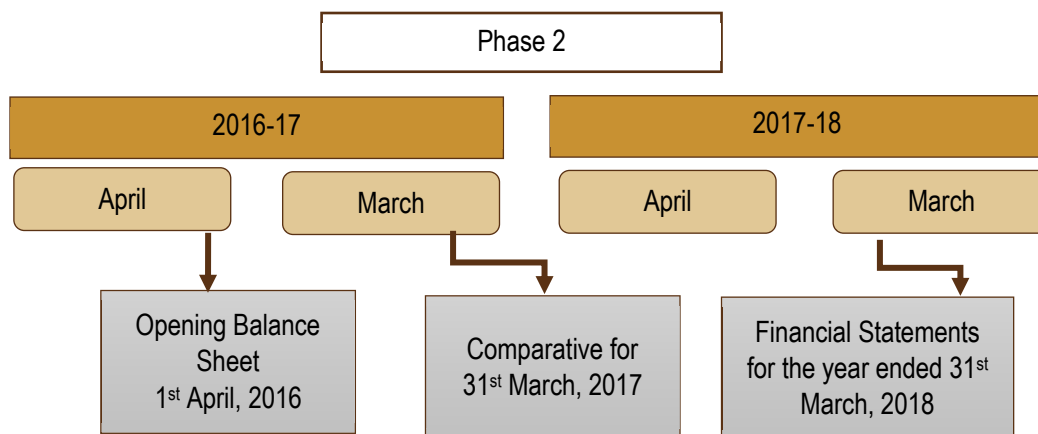


Phase II

Following companies were covered under Phase II for accounting periods beginning on or after 1st April 2017, with the comparatives for the periods ending on 31st March 2017:

- companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;
- companies other than those covered in sub-clause (a) above i.e. unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.
- holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) and sub-clause (b) as mentioned above.

The Companies (Indian Accounting Standards) Rules, 2015 clarifies that, the roadmap shall not be applicable to companies whose securities are listed or are in the process of being listed on SME exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. For the purpose, it clarifies SME Exchange to have the same meaning as assigned to it in Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.



Ind AS would not be applicable to companies other than listed companies whose net worth is less than ₹ 250 Crores and they will continue to follow AS as per its applicability discussed above. However, they can voluntary adopt Ind AS.

It is notable that the Companies (Indian Accounting Standards) Rules, 2015 gave an option to the companies for early adoption of Ind AS for their financial statements for accounting periods beginning on or after 1st April 2015, with the comparatives for the periods ending on 31st March 2015 or any time thereafter.

10.1.1 Key Matters on Transition

1) Comparative Financial Information

All companies applying Ind AS are required to present comparative information as per Ind AS for one year. To comply with this requirement, Ind AS will be applicable from the beginning of the previous period.

Example 3

A company adopted Ind AS from 1st April, 20X4 for its accounting period 20X4-20X5. Hence it will be required to prepare its first Ind AS financial statements for financial year 20X4-20X5 with comparatives for financial year 20X3-20X4, and the date of transition to Ind AS will be considered as 1st April 20X3.

2) Ind AS applicability

As per clause 4 of the aforementioned MCA notification, companies to which Indian Accounting Standards (Ind AS) are applicable as specified in those rules shall prepare their first set of financial statements in accordance with the Ind AS effective at the end of its first Ind AS reporting period.

Example 4

A company adopted Ind AS from 1st April, 20X4 for its accounting period 20X4-20X5. Hence it shall prepare Ind AS financial statements for financial year 20X4-20X5 by applying all Ind AS duly effective as on 31st March 20X5.

3) Consistent Application of Ind AS

As per clause 9 of the notification, once a company starts following the Indian Accounting Standards (Ind AS) either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow the Indian Accounting Standards (Ind AS) for all the subsequent financial statements even if any of the criteria specified in the Rules does not subsequently apply to it.

4) Ind AS Applicability for Indian Group Companies

As specified in the Companies (Indian Accounting Standards) Rules, 2015 issued by MCA, if Ind AS is applicable to a company, it would also be applicable to its holding company, subsidiary company, associate company and joint venture.

5) Ind AS Applicability for Overseas Group Companies

As per clause 5 of the Companies (Indian Accounting Standards) Rules, 2015 issued by MCA, overseas subsidiary, associate, joint venture and other similar entities of an Indian company may prepare its standalone financial statements in accordance with the requirements of the specific jurisdiction, provided that such Indian company shall prepare its consolidated financial statements in accordance with the Indian Accounting Standards (Ind AS) either voluntarily or mandatorily as per the criteria as specified in the Rules.

6) Ind AS Applicability for Standalone and Consolidated Financial Statements

As per clause 3 of the notification issued by MCA, Ind AS once required to be complied with in accordance with these rules, shall apply to both stand-alone financial statements and consolidated financial statements.

10.1.2 Calculation of Net Worth

For the purpose of determining the applicability of Ind AS as per the roadmap, net worth shall have meaning as per clause 57 of section 2 of the Companies Act, 2013.

Following is the definition of net worth as per the section:

“Net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;”

Further, it is clarified that:

- a) the net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31st March, 2014 or the first audited financial statements for accounting period which ends after that date;
- b) for companies which are not in existence on 31st March, 2014 or an existing company falling under any of thresholds specified in the Ind AS applicability thresholds above for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in respect of which it meets the thresholds specified.

Example 5

The companies meeting net worth threshold for the first time as per financial statements of the year ending on 31st March, 2017 shall apply Ind AS for the financial year 2017-2018 with comparatives for financial year 2016-2017.

Hence to summarize, the roadmap considers net worth as on 31st March 2014 as cut-off date for Ind AS applicability. A company which meets the Ind AS applicability criteria on this cut-off date, needs to apply Ind AS as per the applicable phase. If any company does not meet the Ind AS applicability criteria as on the cut-off date, they will have to reassess the Ind AS applicability criteria at each balance sheet date.

Illustration 1

Following is a snapshot of audited balance sheet of company A as on 31st March 2014. Company A's equity shares are listed on Bombay Stock Exchange since 2010.

Liabilities	₹ in crores	Assets	₹ in crores
Equity Share Capital	160	Fixed Assets	455
Securities Premium	200	Investments	200
General Reserve	150	Current Assets	50
Revaluation Reserve	40	Miscellaneous Expenditure not written off	80
Profit and Loss A/c	75		
Liabilities	<u>160</u>		<u> </u>
Total	<u>785</u>	Total	<u>785</u>

- As per roadmap, which Phase company A fall into?
- Will your answer change if Company A is an unlisted company?

Solution**Calculation of Net Worth:**

Particulars	₹ in crores
Equity Share Capital	160
Securities Premium	200
General Reserve	150
Profit and Loss A/c	75
Miscellaneous Expenditure not written off	(80)
Net Worth as per Section 2(57) of The Companies Act, 2013	505

Note – Revaluation Reserve would not be included in the calculation of net worth as per definition mentioned in section 2(57) of The Companies Act, 2013

The company is a listed company and it does meet the net worth threshold of ₹ 500 Crores. Hence it would be covered under phase I. Hence Ind AS would be applicable to the company for accounting periods beginning on or after 1st April 2016.

Even if Company A is an unlisted company as company A's net worth is more than 500 Crores, it would be covered under Phase I of the road map and hence Ind AS would be applicable for the accounting periods beginning on or after 1st April 2016.

Illustration 2

Let's say in Illustration 1, the balance of profit and loss account is negative ₹ 375 crores. When Ind AS should be applicable to Company A? Will your answer change if Company A is an unlisted company?

Solution

If the balance of Profit and Loss A/c is negative 375 Crores, the net worth as per section 2(57) of The Companies Act, 2013 would be ₹ 55 Crores (Equity share capital ₹ 160 Cr + Securities Premium ₹ 200 Cr + General Reserve ₹ 150 Cr – Debit balance of P&L ₹ 375 Cr – Miscellaneous expenditure not written off ₹ 80 Cr). Hence, it does not meet the criteria as mentioned in Phase I i.e. Listed company or Net worth of ₹ 500 Cr or more.

However, as Company A is a listed company, it will irrespective be covered under Phase II as the first criteria of phase II states "companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore". Hence, Ind AS would be applicable to Company A for the accounting periods beginning on or after 1st April 2017.

If Company A is an unlisted company, Ind AS would not be applicable until it breaches the net worth criteria mentioned in the roadmap.

Illustration 3

The net worth of Company B (an unlisted company) was ₹ 600 crores as on 31st March 2014. However due to losses incurred in FY 14-15, the net worth of the company was ₹ 400 Crores as on 31st March 2015. From when company B shall apply Ind AS?

Solution

Here the company's net worth as on cut-off date was greater than ₹ 500 crores, which suggests that it should be covered under phase I of the roadmap. A question may however arise in mind that since, the net worth as on immediately preceding year-end was ₹ 400 crores, would the company be covered under phase II of the roadmap?

"It may be noted that the net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31st March, 2014. Accordingly, if the net worth threshold criteria for a company are once met, then it shall be required to comply with Ind AS, irrespective of the fact that as on later date its net worth falls below the criteria specified."

In view of the above, the Company B will be required to follow Ind AS for accounting periods beginning on or after 1st April 2016

Illustration 4

The net worth of Company C (an unlisted company) was ₹ 400 crores as on 31st March 2014. However, the net worth of the company was ₹ 600 Crores as on 31st March 2015. From when company B shall apply Ind AS?

Solution

Similar issue has been encountered in ITFG Bulletin 1, Issue 1 which gives reference to clause 2b of the notification wherein it is stated that:

"For companies which are not in existence on 31st March, 2014 or an existing company falling under any of thresholds specified in sub-rule (1) for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in respect of which it meets the thresholds specified in sub-rule (1)"

Hence, any company that meets the thresholds as specified in the Companies (Indian Accounting Standards) Rules, 2015 in a particular financial year, Ind AS will become applicable to such company in immediately next financial year. Hence, in the present case, Company C is covered by Phase I of the roadmap and accordingly, Ind AS will be applicable to Company C for accounting periods beginning on or after 1st April 2016

Illustration 5

Company D is the parent company of group A. Company A is an unlisted company having net worth of 60 crores as on 31st March 2014. Following are the other companies of the group.

Name of the company	Relationship	Net worth as on 31 st March 2014
Company B (Unlisted)	Subsidiary of Company A	₹ 600 Crore
Company C (Unlisted)	Subsidiary of Company B	₹ 150 Crore

Whether Ind AS be applicable to companies A, B and C?

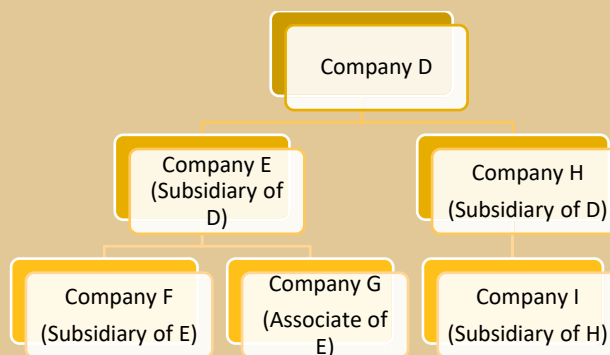
Solution

Company A and C are unlisted and do not exceed the net worth criteria. However, the net worth of Company B exceeds ₹ 500 Crore hence it would be covered under Phase I of the roadmap.

As Ind AS be applicable to Company B, the parent company of Company B i.e. Company A and subsidiary of Company B i.e. Company C would also get covered under Ind AS irrespective of net worth criteria. Hence Ind AS would be applicable to all three companies i.e. Company A, B and C

Illustration 6

Following is the structure of Company D



All the companies in above structure are unlisted companies and the net worth of company E is ₹ 300 Crores and net worth of all the other companies is below ₹ 250 crores. To which company would Ind AS be applicable?

Solution

As mentioned in the Companies (Indian Accounting Standards) Rules, 2015, if Ind AS is applicable to a company, it would also be applicable to its Holding Company, subsidiary company, associate company and Joint Venture.

As the turnover of company E is above ₹ 250 crores, it would be covered under Phase II of the roadmap. Hence, its subsidiary (Company F), associate (Company G) and Holding (Company D) would also be covered under Ind AS with effect from 1st April 2017.

With respect to other companies of the group, following guidance is given in ITFG clarification bulletin 15, Issue 10: “It may be noted that Ind AS applies to holding, subsidiary, joint venture and associate companies of the companies which meet the net worth/listing criteria. This requirement does not extend to another fellow subsidiary of a holding company which is required to adopt Ind AS because of its holding company relationship with a subsidiary meeting the net worth/listing criteria. Holding company will be required to prepare separate and consolidated financial statements mandatorily under Ind AS, if one of its subsidiaries meets the specified criteria and therefore, such subsidiaries may be required by the holding company to furnish financial statements as per Ind AS for the purpose of preparing Holding company’s consolidated Ind AS financial statements. Such fellow subsidiaries may, however, voluntarily opt to prepare their financial statements as per Ind AS.”

Hence the other companies of the group i.e. Company H and Company I would not be covered under Ind AS. However, as mentioned in ITFG, Company H and I would be required to prepare its financial statements under Ind AS so as to facilitate Company D for preparation of its consolidated financial statements. Hence, though statutorily Company H and I may continue to prepare its financial statements under AS, but it will also have to converge to Ind AS. Moreover, they may also opt to voluntarily adopt Ind AS and prepare its statutory accounts under Ind AS too.

Illustration 7

ABC Inc., incorporated in a foreign country has a net worth of ₹700 Crores. It has two subsidiaries Company X whose net worth as on 31st March 2014 is ₹ 600 Crores and Company Y whose net worth is ₹ 150 Crores. Whether Company X and Y would be required to follow Ind AS from accounting periods commencing on or after 1st April 2016 on the basis of their own net worth or on the basis of the net worth of ABC Inc.?

Solution

Similar issue has been dealt in ITFG Clarification Bulletin 2, Issue 2. ITFG noted that as per Rule 4(1)(ii)(a) of the Companies (Indian Accounting Standards) Rules, 2015, Company X having net worth of ₹ 600 crores at the end of the financial year 2015-16, would be required to prepare its financial statements for the accounting periods commencing from 1st April, 2016, as per the Companies (Indian Accounting Standards) Rules, 2015. While Company Y Ltd. having net worth of ₹ 150 crores in the year 2015-16, would be required to prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006.

Since, the foreign company ABC Inc., is not a company incorporated under the Companies Act, 2013 or the earlier Companies Act, 1956, it is not required to prepare its financial statements as per the Companies (Indian Accounting Standards) Rules, 2015. As the foreign company is not required to prepare financial statements based on Ind AS, the net worth of foreign company ABC would not be the basis for deciding whether Indian Subsidiary Company X Ltd. and Company Y Ltd. are required to prepare financial statements based on Ind AS.

10.2 Ind AS Roadmap for Non -Banking Financial Companies (NBFC)

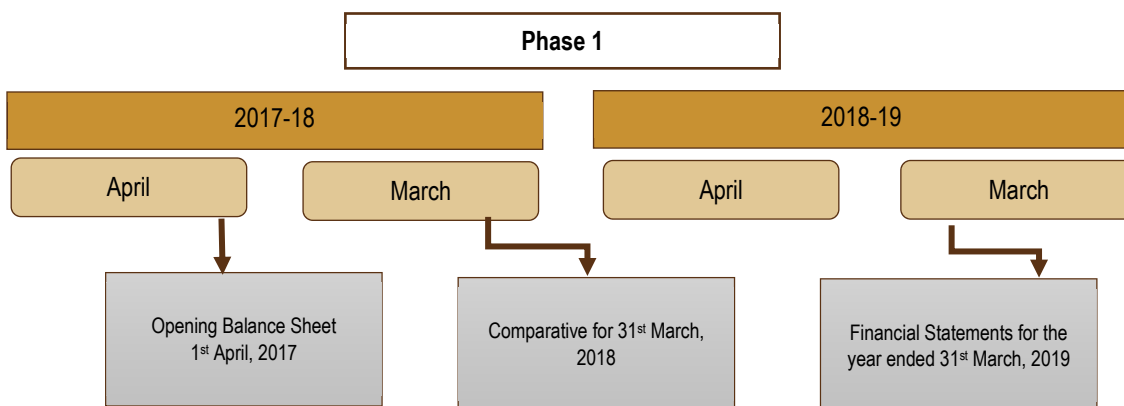
For the purpose, NBFC is defined as a Non-Banking Financial Company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 and includes Housing Finance Companies, Merchant Banking companies, Micro Finance Companies, Mutual Benefit Companies, Venture Capital Fund Companies, Stock Broker or Sub-Broker Companies, Nidhi Companies, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies

Ministry of Corporate Affairs, in its circular dated 30th March 2016, amended the Companies (Indian Accounting Standards) Rules, 2015 to include its applicability to Non-Banking Finance Companies. As per the circular, NBFCs to apply Ind AS in the following two phases:

Phase I

As per the Companies (Indian Accounting Standards) Rules, 2015, following NBFCs were covered under Phase I for accounting periods beginning on or after 1st April 2018, with the comparatives for the periods ending on 31st March 2018.

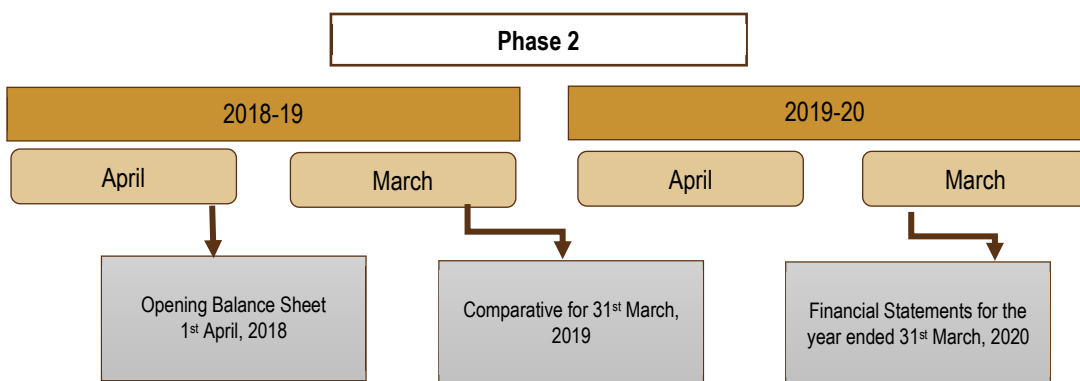
- a. NBFCs having net worth of ₹ 500 Crores or more
- b. Holding, subsidiary, associate or Joint Venture of NBFCs already covered under sub clause (a) above, other than companies already covered under Ind AS roadmap for Non-Financial companies



Phase II

Following NBFCs were covered under Phase II for accounting periods beginning on or after 1st April 2019, with the comparatives for the periods ending on 31st March 2019

- a. NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchange in India or outside India and having net worth less than rupees five hundred crore;
- b. NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and
- c. Holding, subsidiary, associate or Joint Venture of Companies already covered under sub clause (a) and (b) above, other than companies already covered under Ind AS roadmap for Non-financial companies



NBFCs having net worth below rupees two fifty crores and not covered above shall continue to apply ASs. Further, where Ind AS is applicable to NBFCs, the same shall apply to both standalone and consolidated financial statements.

It is notable that NBFC can apply Ind AS only if they fall in any of the above criteria. Voluntary adoption of Ind AS by NBFCs are not allowed.

10.2.1 Clarification on calculation of Net Worth

For the purposes of calculation of net worth of NBFCs for determining the applicability of Ind AS, the following principles shall apply, namely:-

- a) the net worth shall be calculated in accordance with the stand-alone financial statements of the NBFCs as on 31st March 2016 or the first audited financial statements for accounting period which ends after that date;
- b) for NBFCs which are not in existence on 31st March 2016 or an existing NBFC falling first time, after 31st March 2016, the net worth shall be calculated on the basis of the first audited

stand-alone financial statements ending after that date, in respect of which it meets the thresholds.

Explanation.- For the purposes of sub-clause (b), the NBFCs meeting the specified thresholds as given in the roadmap for the first time at the end of an accounting year shall apply Ind AS from the immediately next accounting year

For E.g. –

- (i) The NBFCs meeting threshold for the first time as on 31st March, 2019 shall apply Ind AS for the financial year 2019-20 onwards.
- (ii) The NBFCs meeting threshold for the first time as on 31st March, 2020 shall apply Ind AS for the financial year 2020-21 onwards and so on.

Application of Ind AS to non-finance companies whose parent / subsidiary or associate or joint venture is a NBFC

The date for application of Ind AS to non-finance companies is not aligned with that of NBFCs. Hence it has been clarified in the notification that the companies shall apply AS or Ind AS on the basis of respective standard applicable to them. However, for the purpose of preparation of Consolidated Financial Statements it is clarified that :

- A)** where an NBFC is a parent (at ultimate level or at intermediate level), and prepares consolidated financial statements as per AS, and its subsidiaries, associates and joint ventures are non-finance companies and are required to prepare financial statements as per Ind AS as per the roadmap given in The Companies (Indian Accounting Standards) Rules, 2015, such subsidiaries, associate and joint venture shall prepare its financials as per Ind AS. However, such subsidiaries, associate and joint venture has to provide the relevant financial statement data in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under Ind AS).
- B)** Where a parent is a non-finance company covered under Ind AS as per the roadmap given in The Companies (Indian Accounting Standards) Rules, 2015 and has a NBFC subsidiary, associate or a joint venture, the parent has to prepare Ind AS-compliant consolidated financial statements and the NBFC subsidiary, associate and a joint venture has to provide the relevant financial statement data in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under Ind AS).

It implies that the NBFC subsidiary, associate or a joint venture, in such case shall continue to prepare the financials under AS until Ind AS are applicable to it.

Illustration 8

As per the roadmap, Ind AS is applicable to Company X from the financial year 2017-18. Company X (non-finance company) is a subsidiary of Company Y (NBFC). Company Y is an unlisted NBFC company having net worth of ₹ 400 crores. What will be the date of applicability of Ind AS for company X and company Y? If Ind AS applicability date for parent NBFC is different from the applicability date of corporate subsidiary, then, how will the consolidated financial statements of parent NBFC be prepared?

Solution

In accordance with the roadmap, it may be noted that NBFCs having net worth of less than 500 crore shall apply Ind AS from 1 April, 2019 onwards. Further, the holding, subsidiary, joint venture or associate company of such an NBFC other than those covered by corporate roadmap shall also apply Ind AS from 1 April, 2019.

Accordingly, in the given case, Company Y (NBFC) shall apply Ind AS for the financial year beginning 1 April, 2019 with comparative for the period ended 31 March, 2019. Company X shall apply Ind AS in its statutory individual financial statements from financial year 2017-2018 (as per the corporate roadmap). However, for the purpose of Consolidation by Company Y for financial years 2017-2018 and 2018-2019, Company X shall also prepare its individual financial statements as per AS.

10.3 Ind AS Roadmap for Banking and Insurance Companies

As per the Companies (Indian Accounting Standards) (Amendment) Rules, 2016, The Banking Companies and Insurance Companies shall apply the Ind AS as notified by the Reserve Bank of India (RBI) and Insurance Regulatory Development Authority (IRDA) respectively. As the same are yet to be notified, Ind AS is not applicable to Banking and Insurance Companies presently.

It is notable that Banks and Insurance Companies shall not be allowed to voluntarily adopt Ind AS. However, this does not preclude them from providing Ind AS compliant financial statements for the purpose of preparation of consolidated financial statements by its parent/investor, as required by the parent/investor to comply with the existing requirements of law.

10.4 Ind AS Roadmap for Mutual Funds

The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (the MF Regulations) lay down the regulatory framework for operations and functioning of Mutual Funds (MFs). The MF Regulations are amended by SEBI from time to time to enhance transparency and disclosures, to address emerging issues, to protect the interests of investors, and to strengthen the regulatory framework of MFs.

On 25 January 2022, SEBI vide a notification issued the SEBI (Mutual Funds) (Amendment) Regulations, 2022. As per this notification, the financial statements and accounts of MF schemes will be prepared in accordance with Indian Accounting Standards (Ind AS). Additionally, SEBI vide a circular dated 4 February 2022 (the circular) provided certain guidelines on accounting with respect to Ind AS for MFs. The circular also provides specific formats of the financial statements to be prepared for the MF schemes under Ind AS. The requirements of the circular will become applicable from 1 April 2023.



11. IND AS RELEVANT STATUTORY PROVISIONS

11.1 Relevant Sections referring to Ind AS in the Companies Act, 2013 and Rules

Ind AS were initially notified under the Companies (Indian Accounting Standards) Rules, 2015. Post that it was amended from time to time to include the amendments / changes in the Ind AS.

Following are the some of the key relevant provisions of the Companies Act 2013, which gives reference to Ind AS:

- **Section 2(2)** states that accounting standards means the standards of accounting or any addendum thereto for companies or class of companies referred to in Section 133
- **Section 133** states the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Under the power given to the Central Government under section 133, it notified the Companies (Indian Accounting Standards) Rules, 2015.
- **Section 129** suggests the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III:
- **Section 134 (5) (a)**, a statement that the applicable accounting standards had been followed with proper explanation relating to material departures shall be given in the Director Responsibility statement to be issued under section 134 (3) (c) in the Director's report to be published in Annual General Meeting
- **Section 143**, auditor has to opine whether the financial statements comply with the accounting standards

- **Section 230** – Power to compromise or make arrangements with creditors and members and Section 232 – Merger and amalgamation of Companies, the scheme of compromise or arrangement is to be sanctioned by the tribunal only after obtaining a certificate from the company's auditor that the accounting treatment given proposed in the scheme of compromise or arrangement is in conformity with the accounting standards mentioned in Section 133.
- **Section 66** – Reduction of Share Capital, which states that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

11.2 Relevant SEBI Rules and Regulations

Formats for publishing financial results (Circular dated 30th November 2015)

SEBI via circular dated 30th November, 2015 amended the format for publishing quarterly financial statements. Point 5 of the circular clarified that Companies adopting the Ind AS in terms of Companies (Indian Accounting Standards) Rules, 2015 notified by the Ministry of Corporate Affairs on 16th February, 2015 while publishing quarterly / annual financial results under Regulation 33 of the Listing Regulations, 2015, shall ensure that the comparatives filed along with such quarterly/annual financial results are also Ind AS compliant.

Clarification regarding applicability of Indian Accounting Standards to disclosures in offer documents under SEBI (ICDR) Regulations, 2018

The applicability of Ind AS for financial information (last 3 years financials) to be disclosed in the offer document as specified under SEBI (ICDR) Regulations, 2018 and provided the year wise applicability of Ind AS based on the period of filling offer document.

Example 6

For a company filling offer document between 1st April 2021 to 31st March 2022, the financial statements of latest financial year, second latest financial year and third latest financial year shall be as per Ind AS.

Revised Formats for financial results and implementation of Ind AS by Listed Entities

For the period ending on or after 31st March, 2017, the formats for Unaudited / Audited quarterly financial results i.e. Statement of Profit and Loss and the Unaudited / Audited Half-Yearly Balance Sheet to be submitted by the Listed Entities, with the stock exchanges, shall be as per the formats for Balance Sheet and Statement of Profit and Loss (excluding notes and detailed sub-classification) as prescribed in Schedule III to the Companies Act, 2013. However, Banking Companies and Insurance Companies shall follow the formats as prescribed under the respective Acts / Regulations as specified by their Regulators.



12. FORMAT OF DIVISION II TO SCHEDULE III TO THE COMPANIES ACT - STRUCTURE

12.1 Introduction

Schedule III to the Companies Act, 2013 was notified along with the Companies Act, 2013 (Act) itself on 29th August, 2013 thereby providing the way every company registered under the Act shall prepare its Financial Statements. Financial Statements as defined under the Act include Balance Sheet, Statement of Changes in Equity for the period if applicable, the Statement of Profit and Loss for the period, Cash flow statement for the period and Notes.

‘Division II’ – ‘Ind AS Schedule III’ was inserted in the Companies Act, 2013 to give a format of Financial Statements for companies that are required to comply with the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time. This is newly inserted into Schedule III for companies that adopt Ind AS. Accordingly, such companies, while preparing its first and subsequent Ind AS Financial Statements, would apply Division II to Schedule III to the Act.

The requirements of Division II to Schedule III, however, do not apply any insurance or banking company or to any other class of company for which a form of Balance Sheet and Statement of Profit and Loss has been specified in or under any other Act governing such class of company. Moreover, the requirements of Division II to Schedule III do not apply to Non-Banking Finance Companies (NBFCs) that adopt Ind AS of Companies (Indian Accounting Standards) Rules, 2015 notified in Companies (Indian Accounting Standards) (Amendment) Rules, 2016 as amended from time to time. For NBFCs, Division III to Schedule III to the Companies Act, 2013 prescribes the formats of financial statements.

‘Division II’ – ‘Ind AS Schedule III’ is divided into following three parts:

- Part I – Format of Balance Sheet and Statement of Changes in Equity and notes related to them (Elements of Balance Sheet and its line items)
- Part II – Format of Statement of Profit and Loss and notes related to it (Elements of Statement of Profit and Loss and its line items)
- Part III – General Instructions for preparation of Consolidated Financial Statements

12.2 Applicability

As per the Government Notification no. S.O. 902 (E) dated 26 March, 2014, Schedule III is applicable for the Financial Statements prepared for the financial year commencing on or after 1st April, 2014. Further, as per the Government Notification no. G.S.R. 404(E) dated

6th April, 2016, Schedule III is amended to include a format of Financial Statements for a company preparing Financial Statements in compliance with the Companies Ind AS Rules. Schedule III has been further amended vide the Government Notification dated 24th March, 2021 to include certain additional presentation and disclosures requirements and changes some existing requirements. These changes need to be applied in preparation of financial statements for the financial year commencing on or after 1st April, 2021. All companies that prepare, either voluntarily or mandatorily, Financial Statements in compliance with the Companies Ind AS Rules, should consider Ind AS Schedule III as well as ICAI's Guidance Note on Division II to Schedule III to the Companies Act, 2013. Additionally, preparers of financial statements should also consider requirements of the Act as well as other Statutes, Notifications, Circulars issued by various Regulators.

Division II to Schedule III to the Companies Act, 2013 has been annexed at the end of the study material for reference.



13. GUIDANCE NOTE ON DIVISION II TO SCHEDULE III TO THE COMPANIES ACT, 2013

Corporate Laws & Corporate Governance Committee (CLCGC) of ICAI issued the Guidance Note on Division-II to Schedule III to the Companies Act, 2013 in 2017 and kept on revising the same as per requirements. Latest Guidance Note on the subject is issued in January, 2022. This Guidance Note aims to provide guidance on the amended Division-II to Schedule III to the Companies Act, 2013. It also lays down broad guidelines to deal with practical issues that may arise in the implementation of Division-II to Schedule III to the Companies Act, 2013. Accordingly, wherever required conceptual guidance has been provided in the Guidance Note.

Following are the some of the key guidance stated in guidance note. The following should be read in conjunction with Guidance Note issued on the subject:

- 1) Property, Plant and Equipment: Under the Ind AS Schedule III, land and building are presented as two separate classes of property, plant and equipment. In contrast, paragraph 37 of Ind AS 16 gives an example of grouping land and building under same class for revaluation purposes. The para states that a class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. However, companies should continue to present land and building separately as given in Ind AS Schedule III and such presentation needs to be followed consistently.

As per Ind AS Schedule III, capital advances/ advances for purchase of capital assets should be included under other non- current assets and hence, should not be included under capital work-in-progress

- 2) Non-current Investment: Under each sub-classification of Investments, there is a requirement to disclose details of investments including names and the nature and extent of the investment in each body corporate which is a subsidiary, associate, joint venture and structured entity. The nature and extent would imply the number of such instruments held and the face value of such instrument.

Ind AS Schedule III requires disclosure of the aggregate amount of quoted investments and market value thereof and the aggregate amount of unquoted investments. The aggregate amount of such investments would include aggregate amount of carrying value of these investments as at the reporting date as included in the financial statements.

The market value of quoted investments would, generally, mean disclosure of the 'fair value' of quoted investments as at each reporting date. Ind AS 113 defines fair value and also states that the fair value of assets might be affected when there has been a significant decrease in the volume or level of activity for that asset in relation to normal market activity for that asset. A decrease in the volume or level of activity on its own may not indicate that a quoted price does not represent fair value. However, based on the company's evaluation, if it determines that a quoted price does not represent fair value, then the company shall disclose the market value of quoted investments based on the quoted price which would be different from the investment's fair value.

As per Ind AS Schedule III, aggregate amount for impairment in value of investments should be disclosed separately. As per Ind AS 109, the company is required to recognize a loss allowance (i.e. impairment) for expected credit losses on investments measured at amortized cost. Such loss allowance should be presented as an adjustment to the amortized cost of the investment.

As per Ind AS 109, in case of debt investments measured at fair value through other comprehensive income (FVTOCI), a company shall estimate a portion of fair value change, if any, attributable to a change in credit risk of such investment and disclose the same in the profit and loss section of the statement of profit and loss with a corresponding impact in other comprehensive income section.

No disclosure is required in case of equity investments measured at fair value since Ind AS 109 does not permit a separate calculation / evaluation of impairment amount for all such investments.

The aggregate provision for impairment as per Ind AS 36 in the value of investments may be either presented in totality, where relevant, for all the investments or separately for each class of investments (e.g., 'Investment at amortized cost', 'Investment in debt instruments at FVOCI') disclosed in the financial statements.

A limited liability partnership is a body corporate and not a partnership firm as envisaged under the Partnership Act, 1932. Hence, disclosures pertaining to Investments in partnership firms will not extend to investments in limited liability partnerships. The investments in limited liability partnerships will be disclosed separately under 'other investment'.

Note: Any application money paid towards securities, where security has not been allotted on the date of the Balance Sheet, shall be disclosed as a separate line item under 'other non-current financial assets'. In case the investment is of current investment in nature, such share application money shall be accordingly, disclosed under other current financial assets.

- 3) Trade Receivables: A receivable shall be classified as 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business and the company has a right to an amount of consideration that is unconditional (i.e. if only the passage of time is required before payment of that consideration is due). Hence, amounts due under contractual rights, other than arising out of sale of goods or rendering of services, cannot be included within Trade Receivables. Such items may include dues in respect of insurance claims, sale of Property, Plant and Equipment, contractually reimbursable expenses, etc. Such receivables should be classified as "other financial assets" and each such item should be disclosed nature-wise

The ageing of the trade receivables needs to be determined from the due date of the invoice. Due date is generally considered to be the date on which the payment of an invoice falls due. The due date of an invoice is determined based on terms agreed upon between the buyer and supplier. In case if the due date is neither agreed in writing nor orally, then the ageing related disclosure needs to be prepared from the transaction date.

Schedule III requires split of trade receivables between 'disputed' and 'undisputed'. These terms have not been defined in the Schedule III. A dispute is a matter of facts and circumstances of the case; however, dispute means disagreement between two parties demonstrated by some positive evidence which supports or corroborates the fact of disagreement. In case there are any disputes such fact should also be considered while assessing the credit risk associated with respective party while computing the impairment loss. However, a dispute might not always be an indicator of counterparty's credit risk and vice-versa. Hence, both of these should be evaluated independently for the purpose of making these disclosures.

- 4) Other Non-Current Financial Assets – Ind AS Schedule III does not specify about the presentation of finance lease receivables. However, the guidance note clarifies that the non-current portion of a finance lease receivable shall be presented under 'Other non-current financial assets' while its current portion shall be presented under 'Other current financial assets'.

- 5) Current Assets - As per Ind AS Schedule III, all items of assets and liabilities are to be bifurcated between current and non-current portions. In some cases, the items presented under the “non-current” head of the Balance Sheet may not have a corresponding “current” head under the format given in Ind AS Schedule III. Since Ind AS Schedule III permits the use of additional line items, in such cases the current portion should be classified under the “Current” category of the respective balance as a separate line item and other relevant disclosures should be made.
- 6) Cash and Cash Equivalents - Cash and cash equivalents is not defined in Ind AS Schedule III however, according to Ind AS 7 Statement of Cash Flows, Cash is defined to include cash on hand and demand deposits with banks. Cash Equivalents are defined as short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

As per para 8 of Ind AS 7 “where bank overdrafts which are repayable on demand form an integral part of an entity’s cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.” Although Ind AS 7 permits bank overdrafts to be included as cash and cash equivalent, however for the purpose of presentation in the balance sheet, it is not appropriate to include bank overdraft as a component of cash and cash equivalents unless the offset conditions as given in paragraph 42 of Ind AS 32 are complied with. Bank overdraft, in the balance sheet, should be included as ‘borrowings’ under Financial Liabilities.

- 7) Current Tax Assets - If amount of tax already paid in respect of current and prior periods exceeds the amount of tax due for those periods (assessment year-wise and not cumulative unless tax laws allow for e.g., say tax laws in the country of overseas subsidiary permits), then such excess tax shall be recognised as an asset. The excess tax paid (presented as current tax assets) may not be expected to be recovered / realised within one year from the balance sheet date and if so, the same shall be presented under non-current assets. An entity should evaluate whether current tax assets meet the definition of current assets or not and should accordingly present the same.
- 8) Equity Share Capital - The accounting definition of ‘Equity’ is principle based as compared to the legal definition of ‘Equity’ or ‘Share’, such that any contract that evidences residual interest in an entity’s net asset is termed as ‘Equity’ irrespective of whether it is legally recognized as a ‘Share’ or not. Accordingly, all instruments (including convertible preference shares and convertible debentures) that meet the definition of ‘Equity’ as per Ind AS 32 in its entirety and when they do not have any component of liability, should be considered as having the nature of ‘Equity’ for the purpose of Ind AS Schedule III. Such instruments shall be termed as ‘Instruments entirely equity in nature’.

- 9) Borrowings- The phrase "term loan" has not been defined in the Schedule III. Term loans normally have a fixed or pre-determined maturity period or a repayment schedule.

Terms of repayment of term loans and other loans shall be disclosed. The term 'other loans' is used in general sense and should be interpreted to mean all categories listed under the heading 'Non – Current borrowings' as per Ind AS Schedule III. Disclosure of terms of repayment should be made preferably for each loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated.

Ind AS Schedule III requires presenting 'current maturities of long-term debt' under 'current borrowings'. Long-term debt is specified in Ind AS Schedule III as a borrowing having a period of more than twelve months at the time of origination. The portion of non-current borrowings, which is due for payments within twelve months of the reporting date is required to be classified under "current borrowings" while the balance amount should be classified under non-current borrowings.

- 10) Trade Payable - A payable shall be classified as 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business. Hence, amounts due under contractual obligations or which are statutory payables should not be included within Trade Payables. Such items may include dues payable in respect of statutory obligations like contribution to provident fund or contractual obligations like contractually reimbursable expenses, amounts due towards purchase of capital goods, etc.

Due date shall be the date by when a buyer should make payment to the supplier as per terms agreed upon between the buyer and supplier. In case if the due date is neither agreed in writing nor oral, then the disclosure needs to be prepared from the transaction date. Transaction date shall be the date on which the liability is recognised in the books of accounts as per the requirement of applicable standards. A dispute is a matter of facts and circumstances of the case. However, dispute means disagreement between two parties demonstrated by some positive evidence which supports or corroborates the fact of disagreement. Reference is given to the term "Dispute" as defined under the Insolvency and Bankruptcy Code, 2016.

- 11) Current Borrowings - Loans payable on demand should be treated as part of current borrowings. Current borrowings will include all loans payable within a period of 12 months from the date of the loan. In the case of current borrowings, the period and the amount of defaults existing as at the date of the Balance Sheet should be disclosed (item-wise).

To provide relevant information to the users of the financial statements regarding total amount of liability under the respective category of noncurrent borrowings, Companies shall provide the amount of non-current as well as current portion for each of the respective category of non-current borrowings either by way of a note or a schedule or a cross-reference, as appropriate. This shall be in addition to Ind AS Schedule III requirements for presenting 'current maturities of long-term borrowings' under current borrowings.

- 12) Other Current Liabilities - Trade Deposits and Security Deposits, which do not meet the definition of financial liabilities, should be classified as 'Others' grouped under this head. Others may also include liabilities in the nature of statutory dues such as Withholding taxes, Service Tax, VAT, Excise Duty, Goods and Services Tax (GST), etc.
- 13) Contingent Liabilities and Commitments - A contingent liability in respect of guarantees arises when a company issue guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance Sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premium, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premium when demanded or to make deferred payments when due. Hence, such performance guarantees and counter guarantees should not be disclosed as contingent liabilities.
- 14) Revenue from Operations and other operating income- Indirect taxes such as Sales tax, Goods and Services tax, etc. are generally collected from the customer on behalf of the government in majority of the cases. However, this may not hold true in all cases and it is possible that a company may be acting as principal rather than as an agent in collecting these taxes. Whether revenue should be presented gross or net of taxes should depend on whether the company is acting as a principal and hence, is responsible for paying tax on its own account or, whether it is acting as an agent i.e. simply collecting and paying tax on behalf of government authorities. If the entity is the principal, then revenue should also be grossed up for the tax billed to the customer and the tax payable should be shown as an expense. However, in cases, where a company collects such taxes only as an agent, revenue should be presented net of taxes.

The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.

- 15) Exceptional Items - The term 'Exceptional items' is neither defined in Ind AS Schedule III nor in Ind AS. However, Ind AS 1 has reference to such items. Ind AS 1 states that disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity

considers factors including materiality and the nature and function of the items of income and expense. It indicates circumstances that would give rise to the separate disclosures of items of income and expenses and include:

- (a) Write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- (c) disposals of items of property, plant and equipment;
- (d) disposals of investments;
- (e) discontinued operations;
- (f) litigation settlements; and
- (g) other reversals of provisions.

SUMMARY

- Accounting Standards is an essential building block in the economics financial reporting world. These Accounting Standards provide principles and rules that must be followed to ensure accuracy, consistency and comparability of financial statements
- Prior to introduction of Ind AS, ASB has issued various AS to deal with various reporting matters which were known as AS and were applicable to companies and also non-corporate entities.
- To enable free flow of capital across jurisdiction without increasing cost and complexity of compliances along with need to provide comprehensive guidance to deal with rising complexities of business and financial world, the need to have Global Accounting Standards have strongly emerged, leading to rise of IFRS.
- In response to commitment to G20, MCA has notified IFRS converged Standards i.e. Ind AS phase wise for India Corporates in 2015, which eventually got extended to NBFCs.
- MCA and ICAI had worked extensively together to align Statutory provisions not in cognisant with Ind AS to ease the implementation challenges for the companies.

Schedule III revision, extensive guidance note dealing with practical application thereof, amendment in listing regulations by SEBI, continuous guidance on key matters by ITFG are some of the many initiatives which helped companies to transition to Ind AS smoothly.

[illegible]

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING UNDER INDIAN ACCOUNTING STANDARDS (IND AS)



LEARNING OUTCOMES

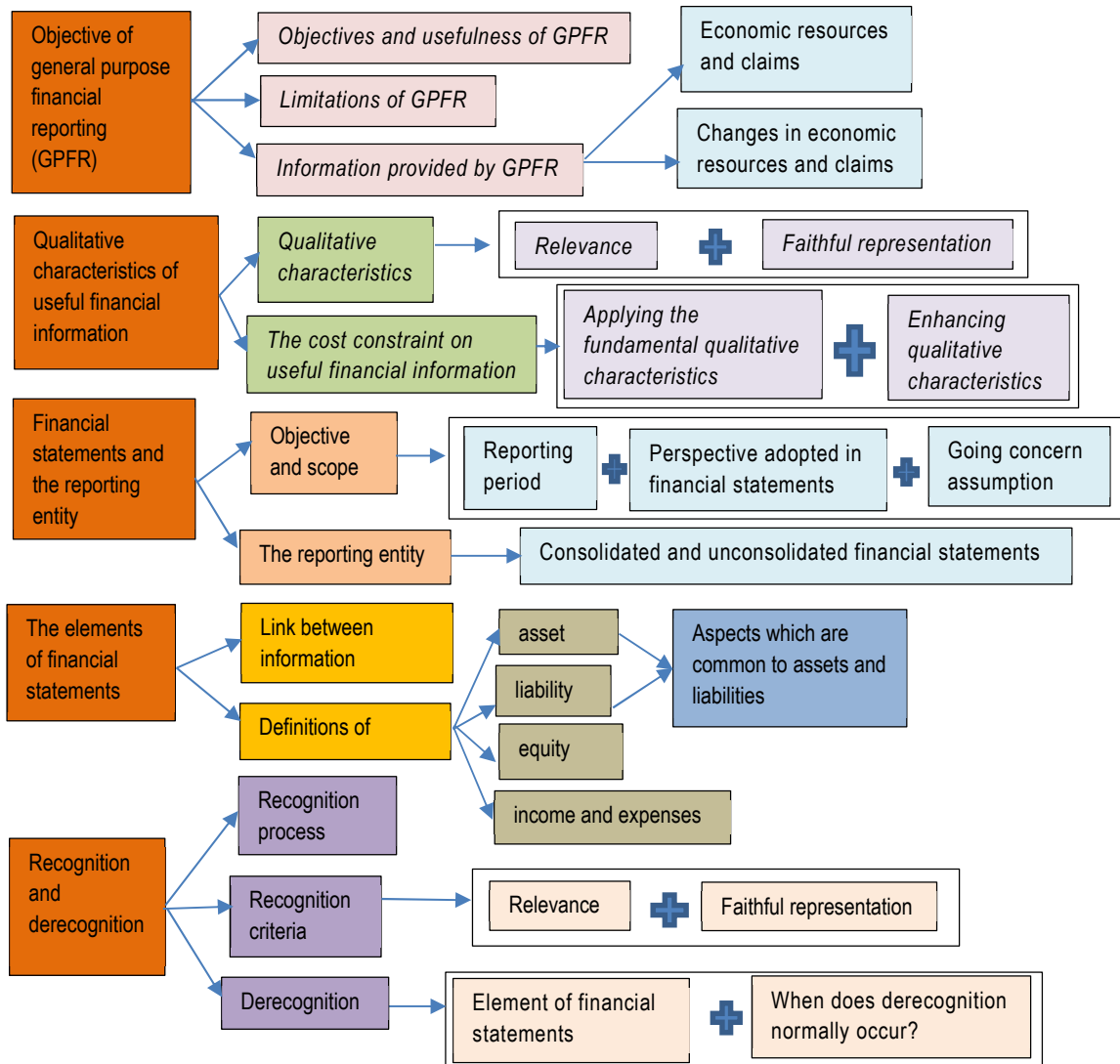
After studying this chapter, you would be able to:

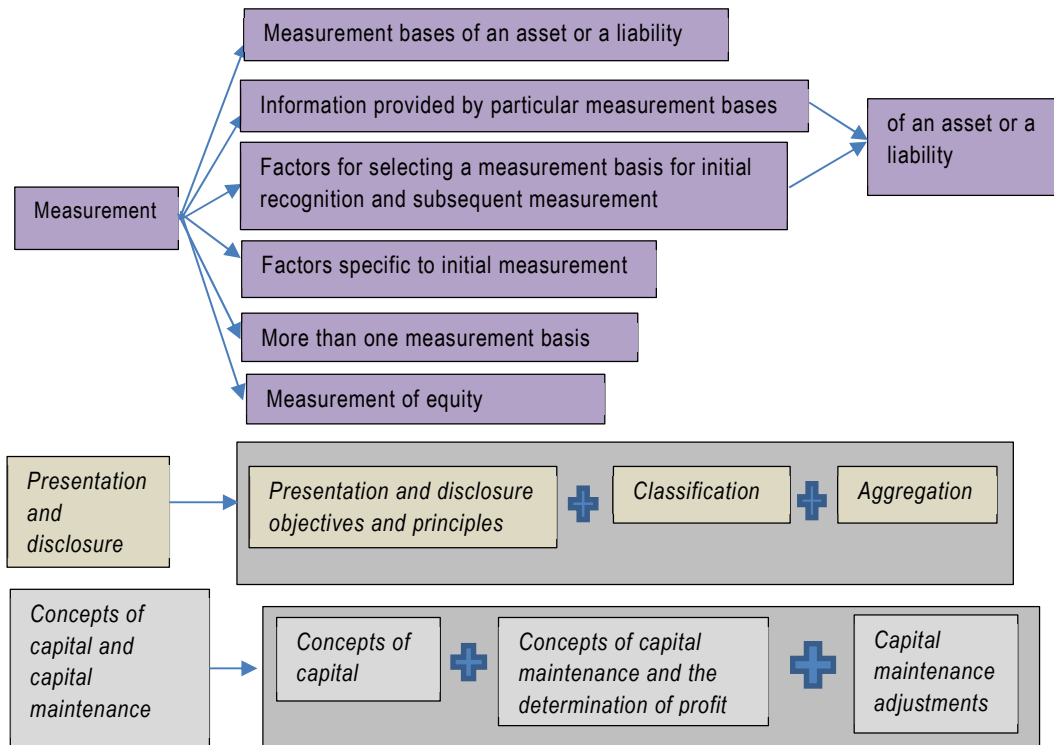
- ☐ Identify the objectives of general purpose financial reporting.
- ☐ Apply qualitative characteristics of useful financial information
- ☐ Define the concept of financial statements and the reporting entity
- ☐ Describe the various elements of financial statements i.e. asset, liability, income and expenses
- ☐ Explain the criteria for including assets and liabilities in financial statements (recognition) and when to remove them (derecognition)
- ☐ Recognize measurement bases and when to use them
- ☐ Comprehend the concept of presentation and disclosure and its importance as communication tools
- ☐ Explain the concept of capital and capital maintenance and identify how it links to the concept of profit.

UNIT OVERVIEW



Conceptual Framework for Financial Reporting



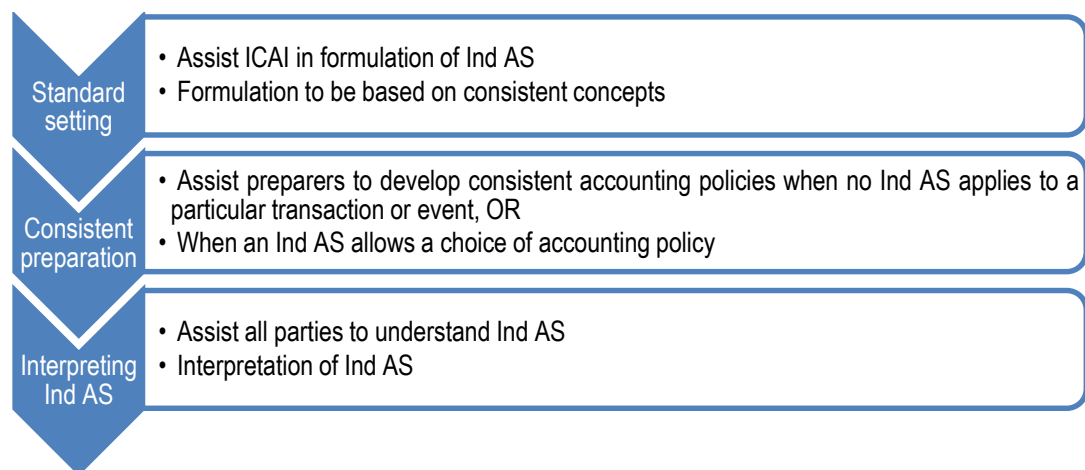


UNIT 1: INTRODUCTION

The Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS) (hereinafter the '*Conceptual Framework under Ind AS*') is not a Standard and it does not override any standard or any requirement in any standard. Therefore, this does not form part of a set of standards pronounced by the standard-setters. While the *Conceptual Framework under Ind AS* is primarily meant for the standard-setter for formulating the standards, it has relevance to the preparers in certain situations such as to develop consistent accounting policies for areas that are not covered by a standard or where there is a choice of accounting policy, and to assist all parties to understand and interpret the Standards. As a result, certain individual standards e.g. Ind AS 1, Presentation of Financial Statements, Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors, Ind AS 103, Business Combinations, etc., require the preparers to follow the guidance in the *Conceptual Framework for Financial reporting under Indian Accounting Standards*.

The Institute of Chartered Accountants of India (ICAI), in the past, has issued a pronouncement with the title 'Framework for the Preparation and Presentation of Financial Statements under Indian Accounting Standards'. This framework was primarily based on the Framework issued by the International Accounting Standards Board's (IASB's) predecessor body IASC in 1989 (Framework 1989). In March 2018, the IASB issued a comprehensive revised framework titled 'Conceptual Framework for Financial Reporting'. In view of the issuance of new Conceptual Framework by the IASB and with an objective to remain converged with the global accounting framework, the ICAI has developed the *Conceptual Framework under Ind AS* corresponding to IASB's Conceptual Framework 2018.

The purpose of the *Conceptual Framework under Ind AS* can be summarised as below:



Ind AS or any requirement in an Ind AS overrides the *Conceptual Framework under Ind AS*. To meet the objective of general-purpose financial reporting, the ICAI may sometimes specify requirements that depart from aspects of the Conceptual Framework. If the ICAI does so, it will explain the departure in the Appendix to the relevant Ind AS.

UNIT 2

OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

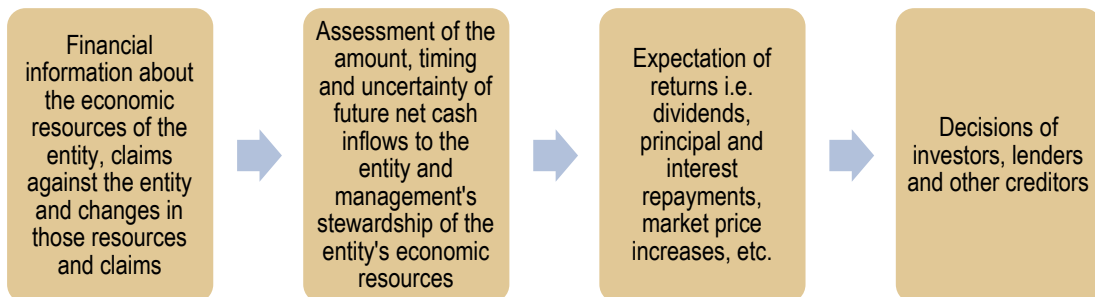


2.1 OBJECTIVES AND USEFULNESS OF GENERAL PURPOSE FINANCIAL REPORTING

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about:

- (a) buying, selling or holding equity and debt instruments;
- (b) providing or settling loans and other forms of credit; or
- (c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

The chart below is intended to demonstrate the strong correlation between general purpose financial reports and decision making process of relevant stakeholders:



2.2 LIMITATIONS OF GENERAL PURPOSE FINANCIAL REPORTING

General purpose financial reports:

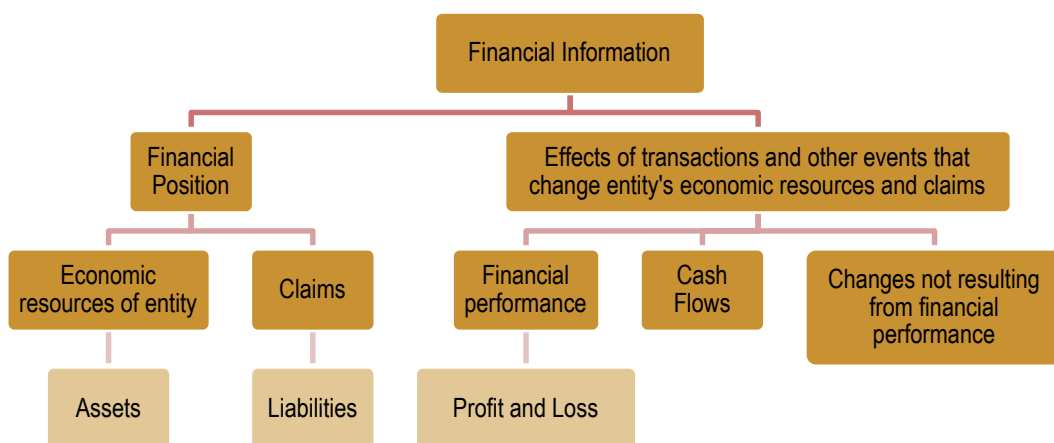
- ◆ do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks;

- ◆ are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity; and
- ◆ are not primarily directed to other parties, such as regulators and members of the public other than investors, lenders and other creditors.



2.3 INFORMATION PROVIDED BY GENERAL PURPOSE FINANCIAL REPORTS

The chart below provides an overview of the information sought to be provided in the general purpose financial reports, which will, in turn, be used by the relevant stakeholders in making their economic decisions, as presented in the flowchart above.



2.3.1 Economic resources and claims

Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to:

- (a) assess the reporting entity's:
 - (i) liquidity and solvency,
 - (ii) its needs for additional financing and
 - (iii) how successful it is likely to be in obtaining that financing
- (b) assess management's stewardship of the entity's economic resources

- (c) predict how future cash flows will be distributed among those with a claim against the reporting entity

2.3.2 Changes in economic resources and claims

Changes in a reporting entity's economic resources and claims result from:

- ◆ that entity's financial performance and
- ◆ other events or transactions such as issuing debt or equity instruments

To properly assess both the prospects for future net cash inflows to the reporting entity and management's stewardship of the entity's economic resources, users need to be able to identify those two types of changes.

2.3.2.1 Financial performance reflected by accrual accounting

Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period.

Such information is useful in:

- ◆ assessing the entity's past and future ability to generate net cash inflows,
- ◆ indicating the extent to which the reporting entity has increased its available economic resources, and thus its capacity for generating net cash inflows through its operations,
- ◆ helping users to assess management's stewardship of the entity's economic resources, and
- ◆ indicating the extent to which events such as changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.

2.3.2.2 Financial performance reflected by past cash flows

Information about a reporting entity's cash flows during a period helps in assessment of:

- ◆ entity's ability to generate future net cash inflows, by helping users:
 - understand reporting of entity's operations,
 - evaluate its financing and investing activities,
 - assess its liquidity or solvency and
 - interpret other information about financial performance
- ◆ management's stewardship of the entity's economic resources.

2.3.2.3 Changes in economic resources and claims not resulting from financial performance

A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing debt or equity instruments. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

UNIT 3

QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

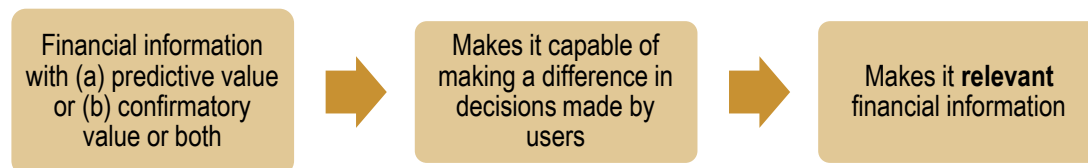
If financial information is to be useful, it must be **relevant** and **faithfully represent** what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Let's look at these two fundamental qualitative characteristics in more detail.

3.1 QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

3.1.1 Relevance

The following chart will explain what is considered as “relevant financial information”:



Financial information has **predictive value** if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

Financial information has **confirmatory value** if it provides feedback about (confirms or changes) previous evaluations.

The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value.

Example 1

Revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

The characteristic of 'relevance' also includes the concept of **materiality**. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the ICAI cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

3.1.2 Faithful representation

To be useful, financial information must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

- ◆ **Complete:** A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.

Example 2

A complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, historical cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction (e.g. facts such as encumbrance / hypothecation / mortgage of items of Property, Plant and Equipment against secured borrowings, disclosure of fair value of Investment Property etc.).

- ◆ **Neutral:** A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users.

Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.

Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.

- ◆ *Free from error*: Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Example 3

The use of reasonable estimates is an essential part of the preparation of financial statements. Examples of estimates could include useful life of an item of Property, Plant and Equipment, net realizable value of inventories, fair value of investment in an unlisted entity, expected credit losses etc. As long as the estimates are fair, the financial statements will be concluded to be free from error, even though the actual outcome may be different from the original estimate.

3.1.3 Applying the fundamental qualitative characteristics

The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows:

Identify an economic phenomenon, information about which is capable of being useful to users of the reporting entity's financial information

Identify the type of information about that phenomenon that would be most relevant

Determine whether that information is available and whether it can provide a faithful representation of the economic phenomenon

If faithful representation is achieved, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

In some cases, a trade-off between the fundamental qualitative characteristics may need to be made in order to meet the objective of financial reporting, which is to provide useful information about economic phenomena. For example, the most relevant information about a phenomenon may be a highly uncertain estimate. In some cases, the level of measurement uncertainty involved in making that estimate may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that phenomenon. In some such cases, the most useful information may be the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. In other such cases, if that information would not provide a sufficiently faithful representation of that phenomenon, the most useful information may include an estimate of another type that is slightly less relevant but is subject to lower measurement uncertainty. In limited circumstances, there may be no estimate that provides useful information. In those limited circumstances, it may be necessary to provide information that does not rely on an estimate.

3.1.4 Enhancing qualitative characteristics

As mentioned at the beginning of Unit 3, the usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. Having identified the fundamental qualitative characteristics of useful financial information, let's understand how to enhance the usefulness by applying four enhancing qualitative characteristics.

- ◆ *Comparability:* Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

Comparability is neither same as consistency, nor as uniformity. Comparability is the goal; consistency helps to achieve that goal. Comparability refers to the use of the same methods for the same items, and uniformity implies that like things must look alike and different things must look different.

- ◆ *Verifiability:* Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.

Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of

inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first-out method).

- ♦ *Timeliness*: Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.
- ♦ *Understandability*: Classifying, characterising and presenting information clearly and concisely makes it understandable. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore possibly misleading. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

3.1.5 Applying the enhancing qualitative characteristics

- ♦ Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or does not provide a faithful representation of what it purports to represent.
- ♦ Applying the enhancing qualitative characteristics is an iterative process that does not follow a prescribed order. Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new Ind AS may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.



3.2 THE COST CONSTRAINT ON USEFUL FINANCIAL INFORMATION

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Both the providers and users of financial information incur costs in reporting and analysing financial information. In applying the cost constraint, the ICAI assesses whether the benefits of

reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, the ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

UNIT 4

FINANCIAL STATEMENTS AND THE REPORTING ENTITY

In this unit, we will address two critical aspects:

- ◆ What are financial statements?
- ◆ What is reporting entity?



4.1 OBJECTIVE AND SCOPE OF FINANCIAL STATEMENTS

The objective of financial statements is to provide financial information about the reporting entity's:

- ◆ assets, liabilities and equity; and
- ◆ income and expenses

(i.e. the elements of the financial statements – we will discuss this in more detail in Unit 5)

that is useful to users of financial statements in assessing:

- ◆ the prospects for future net cash inflows to the reporting entity, and
- ◆ management's stewardship of the entity's economic resources.

Such financial information is provided:

- (a) in the balance sheet, by recognising assets, liabilities and equity;
- (b) in the statement of profit and loss, by recognising income and expenses; and
- (c) in other statements and notes, by presenting and disclosing information about:
 - (i) recognised assets, liabilities, equity, income and expenses, including information about their nature and about the risks arising from those recognised assets and liabilities;
 - (ii) assets and liabilities that have not been recognised, including information about their nature and about the risks arising from them;
 - (iii) cash flows;
 - (iv) contributions from holders of equity claims and distributions to them; and
 - (v) the methods, assumptions and judgements used in estimating the amounts presented or disclosed, and changes in those methods, assumptions and judgements.

4.1.1 Reporting period

Financial statements are prepared for a specified period of time (reporting period) and to help users of financial statements to identify and assess changes and trends; financial statements also provide comparative information for at least one preceding reporting period.

Information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it:

- (a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and
- (b) is useful to users of financial statements.

For example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

Financial statements include information about transactions and other events that have occurred after the end of the reporting period if providing that information is necessary to meet the objective of financial statements.

4.1.2 Perspective adopted in financial statements

Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors.

4.1.3 Going concern assumption

Financial statements are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the financial statements describe the basis used.



4.2 THE REPORTING ENTITY

A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.

Sometimes one entity (parent) has control over another entity (subsidiary). If a reporting entity comprises both the parent and its subsidiaries, the reporting entity's financial statements are referred to as '**consolidated financial statements**'. If a reporting entity is the parent alone, the reporting entity's financial statements are referred to as '**standalone financial statements**' or 'separate financial statements' as the case may be.

If a reporting entity comprises two or more entities that are not all linked by a parent-subsidiary relationship, the reporting entity's financial statements are referred to as '**combined financial statements**'.

If the reporting entity is not a legal entity and does not comprise only legal entities linked by a parent-subsidiary relationship, how can the boundary of reporting entity be determined?

In such cases, determining the boundary of the reporting entity is driven by the information needs of the primary users of the reporting entity's financial statements. Those users need relevant information that faithfully represents what it purports to represent. Faithful representation requires that:

- (a) the boundary of the reporting entity does not contain an arbitrary or incomplete set of economic activities;
- (b) including that set of economic activities within the boundary of the reporting entity results in neutral information; and
- (c) a description is provided of how the boundary of the reporting entity was determined and of what constitutes the reporting entity.

4.2.1 Consolidated and unconsolidated financial statements

Consolidated financial statements provide information about the assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity. That information is useful for existing and potential investors, lenders and other creditors of the parent in their assessment of the prospects for future net cash inflows to the parent. This is because net cash inflows to the parent include distributions to the parent from its subsidiaries, and those distributions depend on net cash inflows to the subsidiaries.

Consolidated financial statements are not designed to provide separate information about the assets, liabilities, equity, income and expenses of any particular subsidiary. A subsidiary's own financial statements are designed to provide that information.

Unconsolidated financial statements are designed to provide information about the parent's assets, liabilities, equity, income and expenses, and not about those of its subsidiaries. That information can be useful to existing and potential investors, lenders and other creditors of the parent because:

- (a) a claim against the parent typically does not give the holder of that claim a claim against subsidiaries; and
- (b) in some jurisdictions, the amounts that can be legally distributed to holders of equity claims against the parent depend on the distributable reserves of the parent.

Another way to provide information about some or all assets, liabilities, equity, income and expenses of the parent alone in consolidated financial statements, is in the notes.

Information provided in unconsolidated financial statements is typically not sufficient to meet the information needs of existing and potential investors, lenders and other creditors of the parent. Accordingly, when consolidated financial statements are required, unconsolidated financial statements cannot serve as a substitute for consolidated financial statements. Nevertheless, a parent may require, or choose, to prepare unconsolidated financial statements in addition to consolidated financial statements.

UNIT 5

THE ELEMENTS OF FINANCIAL STATEMENTS

As explained in Unit 2, general purpose financial reports provide the information about:

- ◆ **Financial position** i.e. economic resources of the entity and claims against the entity; and
- ◆ **Effects of transactions and other events** that change entity's economic resources and claims

The elements of financial statements defined in the *Conceptual Framework under Ind AS* are:

- (a) assets, liabilities and equity, which relate to a reporting entity's financial position; and
- (b) income and expenses, which relate to a reporting entity's financial performance.



5.1 LINK BETWEEN INFORMATION IN GENERAL PURPOSE FINANCIAL REPORTS AS PER CONCEPTUAL FRAMEWORK AND ELEMENTS OF FINANCIAL STATEMENTS

In this Unit 5, we will discuss how the information in general purpose financial reports is represented by the elements of financial statements. The table below links the two:

Information provided by general purpose financial reports	Element of financial statements	Definition or description
Economic Resources	Asset	A present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.
Claim	Liability	A present obligation of the entity to transfer an economic resource as a result of past events.
	Equity	The residual interest in the assets of the entity after deducting all its liabilities.

Changes in economic resources and claims, reflecting financial performance	Income	Increases in assets, or decreases in liabilities, that result in increases in equity, <u>other than</u> those relating to contributions from holders of equity claims.
	Expenses	Decreases in assets, or increases in liabilities, that result in decreases in equity, <u>other than</u> those relating to distributions to holders of equity claims.
Other changes in economic resources and claims	-	Contributions from holders of equity claims, and distributions to them.
	-	Exchanges of assets or liabilities that do not result in increases or decreases in equity.



5.2 DEFINITION OF AN ASSET

The definition of 'asset', which, in turn, is dependent on definition of economic resource, has three key aspects – right, potential to produce economic benefits and control.

Let us look at these three aspects in more detail.

5.2.1 Right

The concept of what constitutes a 'right' is a very wide subject and can be better illustrated with reference to various lenses through which it can be seen, and a couple of such lenses are explained below. It must be understood that merely having a right does not mean the entity has an 'asset'.

5.2.1.1 Obligation of another party

Certain rights correspond to obligation of another party. For example:

- ◆ *Rights to receive cash* – say, when a loan or security deposit is given or debt instrument of another entity is subscribed for
- ◆ *Rights to receive goods or services* – say, when an advance for purchase of inventory or capital goods is given
- ◆ *Rights to exchange economic resources with another party on favourable terms* – say, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource

- ◆ *Rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs* – say, an insurance claim receivable upon happening of the insured event.

However, there are cases when a right exists even when no other party has any obligation towards the entity. For example,

- ◆ Rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from the residual value of a leased object
- ◆ Rights to use intellectual property.

5.2.1.2 Contract, legislation or similar means

Many rights are established by contract, legislation or similar means. For example, an entity might obtain rights from owning or leasing a physical object, from owning a debt instrument or an equity instrument, or from owning a registered patent.

However, an entity might also obtain rights in other ways, for example:

- (a) by acquiring or creating know-how that is not in the public domain; or
- (b) through an obligation of another party that arises because that other party has no practical ability to act in a manner inconsistent with its customary practices, published policies or specific statements, often referred to as a 'constructive obligation'.

Some goods or services—for example, employee services—are received and immediately consumed. An entity's right to obtain the economic benefits produced by such goods or services exists momentarily until the entity consumes the goods or services.

Not all of an entity's rights are assets of that entity — to be assets of the entity, the rights must have the potential to produce for the entity economic benefits beyond those available to all other parties. The concept of 'asset' can also be understood if we understand what rights **do not** constitute asset. A couple of such situations are discussed below:

- (a) Rights available to all parties without significant cost — for instance, rights of access to public goods, such as public rights of way over land, or know-how that is in the public domain — are typically not assets for the entities that hold them.
- (b) Similarly, an entity cannot have a right to obtain economic benefits from itself. Hence:
 - (i) debt instruments or equity instruments issued by the entity and repurchased and held by it—for example, treasury shares—are not economic resources of that entity; and

- (ii) if a reporting entity comprises more than one legal entity, debt instruments or equity instruments issued by one of those legal entities and held by another of those legal entities are not economic resources of the reporting entity.

In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single unit of account that is a single asset. For example, legal ownership of a physical object may give rise to several rights, including:

- (a) the right to use the object;
- (b) the right to sell rights over the object;
- (c) the right to pledge rights over the object; and
- (d) other rights not listed in (a)–(c).

In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the economic resource is the set of rights, not the physical object. Nevertheless, describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.

Example 4

Ownership of land gives the entity the right to use the land, the right to sell the land, the right to give the land on lease, the right to pledge land to obtain a secured loan etc. However, these rights are normally bundled up as a single asset 'Land' as such classification provides a faithful representation of those rights in the most concise and understandable way.

Lastly, in some cases, it is uncertain whether a right exists.

Example 5

An entity and another party might dispute whether the entity has a right to receive an economic resource from that other party. Until that existence uncertainty is resolved — for example, by a court ruling — it is uncertain whether the entity has a right and, consequently, whether an asset exists.

5.2.2 Potential to produce economic benefits

Role of probability

For the potential to exist, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the right already exists and that, in at least one circumstance, it would produce for the entity economic benefits beyond those available to all other parties.

A right can meet the definition of an economic resource, and hence can be an asset, even if the probability that it will produce economic benefits is low. Nevertheless, that low probability might affect decisions about what information to provide about the asset and how to provide that information, including decisions about whether the asset is recognised and how it is measured.

Example 6

Receivable from a bankrupt customer is a right, even if the measurement principle renders the net carrying amount of such an asset as 'nil'.

Role of timing

Although an economic resource derives its value from its present potential to produce future economic benefits, the economic resource is the present right that contains that potential, not the future economic benefits that the right may produce.

For example, a purchased option derives its value from its potential to produce economic benefits through exercise of the option at a future date. However, the economic resource is the present right—the right to exercise the option at a future date. The economic resource is not the future economic benefits that the holder will receive if the option is exercised.

Role of expenditure

There is a close association between incurring expenditure and acquiring assets, but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that the entity has sought future economic benefits but does not provide conclusive proof that the entity has obtained an asset. Similarly, the absence of related expenditure does not preclude an item from meeting the definition of an asset. Assets can include, for example, rights that a government has granted to the entity free of charge or that another party has donated to the entity.

5.2.3 Control

Control links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts. For example, an entity may control a proportionate share in a property without controlling the rights arising from ownership of the entire property. In such cases, the entity's asset is the share in the property, which it controls, not the rights arising from ownership of the entire property, which it does not control.

An entity controls an economic resource if:

- (a) it has the present ability to direct the use of the economic resource i.e. it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities, and
- (b) obtain the economic benefits that may flow from it. For an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. This aspect of control does not imply that

the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them either directly or indirectly. Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of whether control exists.

An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.

Control of an economic resource usually arises from an ability to enforce legal rights. However, control can also arise if an entity has other means of ensuring that it, and no other party, has the present ability to direct the use of the economic resource and obtain the benefits that may flow from it. For example, an entity could control a right to use know-how that is not in the public domain if the entity has access to the know-how and the present ability to keep the know-how secret, even if that know-how is not protected by a registered patent.

It must be remembered that if one party controls an economic resource, no other party controls that resource.

Would control exist with the principal in a principal-agent relationship?

Sometimes one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal. For example, a principal may engage an agent to arrange sales of goods controlled by the principal. If an agent has custody of an economic resource controlled by the principal, that economic resource is not an asset of the agent.

Furthermore, if the agent has an obligation to transfer to a third party an economic resource controlled by the principal, that obligation is not a liability of the agent, because the economic resource that would be transferred is the principal's economic resource, not the agent's.



5.3 DEFINITION OF A LIABILITY

For a liability to exist, three criteria must all be satisfied:



Let us look at these three criteria in more detail.

5.3.1 Obligation

An obligation is a duty or responsibility that an entity has no practical ability to avoid. An obligation is always owed to another party (or parties). The other party (or parties) could be a person or another entity, a group of people or other entities, or society at large. It is not necessary to know the identity of the party (or parties) to whom the obligation is owed. However, a requirement for one party to recognise a liability and measure it at a specified amount does not imply that the other party (or parties) must recognise an asset or measure it at the same amount. For example, particular Ind AS may contain different recognition criteria or measurement requirements for the liability of one party and the corresponding asset of the other party (or parties) if those different criteria or requirements are a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements if the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a '**constructive obligation**'.

Whether an entity's duty to transfer an economic resource, that is conditional on an action that an entity itself may choose to take, is an obligation or not?

In such situations, the entity has an obligation if it has no practical ability to avoid taking that action. A conclusion that it is appropriate to prepare an entity's financial statements on a going concern basis also implies a conclusion that the entity has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or by ceasing to trade.

The factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity's duty or responsibility. For example, in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the transfer itself. However, neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer.

5.3.2 Transfer of an economic resource

To satisfy this criterion, the obligation must have the potential to require the entity to transfer an economic resource to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource — the transfer may, for example, be required only if a specified uncertain future event occurs. It is only

necessary that the obligation already exists and that, in at least one circumstance, it would require the entity to transfer an economic resource.

An obligation can meet the definition of a liability even if the probability of a transfer of an economic resource is low. Nevertheless, that low probability might affect decisions about what information to provide about the liability and how to provide that information, including decisions about whether the liability is recognised and how it is measured.

Obligations to transfer an economic resource include, for example:

- (a) obligations to pay cash.
- (b) obligations to deliver goods or provide services.
- (c) obligations to exchange economic resources with another party on unfavourable terms. Such obligations include, for example, a forward contract to sell an economic resource on terms that are currently unfavourable or an option that entitles another party to buy an economic resource from the entity.
- (d) obligations to transfer an economic resource if a specified uncertain future event occurs.
- (e) obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer an economic resource.

Instead of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, entities sometimes decide to, for example:

- (a) settle the obligation by negotiating a release from the obligation;
- (b) transfer the obligation to a third party; or
- (c) replace that obligation to transfer an economic resource with another obligation by entering into a new transaction.

It is however important to note that in the situations described above, the entity has the obligation to transfer an economic resource until it has settled, transferred or replaced that obligation.

5.3.3 Present obligation as a result of past events

A present obligation exists as a result of past events only if:

- (a) the entity has already obtained economic benefits (for example, goods or services obtained from a supplier) or taken an action (for example, operating a particular business or operating in a particular market); and
- (b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

A present obligation can exist even if a transfer of economic resources cannot be enforced until some point in the future. For example, a contractual liability to pay cash may exist now even if the contract does not require a payment until a future date. Similarly, a contractual obligation for an entity to perform work at a future date may exist now even if the counterparty cannot require the entity to perform the work until that future date.

An entity does not yet have a present obligation to transfer an economic resource if it has not yet satisfied the criteria above, that is, if it has not yet obtained economic benefits, or taken an action, that would or could require the entity to transfer an economic resource that it would not otherwise have had to transfer.

Example 7

If an entity has entered into a contract to pay an employee a salary in exchange for receiving the employee's services, the entity does not have a present obligation to pay the salary until it has received the employee's services. Before then the contract is executory — the entity has a combined right and obligation to exchange future salary for future employee services. We will discuss more about 'executory contracts' in more detail later in this Chapter.



5.4 ASPECTS WHICH ARE COMMON TO ASSETS AND LIABILITIES

5.4.1 Unit of account

The unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.

A unit of account is selected for an asset or liability when considering how recognition criteria and measurement concepts will apply to that asset or liability and to the related income and expenses.

In some circumstances, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement. For example, contracts may sometimes be recognised individually but measured as part of a portfolio of contracts. For presentation and disclosure, assets, liabilities, income and expenses may need to be aggregated or separated into components.

A unit of account is selected to provide useful information, which implies that:

- (a) the information provided about the asset or liability and about any related income and expenses must be relevant; and

- (b) the information provided about the asset or liability and about any related income and expenses must faithfully represent the substance of the transaction or other event from which they have arisen.

Sometimes, both rights and obligations arise from the same source. For example, some contracts establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability and hence form a single unit of account.

Conversely, if rights are separable from obligations, it may sometimes be appropriate to group the rights separately from the obligations, resulting in the identification of one or more separate assets and liabilities. In other cases, it may be more appropriate to group separable rights and obligations in a single unit of account treating them as a single asset or a single liability.

5.4.2 Executory contracts

An executory contract is a contract, or a portion of a contract, that is equally unperformed — neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

An executory contract establishes a combined right and obligation to exchange economic resources. The right and obligation are interdependent and cannot be separated. Hence, the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable.

Whether such an asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

5.4.3 Substance of contractual rights and contractual obligations

The terms of a contract create rights and obligations for an entity that is a party to that contract. To represent those rights and obligations faithfully, financial statements report their substance. In some cases, the substance of the rights and obligations is clear from the legal form of the contract. In other cases, the terms of the contract or a group or series of contracts require analysis to identify the substance of the rights and obligations.

All terms in a contract — whether explicit or implicit — are considered unless they have no substance. Implicit terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts to sell goods to customers.

Terms that have no substance are disregarded. A term has no substance if it has no discernible effect on the economics of the contract. Terms that have no substance could include, for example:

- (a) terms that bind neither party; or
- (b) rights, including options, that the holder will not have the practical ability to exercise in any circumstances.

A group or series of contracts may achieve or be designed to achieve an overall commercial effect. To report the substance of such contracts, it may be necessary to treat rights and obligations arising from that group or series of contracts as a single unit of account. For example, if the rights or obligations in one contract merely nullify all the rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that the two contracts create no rights or obligations. Conversely, if a single contract creates two or more sets of rights or obligations that could have been created through two or more separate contracts, an entity may need to account for each set as if it arose from separate contracts in order to faithfully represent the rights and obligations.



5.5 DEFINITION OF EQUITY

Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of a liability.

Sometimes, legal, regulatory or other requirements affect particular components of equity, such as share capital or retained earnings. For example, some such requirements permit an entity to make distributions to holders of equity claims only if the entity has sufficient reserves that those requirements specify as being distributable.



5.6 DEFINITION OF INCOME AND EXPENSES

Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

It follows from these definitions of income and expenses that contributions from holders of equity claims are not income, and distributions to holders of equity claims are not expenses.

Income and expenses are the elements of financial statements that relate to an entity's financial performance. Users of financial statements need information about both an entity's financial

position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance.

UNIT 6

RECOGNITION AND DERECOGNITION

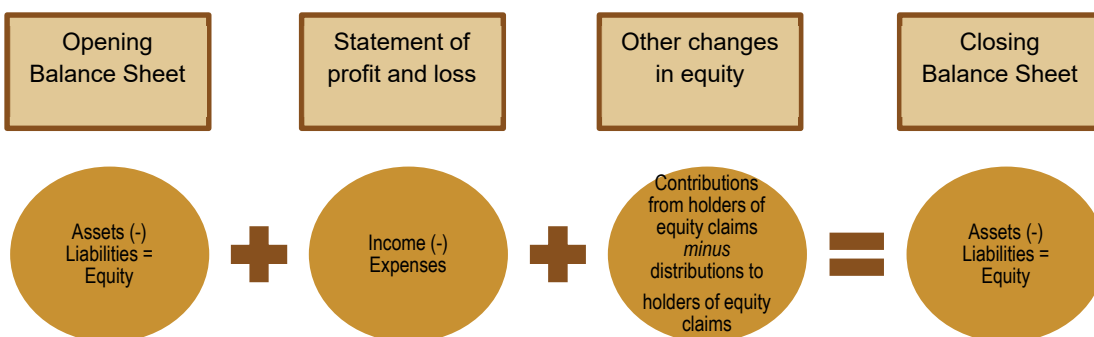


6.1 THE RECOGNITION PROCESS

- ◆ Recognition is the process of capturing for inclusion
- ◆ in the balance sheet or the statement of profit and loss
- ◆ an item
- ◆ that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses.

The amount at which an asset, a liability or equity is recognised in the balance sheet is referred to as its 'carrying amount'.

Recognition links the elements (as discussed in Unit 5), the balance sheet and the statement of profit and loss as follows:



The balance sheet and statement of profit and loss are linked because the recognition of one item (or a change in its carrying amount) requires the recognition or derecognition of one or more other items (or changes in the carrying amount of one or more other items). This principle can be explained in the form of a journal entry as below:

Particulars	Statement of profit or loss	Balance Sheet (alternatives)	
Recognition of income	Credit Income	Debit Asset	Debit Liability

		(initial recognition or increase in carrying amount)	(derecognition or decrease in carrying amount)
Recognition of expense	Debit Expense	Credit Asset (derecognition or decrease in carrying amount)	Credit Liability (initial recognition or increase in carrying amount)

The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses.

Example 8

The sale of goods for cash results in the recognition of both income (from the recognition of one asset — the cash) and an expense (from the derecognition of another asset—the goods sold).

The simultaneous recognition of income and related expenses is sometimes referred to as the **matching of costs with income**. It may be noted that matching of costs with income is not an objective of the *Conceptual Framework under Ind AS*. The *Conceptual Framework under Ind AS* does not allow the recognition in the balance sheet of items that do not meet the definition of an asset, a liability or equity.

6.2 RECOGNITION CRITERIA

Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet. Similarly, only items that meet the definition of income or expenses are recognised in the statement of profit and loss. However, not all items that meet the definition of one of those elements are recognised.

Not recognising an item that meets the definition of one of the elements makes the balance sheet and the statement of profit and loss less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information.

An asset or liability is recognised only if recognition provides users of financial statements with information that is useful, i.e. with:

- (a) relevant information; and
- (b) a faithful representation

of the asset or liability and of any resulting income, expenses or changes in equity.

What is useful to users depends on the item and the facts and circumstances. Consequently, judgement is required when deciding whether to recognise an item, and thus recognition requirements may need to vary between and within Ind AS.

It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.

Even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes. It is important to consider how to make such information sufficiently visible to compensate for the item's absence from the structured summary provided by the balance sheet and, if applicable, the statement of profit and loss.

Let's look at the aspects of 'relevance' and 'faithful presentation' in a bit more detail.

6.2.1 Relevance

Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example:

- (a) it is uncertain whether an asset or liability exists (see 6.2.1.1 below); or
- (b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see 6.2.1.2 below)

The presence of one or both of the factors described above does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described above may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

6.2.1.1 Existence uncertainty

◆ Asset

In some cases, it is uncertain whether a right exists. For example, an entity and another party might dispute whether the entity has a right to receive an economic resource from that other party. Until that existence uncertainty is resolved — for example, by a court ruling — it is uncertain whether the entity has a right and, consequently, whether an asset exists.

◆ *Liability*

In some cases, it is uncertain whether an obligation exists. For example, if another party is seeking compensation for an entity's alleged act of wrongdoing, it might be uncertain whether the act occurred, whether the entity committed it or how the law applies. Until that existence uncertainty is resolved — for example, by a court ruling — it is uncertain whether the entity has an obligation to the party seeking compensation and, consequently, whether a liability exists.

In those cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

6.2.1.2 Low probability of an inflow or outflow of economic benefits

If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.

However, in some cases, recognition of the asset or liability may provide relevant information beyond the disclosure in the notes.

Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described above. Whether that is the case may depend on a variety of factors. For example:

- (a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction.
- (b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

6.2.2 Faithful representation

Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

6.2.2.1 Measurement uncertainty

For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. The use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.

In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based measurement techniques and, in addition, one or more of the following circumstances exists:

- (a) the **range of possible outcomes is exceptionally wide** and the probability of each outcome is exceptionally difficult to estimate.
- (b) the measure is **exceptionally sensitive to small changes** in estimates of the probability of different outcomes — for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.
- (c) measuring the asset or liability requires **exceptionally difficult or exceptionally subjective allocations of cash flows** that do not relate solely to the asset or liability being measured.

In some of the cases described above, the most useful information may be the measure that relies on the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. This is especially likely to be the case if that measure is the most relevant measure of the asset or liability. In other cases, if that information would not provide a sufficiently faithful representation of the asset or liability and of any resulting income, expenses or changes in equity, the most useful information may be a different measure (accompanied by any necessary descriptions and explanations) that is slightly less relevant but is subject to lower measurement uncertainty.

In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

Whether or not an asset or liability is recognised, a faithful representation of the asset or liability may need to include explanatory information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome — the amount or timing of any inflow or outflow of economic benefits that will ultimately result from it.

It may be noted that the level of measurement uncertainty beyond which a measure does not provide a faithful representation depends on facts and circumstances and so, the standard-setters felt, that level can be determined only when developing Standards.

6.2.2.2 Other factors

Faithful representation of a recognised asset, liability, equity, income or expenses involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it.

Hence, when assessing whether the recognition of an asset or liability can provide a faithful representation of the asset or liability, it is necessary to consider not merely its description and measurement in the balance sheet, but also:

- ◆ the depiction of resulting income, expenses and changes in equity. For example, if an entity acquires an asset for consideration, not recognising the asset would result in recognising expenses, and that result could provide a misleading representation that the entity's financial position has deteriorated.
- ◆ whether related assets and liabilities are recognised. If they are not recognised, recognition may create a recognition inconsistency (accounting mismatch). That may not provide an understandable or faithful representation of the overall effect of the transaction or other event giving rise to the asset or liability, even if explanatory information is provided in the notes.
- ◆ presentation and disclosure of information about the asset or liability, and resulting income, expenses or changes in equity. A complete depiction includes all information necessary for a user of financial statements to understand the economic phenomenon depicted, including all necessary descriptions and explanations. Hence, presentation and disclosure of related information can enable a recognised amount to form part of a faithful representation of an asset, a liability, equity, income or expenses.



6.3 DERECOGNITION

Derecognition is the removal of all or part of a recognised asset or liability from an entity's balance sheet. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

Element of financial statements	When does derecognition normally occur?
Asset	When the entity loses control of all or part of the recognised asset
Liability	When the entity no longer has a present obligation for all or part of the recognised liability

The accounting requirements for derecognition are as below:

- (a) derecognise any assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred (referred to as 'transferred component'), and recognise any resulting income and expenses.
- (b) continue to recognise the assets or liabilities retained, referred to as the 'retained component', if any. That retained component becomes a unit of account separate from the transferred component. Accordingly, no income or expenses are recognised on the retained component as a result of the derecognition of the transferred component, unless the derecognition results in a change in the measurement requirements applicable to the retained component. For example, when a parent loses control over a subsidiary and retains a minority shareholding therein, the measurement principles in Ind AS require that minority shareholding to be recognised at its fair value, the resulting gain or loss is then recognised in statement of profit or loss.
- (c) applying following presentation and disclosure requirements:
 - (i) presenting any retained component separately in the balance sheet
 - (ii) presenting separately in the statement of profit and loss any income and expenses recognised as a result of the derecognition of the transferred component
 - (iii) providing explanatory information.

In some cases, an entity might appear to transfer an asset or liability, but derecognition of that asset or liability is not appropriate. For example,

- ◆ if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, this sometimes indicates that the entity might continue to control that asset
- ◆ if an entity has transferred an asset to another party that holds the asset as an agent for the entity, the transferor still controls the asset.

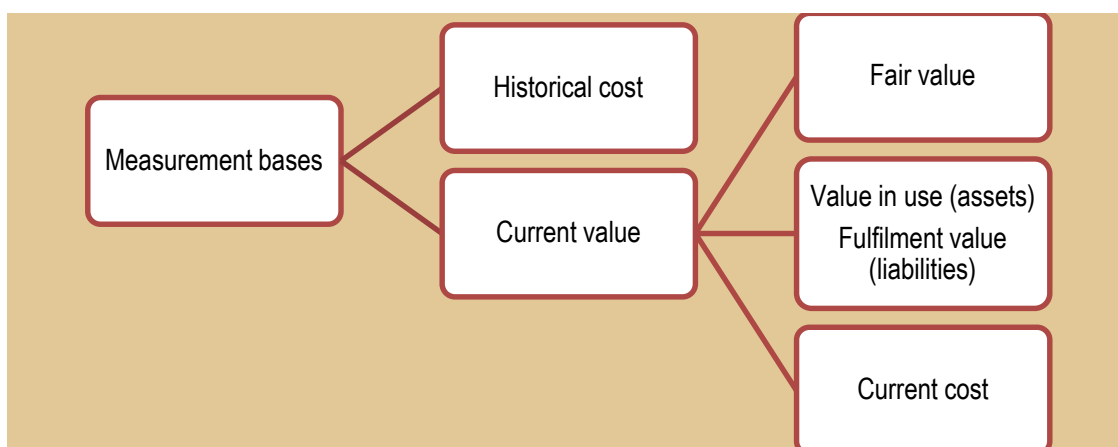
UNIT 7

MEASUREMENT

Elements recognised in financial statements are quantified in monetary terms. This requires the selection of a measurement basis. A measurement basis is an identified feature — for example, historical cost, fair value or fulfilment value — of an item being measured. Applying a measurement basis to an asset or liability creates a measure for that asset or liability and for related income and expenses.



7.1 MEASUREMENT BASES OF AN ASSET OR A LIABILITY



A very broad comparison between the historical cost and current value measurement bases is given below:

Factor	Historical cost	Current value
Monetary information about assets, liabilities and related income and expenses	Derived, at least in part, from the price of the transaction or other event that gave rise to them	Using information updated to reflect conditions at the measurement date
Changes in values	Not reflected except to the extent that those changes relate to impairment of an asset or a liability becoming onerous	Reflect changes, since the previous measurement date, in estimates of cash flows and other factors reflected in those current values

7.1.1 Historical cost

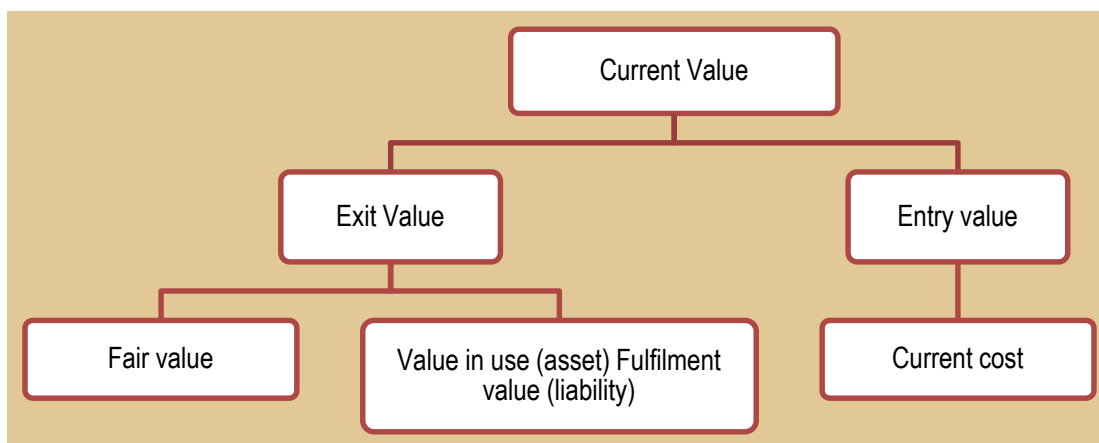
The table below summarises the concept of 'historical cost' in case of assets and liabilities:

Particulars	Assets	Liabilities
Components	Consideration paid (+) transaction costs	Consideration received (-) transaction costs
Changes	consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation)	
	payments received that extinguish part or all of the asset (collection from trade receivables)	fulfilment of the liability, for example, by making payments that extinguish part or all of the liability or by satisfying an obligation to deliver goods
	effect of events that cause the historical cost of the asset to be no longer recoverable (impairment)	effect of events that increase the value of the obligation to transfer the economic resources needed to fulfil the liability to such an extent that the liability becomes onerous. A liability is onerous if the historical cost is no longer sufficient to depict the obligation to fulfil the liability
	accrual of interest to reflect any financing component	accrual of interest to reflect any financing component

When an asset is acquired or created (say, a loan is given by a parent to a subsidiary), or a liability is incurred or taken on, as a result of an event that is not a transaction on market terms (say, at a discounted interest rate), it may not be possible to identify a cost, or the cost may not provide relevant information about the asset or liability. In some such cases, a current value of the asset (say, fair value) or liability is used as a deemed cost on initial recognition and that deemed cost is then used as a starting point for subsequent measurement at historical cost (say, amortised cost in case of the loan - see next paragraph for discussion on this).

One way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortised cost. The amortised cost of a financial asset or financial liability reflects estimates of future cash flows, discounted at a rate determined at initial recognition. For variable rate instruments, the discount rate is updated to reflect changes in the variable rate. The amortised cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset and receipts or payments.

7.1.2 Current value



7.1.2.1 Exit value – Fair value and Value in use / Fulfilment value

The following table summarises these concepts in a comparative form:

Particulars	Fair value	Value in use / Fulfilment value
Definition	Price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date	Value in use - present value of the cash flows, or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal. Fulfilment value - present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability.
Value from whose perspective?	Reflects the perspective of market participants—participants in a market to which the entity has access. The asset or liability is	Reflect entity-specific assumptions rather than assumptions by market participants

	measured using the same assumptions that market participants would use when pricing the asset or liability if those market participants act in their economic best interest.	
How determined?	Directly by observing prices in an active market or using measurement techniques, for example, cash-flow-based measurement techniques	Cannot be observed directly and are determined using cash-flow based measurement techniques
Transaction costs considered in measurement?	Neither those costs incurred on initial recognition, nor those costs to be incurred on disposal of asset or settlement of liability are considered.	Those costs incurred on initial recognition are not considered, but the present value of those costs to be incurred on disposal of asset or settlement of liability are considered.

7.1.2.2 Entry value – Current cost

Like historical cost, current cost is also an entry value. Hence, it would be appropriate to understand the concept of 'current cost' by comparing it with 'historical cost' as below:

Particulars	Historical cost	Current cost
Value determined on	Date of acquisition of asset or incurrence of liability	Each measurement date
Components	Assets: Consideration paid (+) transaction costs Liabilities: Consideration received (-) transaction costs	Assets: Consideration that would be paid (+) transaction costs that would be incurred Liabilities: Consideration that would be received (-) transaction costs that would be incurred



7.2 INFORMATION PROVIDED BY PARTICULAR MEASUREMENT BASES

When selecting a measurement basis, it is important to consider the nature of the information that the measurement basis will produce in both the balance sheet and the statement of profit and loss. The tables below summarise that information.

7.2.1 Assets

7.2.1.1 Balance Sheet

	Historical cost	Current cost	Fair value (market participant assumptions)	Value in use (entity-specific assumptions)
Carrying amount – primary value	Historical cost to the extent unconsumed or uncollected, and recoverable (Includes interest accrued on any financing component)	Current cost to the extent unconsumed or uncollected, and recoverable	Price that would be received to sell the asset	Present value of future cash flows from the use of the asset and from its ultimate disposal
Transaction costs	Included	Included	Without deducting transaction costs on disposal	After deducting present value of transaction costs on disposal

7.2.1.2 Statement of profit and loss

Event	Historical cost	Current cost	Fair value (market participant assumptions)	Value in use (entity-specific assumptions)
Initial recognition – primary value	-	-	Difference between consideration paid and fair value of the asset acquired	Difference between consideration paid and value in use of the asset acquired
Transaction costs – purchase	-	-	Expense	Expense

Event	Historical cost	Current cost	Fair value (market participant assumptions)	Value in use (entity-specific assumptions)
Sale or consumption of the asset	Expense: Historical cost of the asset sold or consumed (eg. Cost of sales of inventory or WDV of a fixed asset)	Expense: Current cost of the asset sold or consumed	Expense: Fair value of the asset sold or consumed	Expense: Value in use of the asset sold or consumed
	Income: Consideration received			
	Expenses and Income could be presented gross or net			
Transaction costs – sale	Included	Included	Included	Already considered in computation of value in use, hence not included
Interest income	At historical rates, updated if the asset bears variable interest	At current rates	Already included in fair value changes, could be identified separately	Already included in value in use changes, could be identified separately
Impairment	Expense	Expense	Already included in fair value changes, could be identified separately	Already included in value in use changes, could be identified separately
Value changes	None, except impairment Financial assets – effect of changes in estimated cash flows is an income or expense	Effect of change in prices is income or expense	Already included in fair value changes	Already included in value in use changes

7.2.2 Liabilities

7.2.2.1 Balance Sheet

	Historical cost	Current cost	Fair value (market participant assumptions)	Fulfilment value (entity-specific assumptions)
Carrying amount – primary value	Consideration received for taking on the unfulfilled part of the liability, increased by excess of estimated cash outflows over consideration received.	Consideration that would be currently received for taking on the unfulfilled part of the liability, increased by excess of estimated cash outflows over that consideration.	Price that would be paid to transfer the unfulfilled part of the liability	Present value of future cash flows that will arise in fulfilling the unfulfilled part of the liability
Transaction costs	Netted off from above	Netted off from above	Not including transaction costs that would be incurred on transfer	Including present value of transaction costs to be incurred in fulfilment or transfer

7.2.2.2 Statement of profit and loss

Event	Historical cost	Current cost	Fair value (market participant assumptions)	Fulfilment value (entity-specific assumptions)
Initial recognition – primary value	-	-	Difference between consideration received and the fair value of the liability	Difference between consideration received and the fulfilment value of the liability

Event	Historical cost	Current cost	Fair value (market participant assumptions)	Fulfilment value (entity-specific assumptions)
Transaction costs – purchase	-	-	Expense	Expense
Fulfilment or transfer of the liability	Income: historical consideration	Income: reflects current consideration	Income: fair value of the liability	Income: fulfilment value of the liability
	Expenses: costs incurred in fulfilling the liability or cost paid to transfer the liability			
	Could be presented net or gross			
Interest expense	At historical rates, updated if the liability bears variable interest	At current rates	Already included in fair value changes, could be identified separately	Already included in changes in fulfilment value, could be identified separately
Effect of events that cause a liability to become onerous	Expenses = estimated cash outflows <i>minus</i> historical cost of the liability	Expenses = estimated cash outflows <i>minus</i> current cost of the liability	Already included in fair value changes, could be identified separately	Already included in changes in fulfilment value, could be identified separately
Value changes	None, to the extent that the liability is onerous. Financial liabilities – effect of changes in estimated cash flows is an income or expense	Effect of change in prices is income or expense	Already included in fair value changes	Already included in changes in fulfilment value



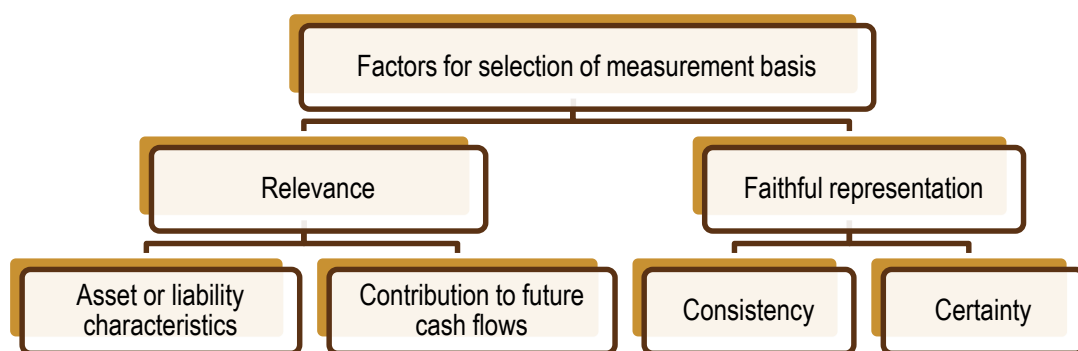
7.3 FACTORS TO CONSIDER WHEN SELECTING A MEASUREMENT BASIS FOR INITIAL RECOGNITION AND SUBSEQUENT MEASUREMENT OF AN ASSET OR A LIABILITY

In section 7.2, we have discussed the information that various measurement basis will produce in both the balance sheet and the statement of profit and loss. While selecting a measurement basis, it is necessary to consider such information.

Additionally, certain other factors must also be considered while selecting a measurement basis for initial recognition and subsequent measurement and this section 7.3 focuses on the same. Section 7.4 will focus on certain additional factors to be considered when selecting measurement basis for initial measurement only.

In most cases, no single factor will determine which measurement basis should be selected. The relative importance of each factor will depend on facts and circumstances. As discussed in Unit 3, the information provided by a measurement basis must be useful to users of financial statements. To achieve this, the information must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should be, as far as possible, comparable, verifiable, timely and understandable.

The following chart lays down the overall scheme of factors relevant for selection of measurement basis, besides the information provided by the same:



7.3.1 Relevance

7.3.1.1 Characteristics of the asset or liability

The relevance of information provided by a measurement basis depends partly on the characteristics of the asset or liability, in particular, on:

- ◆ Variability of cash flows, and
- ◆ Sensitivity of the value of the asset or liability to market factors or other risks

Asset or liability carried at historical cost

If the value of an asset or liability is sensitive to market factors or other risks, its historical cost might differ significantly from its current value and hence may not provide relevant information if information about changes in value is important to users of financial statements.

As an example, amortised cost cannot provide relevant information about a financial asset or financial liability that is a derivative.

Furthermore, if historical cost is used, changes in value are reported not when that value changes, but when an event such as disposal, impairment or fulfilment occurs. This could be incorrectly interpreted as implying that all the income and expenses recognised at the time of that event arose then, rather than over the periods during which the asset or liability was held.

Moreover, because measurement at historical cost does not provide timely information about changes in value, income and expenses reported on that basis may lack predictive value and confirmatory value by not depicting the full effect of the entity's exposure to risk arising from holding the asset or liability during the reporting period.

Asset or liability carried at fair value

Changes in the fair value of an asset or liability reflect changes in expectations of market participants and changes in their risk preferences. Depending on the characteristics of the asset or liability being measured and on the nature of the entity's business activities, information reflecting those changes may not always provide predictive value or confirmatory value to users of financial statements. This may be the case when the entity's business activities do not involve selling the asset or transferring the liability.

As an example, if the entity holds assets solely for use or solely for collecting contractual cash flows or if the entity is to fulfil liabilities itself, information reflecting changes in the fair value of an asset or liability may not always provide predictive value or confirmatory value to users of financial statements.

7.3.1.2 Contribution to future cash flows

How economic resources are used, and hence how assets and liabilities produce cash flows, depends in part on the nature of the business activities conducted by the entity.

When a business activity of an entity involves the use of several economic resources that produce cash flows indirectly, by being used in combination to produce and market goods or services to customers, historical cost or current cost is likely to provide relevant information about that activity.

For example, property, plant and equipment is typically used in combination with an entity's other economic resources. Similarly, inventory typically cannot be sold to a customer, except by making extensive use of the entity's other economic resources (for example, in production and marketing activities). Paragraphs 6.24–6.31 and 6.40–6.42 of the Conceptual Framework explain how measuring such assets at historical cost or current cost can provide relevant information that can be used to derive margins achieved during the period.

For assets and liabilities that produce cash flows directly, such as assets that can be sold independently and without a significant economic penalty (for example, without significant business disruption), the measurement basis that provides the most relevant information is likely to be a current value that incorporates current estimates of the amount, timing and uncertainty of the future cash flows.

As discussed in more detail in the chapter on financial instruments, when a business activity of an entity involves managing financial assets and financial liabilities with the objective of collecting contractual cash flows, amortised cost may provide relevant information that can be used to derive the margin between the interest earned on the assets and the interest incurred on the liabilities. However, in assessing whether amortised cost will provide useful information, it is also necessary to consider the characteristics of the financial asset or financial liability. Amortised cost is unlikely to provide relevant information about cash flows that depend on factors other than principal and interest.

7.3.2 Faithful representation

7.3.2.1 Consistency

When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (accounting mismatch). If financial statements contain measurement inconsistencies, those financial statements may not faithfully represent some aspects of the entity's financial position and financial performance.

Therefore, when the cash flows from one asset or liability are directly linked to the cash flows from another asset or liability, using the same measurement basis for related assets and liabilities may provide users of financial statements with information that is more useful than the information that would result from using different measurement bases. This may be particularly likely when the

cash flows from one asset or liability are directly linked to the cash flows from another asset or liability.

7.3.2.2 Certainty

When a measure cannot be determined directly by observing prices in an active market and must instead be estimated, measurement uncertainty arises. The level of measurement uncertainty associated with a particular measurement basis may affect whether information provided by that measurement basis provides a faithful representation of an entity's financial position and financial performance. A high level of measurement uncertainty does not necessarily prevent the use of a measurement basis that provides relevant information. However, in some cases the level of measurement uncertainty is so high that information provided by a measurement basis might not provide a sufficiently faithful representation. In such cases, it is appropriate to consider selecting a different measurement basis that would also result in relevant information.

Measurement uncertainty is different from both outcome uncertainty and existence uncertainty, but their presence may sometimes contribute to measurement uncertainty.

- (a) outcome uncertainty arises when there is uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability.
- (b) existence uncertainty arises when it is uncertain whether an asset or a liability exists.

The presence of outcome uncertainty or existence uncertainty may sometimes contribute to measurement uncertainty. However, outcome uncertainty or existence uncertainty does not necessarily result in measurement uncertainty. For example, if the fair value of an asset can be determined directly by observing prices in an active market, no measurement uncertainty is associated with the measurement of that fair value, even if it is uncertain how much cash the asset will ultimately produce and hence there is outcome uncertainty.

Illustration 1: Derecognition vs. Faithful Representation

As at 31st March 20X2, Natasha Ltd. carried trade receivables of ₹ 280 crores in its balance sheet. At that date, Natasha Ltd. entered into a factoring agreement with Samantha Ltd., a financial institution, according to which it transferred the trade receivables in exchange for an immediate cash payment of ₹ 250 crores. As per the factoring agreement, any shortfall between the amount collected and ₹ 250 crores will be reimbursed by Natasha Ltd. to Samantha Ltd. Once the trade receivables have been collected, any amounts above ₹ 250 crores, less interest on this amount, will be repaid to Natasha Ltd. The directors of Natasha Ltd. are of the opinion that the trade receivables should be derecognized.

You are required to explain the appropriate accounting treatment of this transaction in the financial statements for the year ending 31st March 20X2, and also evaluate this transaction in the context of the Conceptual Framework.

Solution:**Accounting Treatment:**

Trade Receivables fall within the ambit of financial assets under Ind AS 109, Financial Instruments. Thus, the issue in question is whether the factoring arrangement entered into with Samantha Ltd. requires Natasha Ltd. to derecognize the trade receivables from its financial statements.

As per Para 3.2.3, 3.2.4, 3.2.5 and 3.2.6 of Ind AS 109, Financial Instruments, an entity shall derecognise a financial asset when, and only when:

- (a) the contractual rights to the cash flows from the financial asset expire, or
- (b) it transfers the financial asset or substantially all the risks and rewards of ownership of the financial asset to another party.

In the given case, since the trade receivables are appearing in the Balance Sheet of Natasha Ltd. as at 31st March 20X2 and are expected to be collected, the contractual rights to the cash flows have not expired.

As far as the transfer of the risks and rewards of ownership is concerned, the factoring arrangement needs to be viewed in its substance, rather than its legal form. Natasha Ltd. has transferred the receivables to Samantha Ltd. for cash of ₹ 250 crores, and yet, it remains liable for making good any shortfall between ₹ 250 crores and the amount collected by Samantha Ltd. Thus, in substance, Natasha Ltd. is effectively liable for the entire ₹ 250 crores, although the shortfall would not be such an amount. Accordingly, Natasha Ltd. retains the credit risk despite the factoring arrangement entered.

It is also explicitly stated in the agreement that Samantha Ltd. would be liable to pay to Natasha Ltd. any amount collected more than ₹ 250 crores, after retaining an amount towards interest. Thus, Natasha Ltd. retains the potential rewards of full settlement.

A perusal of the above clearly shows that substantially all the risks and rewards continue to remain with Natasha Ltd., and hence, the trade receivables should continue to appear in the Balance Sheet of Natasha Ltd. The immediate payment (i.e. consideration as per the factoring agreement) of ₹ 250 crores by Samantha Ltd. to Natasha Ltd. should be regarded as a financial liability, and be shown as such by Natasha Ltd. in its Balance Sheet.

According to the Conceptual Framework, an asset should be derecognized when control of all, or part of an asset is lost.

As discussed in Section 6.3 above, in some cases, an entity might appear to transfer an asset or liability, but derecognition of that asset or liability is not appropriate. For example, if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, then this sometimes

indicates that the entity might continue to control that asset, which appears to be the case in the current scenario.

The accounting requirements for derecognition aim to faithfully represent both:

- (a) any assets and liabilities retained after the transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and
- (b) the change in the entity's assets and liabilities as a result of that transaction or other event.

Meeting both the above requirements becomes difficult if there is only a part disposal of an asset, or there is a retention of some exposure to that asset. It is difficult to faithfully represent the legal form (which is, in this scenario, a decrease in trade receivables under the factoring arrangement) with the substance of retaining the corresponding risks and rewards.

In view of the difficulties in practical scenarios in meeting the two aims, the Conceptual Framework does not advocate the use of a control approach or a risk-and-rewards approach to derecognition in every circumstance.

As such, the treatment as per Ind AS 109, as well as the principles laid down in the Conceptual Framework do not appear to be in conflict with each other in this case.

Illustration 2:

Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition of an asset and discuss whether there are inconsistencies with the criteria in Ind AS 38, Intangible Assets.

Solution:

The Conceptual Framework defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful (i.e. it is relevant as well as results in faithful representation). However, the criteria of a cost-benefit analysis always exists i.e. the benefits of the information must be sufficient to justify the costs of providing such information. The recognition criteria outlined in the Conceptual Framework allows for flexibility in the application in amending or developing the standards.

Para 8 of Ind AS 38, Intangible Assets defines an intangible asset as an identifiable non-monetary asset without physical substance. Further, Ind AS 38 defines an asset as a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the entity.

Furthermore, Para 21 of Ind AS 38 states that an intangible asset shall be recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

This requirement is applicable both in case of an externally acquired intangible asset or an internally generated intangible asset. The probability of expected future economic benefits must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset. Further, as per Para 33 of Ind AS 38, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. If the recognition criteria are not satisfied, Ind AS 38 requires the expenditure to be expensed as and when it is incurred.

It is notable that the Conceptual Framework does not prescribe a 'probability criterion'. As long as there is a potential to produce economic benefits, even with a low probability, an item can be recognized as an asset according to the Conceptual Framework. However, in terms of intangible assets, it could be argued that recognizing an intangible asset having low probability of generating economic benefits would not be useful to the users of financial statements given that the asset has no physical substance.

The recognition criteria and definition of an asset under Ind AS 38 are different as compared to those outlined in the Conceptual Framework. To put in simple words, the criteria in Ind AS 38 are more specific, but definitely do provide information that is relevant and a faithful representation. When viewed from the prism of relevance and faithful representation, the requirements of Ind AS 38 in terms of recognition appear to be consistent with the Conceptual Framework. Further, in case of differences between conceptual framework and Ind AS, Ind AS would prevail.

Illustration 3:

The directors of Hind Ltd. are particular about the usefulness of the financial statements. They have opined that although Ind AS implement a fair value model, Ind AS are failing in reflecting the usefulness of the financial statements as they do not reflect the financial value of the entity.

Discuss the views of the directors as regards the use of fair value in Ind AS and the fact that the Ind AS do not reflect the financial value of an entity, making special reference to relevant Ind AS and the Conceptual Framework.

Solution:Usage of Fair Value in Ind AS:*Treatment under Ind AS:*

The statement of the directors regarding Ind AS implementing a fair value model is not entirely accurate. Although Ind AS do use fair value (and present value), it is not a complete fair value system. Ind AS are often based on the business model of the entity and on the expectations of realizing the asset- and liability-related cash flows through operations and transfers.

It is notable that what is preferred is a mixed measurement system, with some items being measured at fair value while others measured at historical cost.

About Fair Value (Ind AS 113)

Ind AS 113 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This price is an exit price.

Ind AS 113 has given consistency to the definition and application of fair value, and this consistency is applied across other Ind AS, which are generally required to measure fair value in accordance with Ind AS 113. However, it cannot be implied that Ind AS requires all assets and liabilities to be measured at fair value. Rather, many entities measure most items at depreciated historical costs, although the exception being in the case of business combinations, where assets and liabilities are recorded at fair value on the date of acquisition. In other cases, usage of fair value is restricted.

Examples of use of fair value in Ind AS:

- (a) Ind AS 16 Property, Plant and Equipment permits revaluation through other comprehensive income, provided it is carried out regularly.
- (b) Disclosure of fair value of Investment Property in Ind AS 40, while the companies account for the same under the cost model.
- (c) Ind AS 38 Intangible Assets allows measurement of intangible assets at fair value with corresponding changes in equity, but only if the assets can be measured reliably by way of existence of an active market for them.
- (d) Ind AS 109 Financial Instruments requires some financial assets and liabilities to be measured at amortized cost and others at fair value. The measurement basis is largely determined by the business model for that financial instrument. Where the financial instruments are carried at fair value, depending on the category and circumstances, the

movement in the fair value (gain or loss) is either recognized in profit or loss or in other comprehensive income.

Financial value of an entity

Although Ind AS makes use of fair values in the measurement of assets and liabilities, the financial statements prepared under Ind AS are not intended to reflect the aggregate value of the entity, as could be the notion among people. As discussed in 2.2 above, the Conceptual Framework specifically states that general purpose financial statements are not intended to show the value of a reporting entity. Furthermore, such an attempt would not be fruitful as certain internally generated intangible assets cannot be recognized under Ind AS. Instead, the objective of general purpose financial reports is to provide financial information about the reporting entity which would be useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

It is only in the case of acquisition of an entity by another entity and subsequent consolidation in group accounts that an entity's net assets are reported at fair value.

7.3.3 Implications of enhancing qualitative characteristics for the selection of measurement basis

As per Section 3.1.4, the usefulness of financial information is enhanced by applying four enhancing qualitative characteristics – comparability, verifiability, timeliness and understandability. Of these, timeliness has no specific implications for measurement. Let's briefly discuss the implications of the other three:

Comparability: Consistently using the same measurement bases for the same items, either from period to period within a reporting entity or in a single period across entities, can help make financial statements more comparable. A change in measurement basis can make financial statements less understandable. However, a change may be justified if other factors outweigh the reduction in understandability, for example, if the change results in more relevant information. If a change is made, users of financial statements may need explanatory information to enable them to understand the effect of that change.

Understandability: Understandability depends partly on how many different measurement bases are used and on whether they change over time. In general, if more measurement bases are used in a set of financial statements, the resulting information becomes more complex and, hence, less understandable and the totals or subtotals in the balance sheet and the statement of profit and loss become less informative. However, it could be appropriate to use more measurement bases if that is necessary to provide useful information.

Verifiability: Verifiability is enhanced by using measurement bases that result in measures that can be independently corroborated either directly, for example, by observing prices, or indirectly, for example, by checking inputs to a model. If a measure cannot be verified, users of financial statements may need explanatory information to enable them to understand how the measure was determined. In some such cases, it may be necessary to specify the use of a different measurement basis.



7.4 FACTORS SPECIFIC TO INITIAL MEASUREMENT OF AN ASSET OR A LIABILITY

As a general principle, the entities should use the same measurement basis for initial recognition and subsequent measurement. Let's look at the two possible scenarios of "at-market" transactions and "off-market" transactions.

7.4.1 Transactions on market terms

Transactions using currency (i.e. cash):

At initial recognition, the cost of an asset acquired, or of a liability incurred is normally similar to its fair value at that date, unless transaction costs are significant. Therefore, whether historical cost or current value is used as a measurement basis subsequently, the same basis is also normally appropriate at initial recognition.

Exchange of asset or liability

When an entity acquires an asset, or incurs a liability, in exchange for transferring another asset or liability, the initial measure of the asset acquired, or the liability incurred, determines whether any income or expenses arise from the transaction.

For example, if the asset transferred is carried for ₹ 100 in the books and the asset acquired is initially measured at fair value (because it is subsequently measured at fair value), of say ₹ 120, the difference of ₹ 20 is recognised in statement of profit and loss as an income. The reverse will apply for a liability.

Continuing with the example above, if the asset acquired is subsequently measured at cost, no income or expenses arise at initial recognition since the asset acquired is initially measured at cost which is the fair value of the asset transferred i.e. given up, unless income or expenses arise from the derecognition of the transferred asset or liability, or unless the asset is impaired or the liability is onerous.

7.4.2 Transactions not on market terms (or off-market transactions)

Assets may be acquired, or liabilities may be incurred, as a result of an event that is not a transaction on market terms. For example:

- (a) the transaction price may be affected by relationships between the parties;
- (b) an asset may be granted to the entity free of charge by a government or
- (c) an asset may be donated to the entity by another party;
- (d) a liability may be imposed by legislation or regulation; or
- (e) a liability to pay compensation or a penalty may arise from an act of wrongdoing.

In such cases, measuring the asset acquired, or the liability incurred, at its historical cost may not provide a faithful representation of the entity's assets and liabilities and of any income or expenses arising from the transaction or other event. Hence, it may be appropriate to measure the asset acquired, or the liability incurred, at deemed cost. In some such cases, a current value of the asset or liability is used as a deemed cost on initial recognition and that deemed cost is then used as a starting point for subsequent measurement at historical cost. Any difference between that deemed cost and any consideration given or received would be recognised as income or expenses at initial recognition.

Example 9

If a parent provides an interest free loan to its subsidiary, it is an off-market transaction. The loan, in parent's books, should be initially measured at its fair value and the difference between the loan given and its fair value should be appropriately accounted for (refer Ind AS 109).

When assets are acquired, or liabilities incurred, as a result of an event that is not a transaction on market terms, all relevant aspects of the transaction or other event need to be identified and considered. For example, it may be necessary to recognise other assets, other liabilities, contributions from holders of equity claims or distributions to holders of equity claims to faithfully represent the substance of the effect of the transaction or other event on the entity's financial position and any related effect on the entity's financial performance.

In the example given above, the difference shall be accounted for as an equity contribution (classified as "investments") in the books of the parent.



7.5 MORE THAN ONE MEASUREMENT BASIS

In some cases, consideration of the factors described in sections 7.3 and 7.4 above may lead to the conclusion that more than one measurement basis is needed for an asset or liability and for

related income and expenses in order to provide relevant information that faithfully represents both the entity's financial position and its financial performance.

In most cases, the most understandable way to provide that information is:

- (a) to use a single measurement basis both for the asset or liability in the balance sheet and for related income and expenses in the statement of profit and loss ; and
- (b) to provide in the notes additional information applying a different measurement basis.

However, in some cases, that information is more relevant, or results in a more faithful representation of both the entity's financial position and its financial performance, through the use of:

- (a) a current value measurement basis for the asset or liability in the balance sheet; and
- (b) a different measurement basis for the related income and expenses in the profit or loss section of statement of profit and loss

Example 10

An entity may choose to measure an interest bearing financial asset at fair value through other comprehensive income. In this case, the total fair value change is separated and classified so that:

- (a) the profit or loss section of statement of profit and loss includes the interest income applying the amortised cost as the measurement basis; and
- (b) other comprehensive income includes all the remaining fair value changes.

For more details on the principles used in this example, refer to chapter on financial instruments.

Therefore, the principle for all such cases is stated as below:

The total income or total expenses arising in the period from the change in the current value of the asset or liability is separated and classified so that:

- (a) the profit or loss section of statement of profit and loss includes the income or expenses measured applying the measurement basis selected for that statement; and
- (b) other comprehensive income includes all the remaining income or expenses.

As a result, the accumulated other comprehensive income related to that asset or liability equals the difference between:

- (i) the carrying amount of the asset or liability in the balance sheet; and

- (ii) the carrying amount that would have been determined applying the measurement basis selected for the profit or loss section of statement of profit and loss.



7.6 MEASUREMENT OF EQUITY

The total carrying amount of equity (total equity) is not measured directly. It equals the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities.

What 'equity' in the financial statements does not represent?

The general purpose financial statements are not designed to show an entity's value. Hence, the total carrying amount of equity will not generally equal:

- (a) the aggregate market value of equity claims on the entity;
- (b) the amount that could be raised by selling the entity as a whole on a going concern basis; or
- (c) the amount that could be raised by selling all of the entity's assets and settling all of its liabilities.

Although total equity is not measured directly, it may be appropriate to measure directly the carrying amount of some individual classes of equity and some components of equity. Nevertheless, because total equity is measured as a residual, at least one class of equity cannot be measured directly. Similarly, at least one component of equity cannot be measured directly.

The total carrying amount of an individual class of equity or component of equity is normally positive but can be negative in some circumstances. Similarly, total equity is generally positive, but it can be negative, depending on which assets and liabilities are recognised and on how they are measured.

UNIT 8

PRESENTATION AND DISCLOSURE

A reporting entity communicates information about its assets, liabilities, equity, income and expenses by presenting and disclosing information in its financial statements.



8.1 PRESENTATION AND DISCLOSURE OBJECTIVES AND PRINCIPLES

To facilitate effective communication of information in financial statements, when developing presentation and disclosure requirements in Ind ASs a balance is needed between:

- (a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets, liabilities, equity, income and expenses; and
- (b) requiring information that is comparable, both from period to period for a reporting entity and in a single reporting period across entities.

Effective communication in financial statements is also supported by considering the following principles:

- (a) entity-specific information is more useful than standardised descriptions; and
- (b) duplication of information in different parts of the financial statements is usually unnecessary and can make financial statements less understandable.



8.2 CLASSIFICATION

Classification is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include — but are not limited to — the nature of the item, its role (or function) within the business activities conducted by the entity, and how it is measured.

Classifying dissimilar assets, liabilities, equity, income or expenses together can obscure relevant information, reduce understandability and comparability and may not provide a faithful representation of what it purports to represent.

8.2.1 Classification of assets and liabilities

Classification is applied to the unit of account selected for an asset or liability. However, it may sometimes be appropriate to separate an asset or liability into components that have different

characteristics and to classify those components separately. That would be appropriate when classifying those components separately would enhance the usefulness of the resulting financial information. For example, it could be appropriate to separate an asset or liability into current and non-current components and to classify those components separately.

8.2.2 Offsetting

Offsetting occurs when an entity recognises and measures both an asset and liability as separate units of account, but groups them into a single net amount in the balance sheet. Offsetting classifies dissimilar items together and therefore is generally not appropriate.

Offsetting assets and liabilities differs from treating a set of rights and obligations as a single unit of account.

8.2.3 Classification of equity

To provide useful information, it may be necessary to classify equity claims separately if those equity claims have different characteristics.

Similarly, to provide useful information, it may be necessary to classify components of equity separately if some of those components are subject to particular legal, regulatory or other requirements. For example, in some jurisdictions, an entity is permitted to make distributions to holders of equity claims only if the entity has sufficient reserves specified as distributable. Separate presentation or disclosure of those reserves may provide useful information.

8.2.4 Classification of income and expenses

Classification is applied to:

- (a) income and expenses resulting from the unit of account selected for an asset or liability; or
- (b) components of such income and expenses if those components have different characteristics and are identified separately. For example, a change in the current value of an asset can include the effects of value changes and the accrual of interest (see tables in section 7.2). It would be appropriate to classify those components separately if doing so would enhance the usefulness of the resulting financial information.

8.2.5 Profit or loss and other comprehensive income

Income and expenses are classified and included either:

- (a) in the profit or loss section of statement of profit and loss; or
- (b) outside the profit or loss section of statement of profit and loss, in other comprehensive income.

Because the profit or loss section of statement of profit and loss is the primary source of information about an entity's financial performance for the period, all income and expenses are, in principle, included in that statement. However, in formulating Ind AS, the ICAI may decide in exceptional circumstances that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so would result in the profit or loss section of statement of profit and loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period.

In principle, income and expenses included in other comprehensive income in one period are reclassified from other comprehensive income into the profit or loss section of statement of profit and loss in a future period when doing so results in the profit or loss section of statement of profit and loss providing more relevant information or providing a more faithful representation of the entity's financial performance for that future period. However, if, for example, there is no clear basis for identifying the period in which reclassification would have that result, or the amount that should be reclassified, the ICAI may, in formulating Ind AS, decide that income and expenses included in other comprehensive income are not to be subsequently reclassified.



8.3 AGGREGATION

Aggregation is adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.

Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. Hence, a balance needs to be found so that relevant information is not obscured either by a large amount of insignificant detail or by excessive aggregation.

Different levels of aggregation may be needed in different parts of the financial statements. For example, typically, the balance sheet and the statement of profit and loss provide summarised information and more detailed information is provided in the notes.

Illustration 4:

Everest Ltd. is a listed company having investments in various subsidiaries. In its annual financial statements for the year ending 31st March 20X2 as well as 31st March 20X3, Everest Ltd. classified Kanchenjunga Ltd. a subsidiary as 'held-for-sale' and presented it as a discontinued operation. On 1st November 20X1, the shareholders had authorized the management to sell all of its holding in Kanchenjunga Ltd. within the year. In the year to 31st March 20X2, the management made a public announcement of its intention to sell the investment but did not actively try to sell the subsidiary as it was still operational within the Everest group.

Certain organizational changes were made by Everest Ltd. during the year to 31st March 20X3, thereby resulting in additional activities being transferred to Kanchenjunga Ltd. Additionally, during the year ending 31st March 20X3, there had been draft agreements and some correspondence with investment bankers, which showed in principle only that Kanchenjunga was still for sale.

Discuss whether the classification of Kanchenjunga Ltd. as held for sale and its presentation as a discontinued operation is appropriate, by referring to the principles of the relevant Ind AS and evaluating the treatment in the context of the Conceptual Framework for Financial Reporting.

Solution:

Kanchenjunga Ltd. is a disposal group in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Disposal group can be defined as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

Para 6 of Ind AS 105 provides that a disposal group shall be classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Ind AS 105 is particularly strict as far as the application of held for sale criteria is concerned, and often the decision to sell an asset or a disposal group is made well before the criteria are met.

Thus, as per Ind AS 105, for the asset (or disposal group) to be classified as held for sale, it 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.

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).
- An active programme to locate a buyer and complete the plan must have been initiated.
- The asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.
- It is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

In the given case, the draft agreements and correspondence with investment bankers are not specific enough to fit in the points above to prove that the criteria for held for sale was met at that

date. Additional information would be needed to confirm that the subsidiary was available for immediate sale, and that it was being actively marketed at an appropriate price so as to satisfy the criteria in the year to 31st March 20X2.

Further, the organizational changes made by Everest Ltd. in the year 20X2-20X3 are a good indicator that Kanchenjunga Ltd. was not available for immediate sale in its present condition at the point of classification. The fact that additional activities have been given to Kanchenjunga Ltd. indicate that the change wasn't insignificant. The shareholders had authorized for a year from 1st November 20X1. There is no evidence that this authorization extended beyond 1st November 20X2.

Conclusion:

Based on the information provided in the given case, it appears that Kanchenjunga Ltd. should not be classified by Everest Ltd. as a subsidiary held for sale. Instead, the results of the subsidiary should be reported as a continuing operation in the financial statements for the year ending 31st March 20X2 and 31st March 20X3.

Evaluation of treatment in context of the Conceptual Framework

The Conceptual Framework states that the users need information to allow them to assess the amount, timing and uncertainty of the prospects for future net cash inflows. Highlighting the results of discontinued operations separately equips users with the information that is relevant to this assessment as the discontinued operation will not contribute to cash flows in the future.

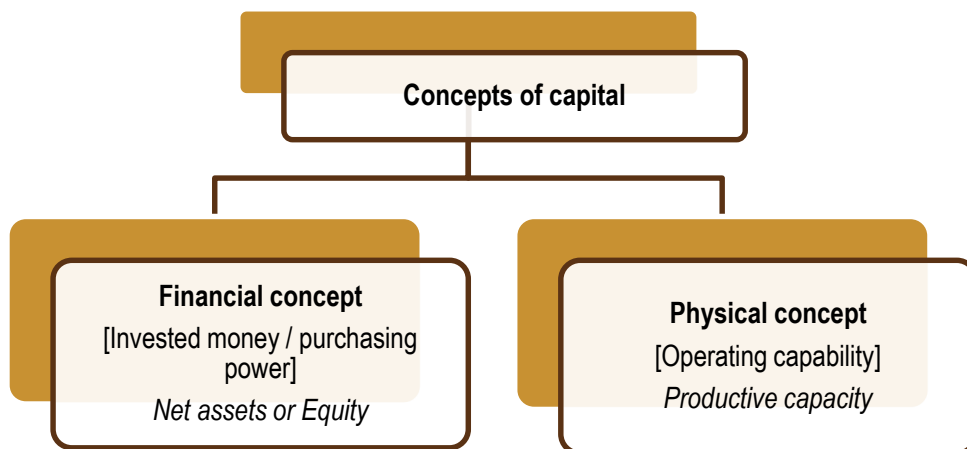
If a company has made a firm decision to sell the subsidiary, it could be argued that the subsidiary should be classified as discontinued operation, even if the criteria to classify it as 'held for sale' as per Ind AS 105 have not been met, because this information would be more useful to users. However, Ind AS 105 criteria was developed with high degree of strictness on classification. Accordingly, this decision could be argued to be in conflict with the Conceptual Framework.

UNIT 9

CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE



9.1 CONCEPTS OF CAPITAL



The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.



9.2 CONCEPTS OF CAPITAL MAINTENANCE AND THE DETERMINATION OF PROFIT

The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

There are two concepts of capital maintenance:

- ◆ Financial capital maintenance: Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.
- ◆ Physical capital maintenance: Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity.

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.



9.3 CAPITAL MAINTENANCE ADJUSTMENTS

The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves.

Example 11

A trader commenced business on 1.1.20X1 with ₹ 12,000 represented by 6,000 units of a certain product at ₹ 2 per unit. During the year 20X1, he sold these units at ₹ 3 per unit and had withdrawn ₹ 6,000. Thus:

Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.

Closing Equity = ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.

Retained Profit = ₹ 12,000 – ₹ 12,000 = Nil

The trader can start year 20X2 by purchasing 6,000 units at ₹ 2 per unit once again for selling them at ₹ 3 per unit. The whole process can repeat endlessly if there is no change in purchase price of the product.

Example 12

In the previous example, suppose that the average price indices at the beginning and at the end of year are 100 and 120 respectively.

Opening Equity = ₹ 12,000 represented by 6,000 units at ₹ 2 per unit.

Opening equity at closing price = (₹ 12,000 / 100) × 120 = ₹ 14,400 (6,000 × ₹ 2.40)

Closing Equity at closing price = ₹ 12,000 (₹ 18,000 – ₹ 6,000) represented entirely by cash.

Retained Profit = ₹ 12,000 – ₹ 14,400 = (-) ₹ 2,400

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund ₹ 12,000 is not sufficient to buy 6,000 units again at increased price ₹ 2.40 per unit. In fact, he should have restricted his drawings to ₹ 3,600 (₹ 6,000 – ₹ 2,400).

Had the trader withdrawn ₹ 3,600 instead of ₹ 6,000, he would have left with ₹ 14,400, the fund required to buy 6,000 units at ₹ 2.40 per unit.

Example 13 (Physical Capital Maintenance)

In the previous example, suppose that the price of the product at the end of year is ₹ 2.50 per unit. In other words, the specific price index applicable to the product is 125.

Current cost of opening stock = (₹ 12,000 / 100) × 125 = 6,000 × ₹ 2.50 = ₹ 15,000

Closing cash after adjustment of stock at current costs = ₹ 9,000 [(₹ 6,000 × 2.5) – ₹ 6,000]

Opening equity at closing current costs = ₹ 15,000

Closing equity at closing current costs = ₹ 9,000

Retained Profit = ₹ 9,000 – ₹ 15,000 = (-) ₹ 6,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund ₹ 9,000 is not sufficient to buy 6,000 units again at increased price ₹ 2.50 per unit. There should not be any drawings in the year.

Had the trader withdrawn nothing during the year instead of ₹ 6,000, he would have left with ₹ 15,000, the fund required to buy 6,000 units at ₹ 2.50 per unit.

Capital maintenance can be computed under all three bases as shown below:

Financial Capital Maintenance at historical costs

	₹	₹
Closing Capital (at historical cost)		12,000
Less: Capital to be maintained		
Opening capital (At historical cost)	12,000	
Introduction (At historical cost)	<u>NIL</u>	<u>(12,000)</u>
Retained profit		<u>12,000</u>

Financial Capital Maintenance at current purchasing power:

	₹	₹
Closing Capital (at closing price)		12,000
Less: Capital to be maintained		
Opening capital (at closing price)	14,400	
Introduction (at closing price)	<u>NIL</u>	<u>(14,400)</u>
Retained profit		<u>(2,400)</u>

Physical Capital Maintenance:

	₹	₹
Closing Capital (at current cost)		9,000
Less: Capital to be maintained		
Opening capital (at current cost)	15,000	
Introduction (at current cost)	<u>NIL</u>	<u>(15,000)</u>
Retained profit		<u>(6,000)</u>

TEST YOUR KNOWLEDGE**Question**

1. The directors of Jayant Ltd. have received the following email from its majority shareholder:

To: Directors of Jayant Ltd.

Re: Measurement

I recently read an article published in the financial press about the 'mixed measurement approach' that is used by lots of companies. I hope Jayant Ltd. does not follow such an approach because 'mixed' seems to imply 'inconsistent'. I believe that consistency is of paramount importance, and hence feel it would be better to measure everything in a uniform manner. It would be appreciated if you could provide further information at the next annual general meeting on measurement bases, covering what approach is taken by Jayant Ltd. and why, and the potential effect such an approach has on the investors trying to analyse the financial statements.

Prepare notes for the directors of Jayant Ltd. to discuss the issue raised in the shareholders' email with reference to the Conceptual Framework wherever appropriate.

Answer

1. 'Mixed measurement' approach implies that a company selects different measurement bases (e.g. historical cost or fair value) for its various assets and liabilities, rather than using one single measurement basis for all items. The measurement basis so selected should reflect the type of entity and the sector in which it operates and the business model that the entity adopts.

There are criticisms of the mixed measurement approach, particularly under the IFRS regime, because investors think that if different measurement bases are used for assets and liabilities, the resulting figures could lack relevance or exhibit little meaning.

It is however important to note that figures of items in the financial statements cannot be derived by following a one-size-fits-all approach. Such an approach may not provide relevant information to users. A particular measurement basis may be easier to understand, more verifiable and less costly to implement. Therefore, to state that 'mixed measurement' approach is 'inconsistent' is a poor argument. In reality, a mixed approach may actually provide more relevant information to the stakeholders.

The Conceptual Framework confirms the allowance of the usage of a mixed measurement approach in developing standards. The measurement methods included in the standards are

those which the standard-setters believe provide the most relevant information and which most faithfully represent the underlying transaction or event. Based on the reactions to the convergence to Ind AS, it feels that most investors feel this approach is consistent with their analysis of financial statements. Thus, the arguments against a mixed measurement are far outweighed by the greater relevance achieved by such measurement bases.

Jayant Ltd. prepares its financial statements under Ind AS, and therefore applies the measurement bases permitted in Ind AS. Ind AS adopt a mixed measurement basis, which includes current value (fair value, value in use, fulfilment value and current cost) and historical cost.

Where an Ind AS allows a choice of measurement basis, the directors of Jayant Ltd. must exercise judgment as to which basis will provide the most useful information for its primary users. Furthermore, when selecting a measurement basis, measurement uncertainty should also be considered. The Conceptual Framework states that for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may be of little relevance.

[illegible]

IND AS ON PRESENTATION OF GENERAL PURPOSE FINANCIAL STATEMENTS



UNIT 1 : INDIAN ACCOUNTING STANDARD 1 : PRESENTATION OF FINANCIAL STATEMENTS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ☐ List the scope and objective of Ind AS 1
- ☐ Define the relevant terms used in Ind AS 1
- ☐ Explain the purpose of financial statements
- ☐ Illustrate the complete set of financial statements
- ☐ Describe the general features of the financial statements
- ☐ Follow the structure and content of the financial statements
- ☐ Identify the various components of financial statements
- ☐ Prepare the disclosures to be made in the financial statements
- ☐ Discuss the significant differences in Ind AS 1 vis-à-vis AS 1
- ☐ Reconcile the carve out in Ind AS 1 from IAS 1.

UNIT OVERVIEW

**Ind AS 1**

- Objective
- Scope
- Definitions

Financial Statements

- Purpose of financial statements
- Complete set of financial statements
- General features

Structure and Content

- Identification of the financial statements
- Components of financial statements



1.1 IND AS 1 'PRESENTATION OF FINANCIAL STATEMENTS' - INTRODUCTION

Ind AS 1 is a basic standard, which prescribes the overall requirements for the presentation of general-purpose financial statements and guidelines for their structure, i.e., components of financial statements, viz., balance sheet, statement of profit and loss (including other comprehensive income), statement of cash flows and notes comprising significant accounting policies, etc. Further, the standard prescribes the minimum disclosures that are to be made in the financial statements and explains the general features of the financial statements. The presentation requirements prescribed in the standard are supplemented by the recognition, measurement and disclosure requirements set out in other Ind AS for specific transactions and other events.



1.2 OBJECTIVE

This standard prescribes the basis for presentation of general-purpose financial statements to ensure comparability:

- a) with the entity's financial statements of previous periods and
- b) with the financial statements of other entities.

It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.



1.3 SCOPE

- This standard **applies** to all types of entities including those that present:
 - (a) consolidated financial statements in accordance with Ind AS 110 'Consolidated Financial Statements'; and
 - (b) separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.
- This standard **does not apply** to structure and content of condensed interim financial statements prepared in accordance with Ind AS 34 except for para 15 to 35 of Ind AS 1.
- This Standard uses terminology that is suitable for profit-oriented entities, including public sector business entities.

- If entities with not for-profit activities in the private sector or the public sector apply this Standard, they may need to amend the descriptions used for line items in the financial statements and for the financial statements themselves.
- Similarly, entities that do not have equity as defined in Ind AS 32 Financial Instruments: Presentation (e.g. some mutual funds) and entities whose share capital is not equity (e.g. some co-operative entities) may need to adapt the financial statement presentation of members' or unit holders' interests.



1.4 DEFINITIONS

1. **Accounting policies** are defined in paragraph 5 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors, and the term is used in this Standard with the same meaning.
2. **General purpose financial statements** (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.
3. **Impracticable**: Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
4. **Indian Accounting Standards (Ind AS)** are Standards prescribed under Section 133 of the Companies Act, 2013.
5. **Material**

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information.

Examples of circumstances that may result in material information being obscured:

- (a) information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;

- (b) information regarding a material item, transaction or other event is scattered throughout the financial statements;
- (c) dissimilar items, transactions or other events are inappropriately aggregated;
- (d) similar items, transactions or other events are inappropriately disaggregated; and
- (e) the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances.

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

6. **Notes** contain information in addition to that presented in the balance sheet, statement of profit and loss, other comprehensive income, statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregation of items presented in those statements and information about items that do not qualify for recognition in those statements.
7. **Owners** are holders of instruments classified as equity.
8. **Profit or loss** is the total of income less expenses, excluding the components of other comprehensive income.
9. **Reclassification adjustments** are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.
10. **Total comprehensive income** is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

Total comprehensive income comprises all components of 'profit or loss' and 'other comprehensive income'.

11. **Other comprehensive income** comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind AS.

The components of Other Comprehensive Income include the following:

S.No.	Components	Reference
1.	Changes in revaluation surplus	Ind AS 16 'Property, Plant and Equipment' and Ind AS 38 'Intangible Assets'
2.	Re-measurements of defined benefit plans	Ind AS 19, Employee Benefits
3.	Gains and losses arising from translating the financial statements of a foreign operation	Ind AS 21 'The Effects of Changes in Foreign Exchange Rates'
4.	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	Paragraph 5.7.5 of Ind AS 109, Financial Instruments
5.	Gains and losses on financial assets measured at fair value through other comprehensive income	Paragraph 4.1.2A of Ind AS 109
6.	The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income	Paragraph 5.7.5 of Ind AS 109
7.	For liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk	Paragraph 5.7.7 of Ind AS 109
8.	Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and	Ind AS 109

	designating as the hedging instrument only the changes in the intrinsic value	
9.	Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument	Ind AS 109



1.5 PURPOSE OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet the objective, financial statements provide information about an entity's:

- assets;
- liabilities;
- equity;
- income and expenses, including gains and losses;
- contributions by and distributions to owners in their capacity as owners; and
- cash flows.

These information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.



1.6 COMPLETE SET OF FINANCIAL STATEMENTS

A complete set of financial statements comprises:

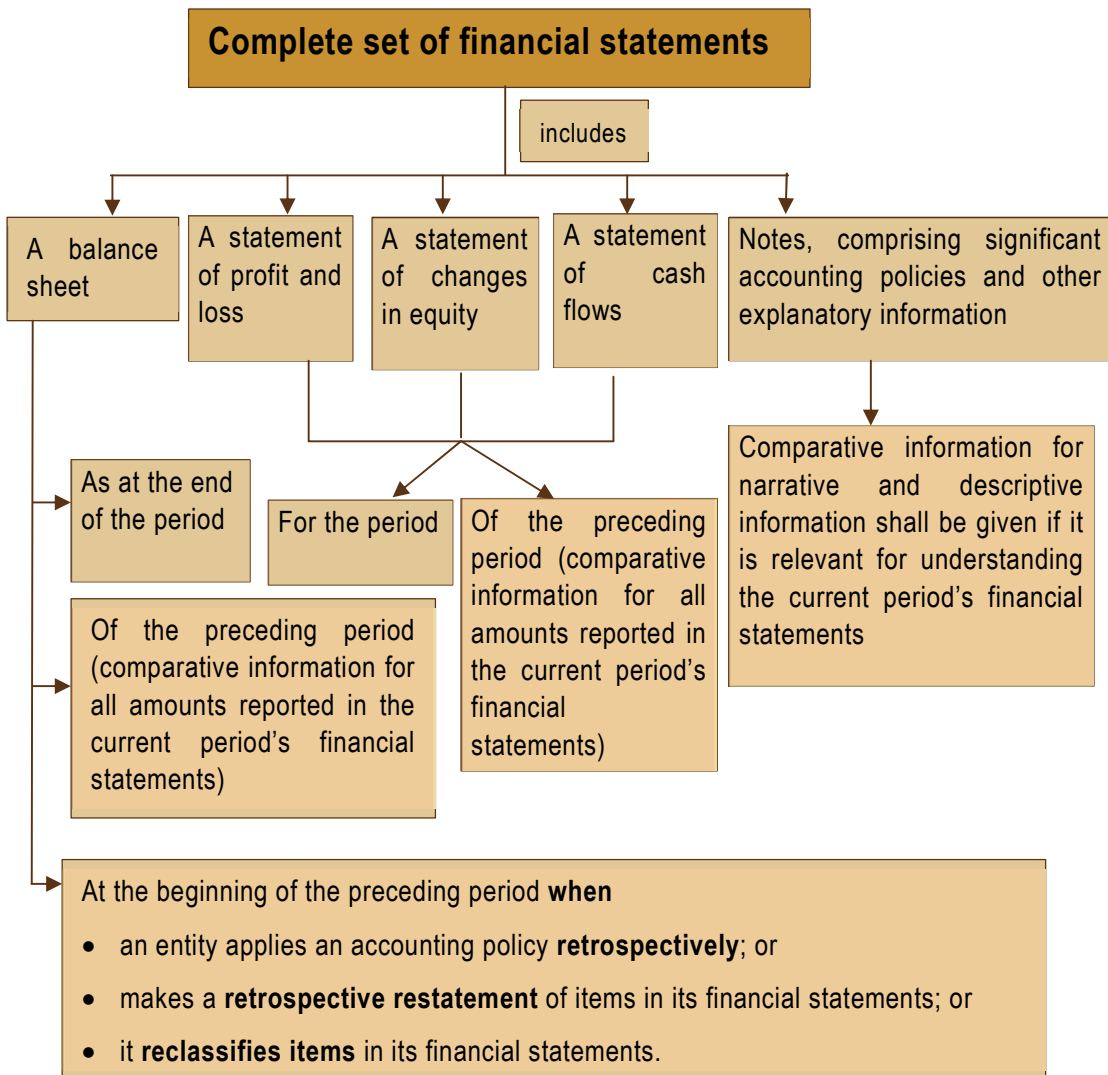
- a balance sheet as at the end of the period;
- a statement of profit and loss for the period;
- statement of changes in equity for the period;

- a statement of cash flows for the period;
- notes, comprising material accounting policy information and other explanatory information;
- comparative information in respect of the preceding period;
- a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatements of items in its financial statements, or when it reclassifies items in its financial statements.

An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

An entity shall present with equal prominence all of the financial statements in a complete set of financial statements.

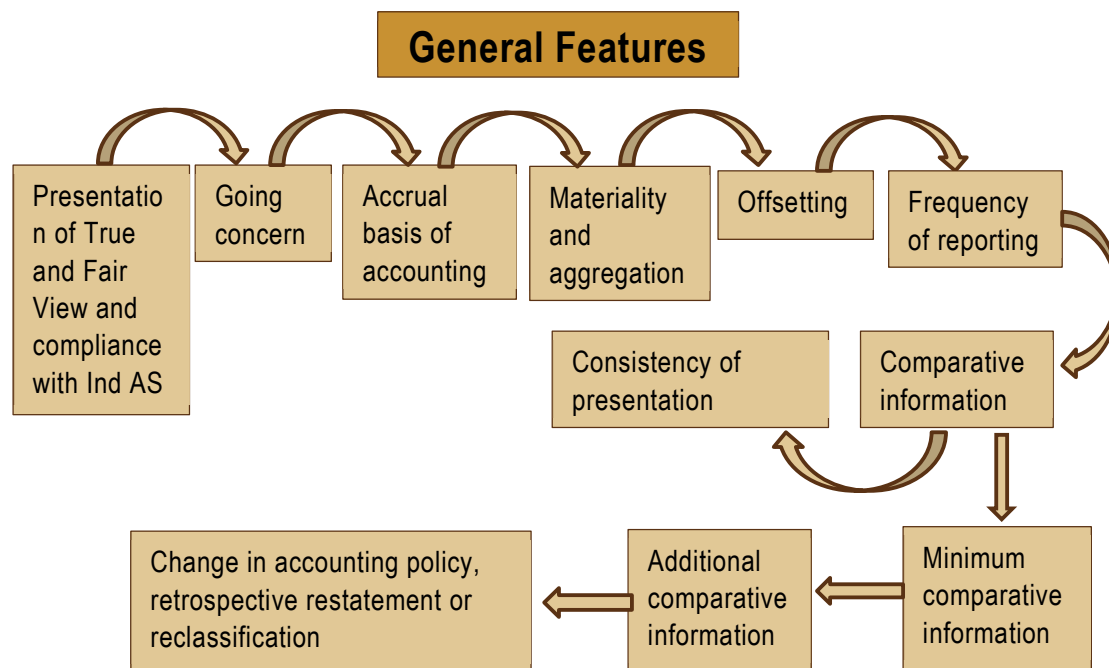
Many entities also present reports and statements (generally in annual reports) such as financial reviews by management, environmental reports, and value added statements that are outside the financial statements. Such reports and statements that are presented outside the financial statements are outside the scope of Ind AS.

**Note:**

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



1.7 GENERAL FEATURES OF FINANCIAL STATEMENTS



1.7.1 Presentation of True and Fair View and compliance with Ind AS

Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Conceptual Framework. The application of Ind AS, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.

1.7.1.1 An explicit and unreserved statement

An entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes.

An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. There may be disagreement between the Company and its auditor on the applicability of any Ind AS or any particular requirement of any Ind AS and accordingly auditor may qualify the audit report. Even in such a situation, the financial statements shall be assumed to be Ind AS compliant.

In virtually all circumstances, presentation of a true and fair view is achieved by compliance with applicable Ind AS. Presentation of a true and fair view also requires an entity:

- (a) to select and apply accounting policies in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Ind AS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an Ind AS that specifically applies to an item.
- (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- (c) to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

An extract from the annual report of Tata Consultancy Services Limited for the year ended 31st March, 2022:

Notes forming part of Standalone Financial Statements

2) Statement of compliance

These standalone financial statements have been prepared in accordance with the Indian Accounting Standards (referred to as "Ind AS") as prescribed under section 133 of the Companies Act, 2013 read with the Companies (Indian Accounting Standards) Rules as amended from time to time.

1.7.1.2 Inappropriate Accounting Policies

An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.

1.7.1.3 Departure from the Requirements of an Ind AS — Whether Permissible?

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Conceptual Framework, the entity shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it shall disclose:

- (a) that management has concluded that the financial statements present a true and fair view of the entity's financial position, financial performance and cash flows;
- (b) that it has complied with applicable Ind AS, except that it has departed from a particular requirement to present a true and fair view;

- (c) the title of the Ind AS from which the entity has departed, the nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Conceptual Framework, and the treatment adopted; and
- (d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

When an entity has departed from a requirement of an Ind AS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures given above. For example, when an entity departed in a prior period from a requirement in an Ind AS for the measurement of assets or liabilities and that departure affects the measurement of changes in assets and liabilities recognised in the current period's financial statements.

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Conceptual Framework, but the relevant regulatory framework prohibits departure from the requirement, the entity shall to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

- (a) the title of the Ind AS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the Conceptual Framework; and
- (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to present a true and fair view.

An item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events and conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements. When assessing whether complying with a specific requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, management considers:

- (a) why the objective of financial statements is not achieved in the particular circumstances; and
- (b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.

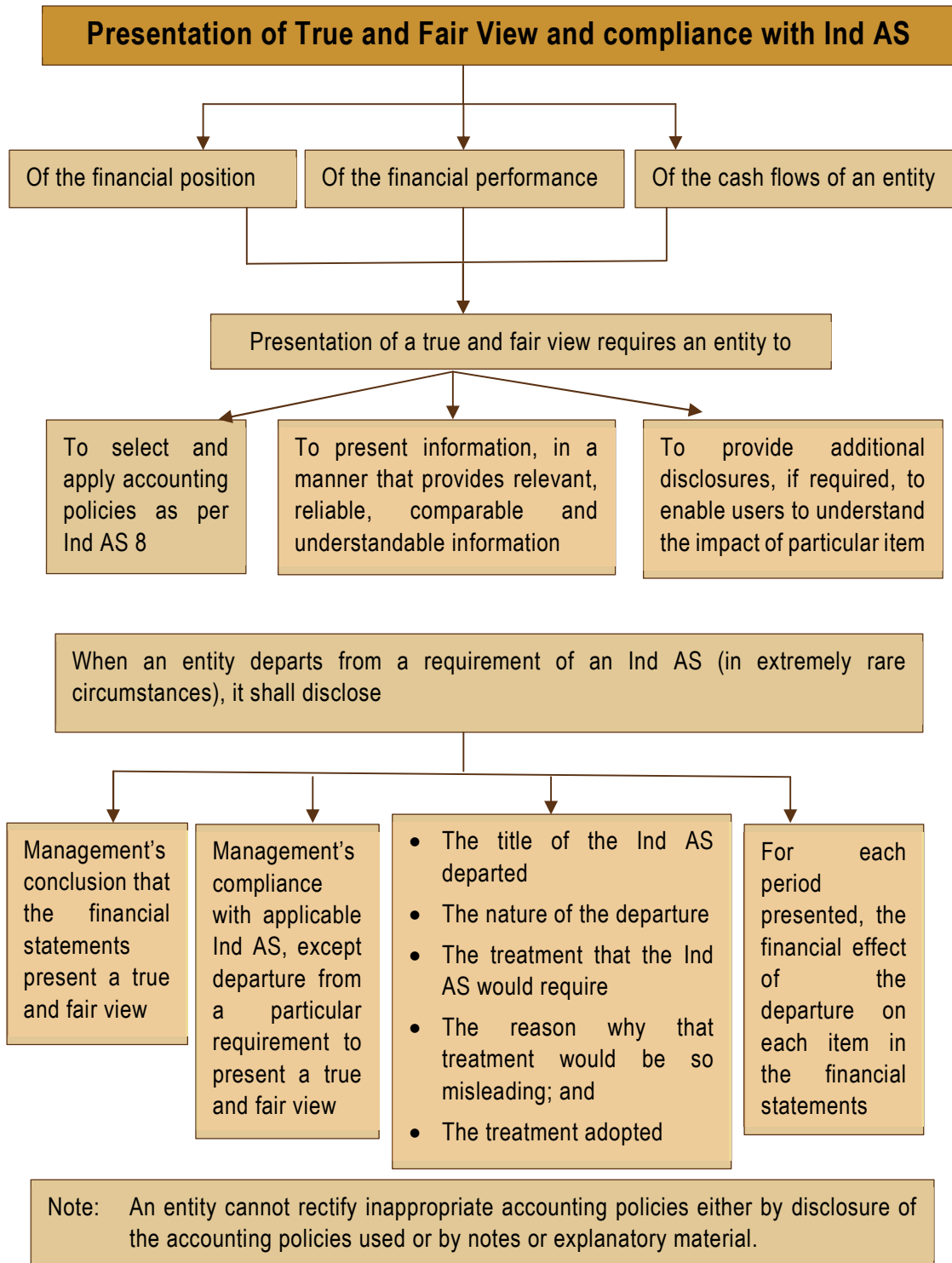


Illustration 1

An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

Solution

Yes, it is possible for an entity to make an unreserved and explicit statement of compliance with Ind AS, even though the auditor's report contains a qualification because of disagreement on application of Accounting Standard(s), as the preparation of financial statements is the responsibility of the entity's management and not the auditors. In case the management has a bona fide reason to believe that it has complied with all Ind AS, it can make an explicit and unreserved statement of compliance with Ind AS.

1.7.2 Going concern

Financial statements prepared under Ind AS should be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. Management is required to assess, at the time of preparing the financial statements, the entity's ability to continue as a going concern, and this assessment should cover the entity's prospects for at least 12 months from the end of the reporting period. The 12-month period for considering the entity's future is a minimum requirement; an entity cannot, for example, prepare its financial statements on a going concern basis if it intends to cease operations 18 months from the end of the reporting period.

The assessment of the entity's status as a going concern will often be straight forward. A profitable entity with no financing problems will generally be a going concern. In other cases, management might need to consider very carefully the entity's ability to meet its liabilities as they fall due. Detailed cash flow and profit forecasts might be required to satisfy management that the entity is a going concern.

The following are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. This listing is neither all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists:

- Net liability or net current liability position;

- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets;
- Indications of withdrawal of financial support by creditors;
- Negative operating cash flows indicated by historical or prospective financial statements;
- Adverse key financial ratios;
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows;
- Arrears or discontinuance of dividends;
- Inability to pay creditors on due dates;
- Inability to comply with the terms of loan agreements;
- Change from credit to cash-on-delivery transactions with suppliers;
- Inability to obtain financing for essential new product development or other essential investments;
- Loss of key management without replacement;
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s);
- Emergence of a highly successful competitor;
- Changes in law or regulation or government policy expected to adversely affect the entity.

If management has significant doubt of the entity's ability to continue as a going concern, the uncertainties should be disclosed.

In case the financial statements are not prepared on a going concern basis, the entity should disclose the basis of preparation of financial statements and also the reason why the entity is not regarded as a going concern.

Events that occur after the reporting period might indicate that the entity is no longer a going concern. An entity does not prepare its financial statements on a going concern basis if management's post-year end assessment indicates that it is not a going concern. Any financial statements that are prepared after that assessment (including the financial statements in respect of which management are making the assessment) are not prepared on a going concern basis. This is consistent with Ind AS 10, which requires a fundamental change to the basis of accounting when the going concern assumption is no longer appropriate.

Illustration 2

Entity XYZ is a large manufacturer of plastic products for the local market. On 1st April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency ₹ appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31st March, 20X7, entity XYZ's equity was ₹ 1,000. During the second quarter of financial year ended 31st March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to ₹ 400 and ₹ 380, respectively. During the year ended 31st March, 20X7, entity XYZ reported a loss of ₹ 4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15th March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term.

Management of the entity XYZ undertook a going concern assessment at 31st March, 20X7. Management projects / forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31st March, 20X7 annual financial statements?

Solution

Going concern is a general feature to be considered while preparing the financial statements. As per Ind AS 1, when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. An entity is required to disclose the facts, if the financial statements are not prepared on a going concern basis. Along with the reason, as to why the financial statements are not prepared on a going concern basis.

While assessing the going concern assumption, an entity is required to take into consideration all factors covering atleast but not limited to 12 months from the end of reporting period.

On the basis of Ind AS 1 and the facts and circumstances of this case, the following disclosure is appropriate:

Extracts from the notes to entity XYZ's 31st March, 20X7 financial statements

Note 1: Basis of preparation

On the basis of management's assessment at 31st March 20X7, the financial statements have been prepared on the going concern basis. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On 15th March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7.

Provided that ₹ does not strengthen, management projects / forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. As at 31st March, 20X7 entity XYZ had net assets of ₹ 1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

1.7.3 Accrual basis of accounting

- An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.
- When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Conceptual Framework.

1.7.4 Materiality and aggregation

- An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.
- Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item

that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.

- An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.
- An entity need not provide a specific disclosure required by an Ind AS if the information is not material except when required by law.

Examples 1 - 3

1. Entity A has made a wrong classification of assets between 2 categories of plant and machinery. Such a classification would not be material in amount if it affected two categories of plant or machinery, however, it might be material if it changes the classification between a non-current and a current asset category.
2. Losses from bad debts or pilferage that could be shrugged off as routine by a large business may threaten the continued existence of a small business.
3. An error in inventory valuation may be material in a small enterprise for which it may cut earnings by half but could be immaterial in an enterprise for which it might make a barely perceptible ripple in the earnings.

1.7.5 Offsetting

- An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.
- An entity reports separately both assets and liabilities, and income and expenses. Measuring assets net of valuation allowances — for example, obsolescence allowances on inventories and doubtful debts allowances on receivables—is not offsetting.
- Ind AS 115, 'Revenue from Contracts with Customers', requires an entity to measure revenue from contracts with customers at the amount of consideration to which the entity expects to be entitled in exchange for transferring promised goods or services. For example, the amount of revenue recognized reflects any trade discounts and volume rebates the entity allows. An entity undertakes, in the course of its ordinary activities, other transactions that do not generate revenue but are incidental to the main revenue-generating activities. An entity presents the results of such transactions, when this presentation reflects the substance of the transaction or other event, by netting any income with related expenses arising on the same transaction.

Examples 4 and 5

4. An entity presents gains and losses on the disposal of non-current assets, including investments and operating assets, by deducting from the amount of consideration on disposal the carrying amount of the asset and related selling expenses; and
 5. An entity may net expenditure related to a provision that is recognised in accordance with Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', and reimbursed under a contractual arrangement with a third party (for example, a supplier's warranty agreement) against the related reimbursement.
- In addition, an entity presents on a net basis gains and losses arising from a group of similar transactions, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses separately if they are material.

Illustration 3

Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

Solution

On the basis of the guidance regarding offsetting, net presentation in the given case would not be appropriate, as it would not reflect substance of the transaction and would detract from the ability of users to understand the transaction.

Accordingly, the commission received by the company as an agent is the gross revenue of the company. The amount of commission paid by it to the sub-agent should be considered as an expense and should not be offset against commission earned by it.

1.7.6 Frequency of reporting

- An entity shall present a complete set of financial statements (including comparative information) at least annually.
- When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:
 - ◆ the reason for using a longer or shorter period, and
 - ◆ the fact that amounts presented in the financial statements are not entirely comparable.

Example 6

In 20X8 entity 'Superb' was acquired by entity 'Happy Go Luck'. To align its reporting date with that of its parent, Superb changed the end of its annual reporting period from 31st January to 31st March. Consequently, entity Superb's reporting period for the year ended 31st March, 20X8 is 14 months. On the basis of these facts, the following disclosure would be appropriate:

Extract from the notes to entity Superb's 31st March, 20X8 financial statements:

Note 1

Basis of preparation and accounting policies

Reporting period

To align the entity's reporting period with that of its parent (Happy Go Luck), the entity changed the end of its reporting period from 31st January to 31st March. Amounts presented for the period ended 31st March, 20X8 are for 14 months. Comparative figures are for a 12 months period. Consequently, comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

1.7.7 Comparative information

1.7.7.1 Minimum comparative information

- An entity should present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements except when Ind AS permit or require otherwise.
- Comparative information for narrative and descriptive information should be included if it is relevant to understand the current period's financial statements.

For example, in the current period an entity discloses details of a legal dispute whose outcome was uncertain at the end of the immediately preceding reporting period and that is yet to be resolved.

- An entity shall present, as a minimum:
 - ◆ 2 Balance Sheets
 - ◆ 2 Statement of Profit and Loss
 - ◆ 2 Statement of Cash Flows
 - ◆ 2 Statement of Changes in Equity and
 - ◆ Related Notes.

1.7.7.2 Additional comparative information

An entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in 'Complete set of financial statements' but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

Example 7

An entity may present a third statement of profit or loss (thereby presenting the current period, the preceding period and one additional comparative period). However, the entity is not required to present a third balance sheet, a third statement of cash flows or a third statement of changes in equity (ie an additional financial statement comparative). The entity is required to present, in the notes to the financial statements, the comparative information related to that additional statement of profit or loss and other comprehensive income.

Illustration 4

A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 20X1 annual financial statements. The business combination accounting was finalised in 20X1-20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-20X2 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 20X0?

Solution

An additional statement of financial position is not required, because the acquisition had no impact on the entity's financial position at 1st April, 20X0.

1.7.7.3 Change in accounting policy, retrospective restatement or reclassification

- When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements and the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period, it shall present, as a minimum, three balance sheets, two of each of the other statements, and related notes. An entity presents balance sheets as at
 - ◆ the end of the current period,

- ◆ the end of the preceding period, and
- ◆ the beginning of the preceding period.
- When an entity is required to present an additional balance sheet as at the beginning of the preceding period, it must disclose the information as required by Ind AS 8 and also the information as explained in subsequent points. However, it need not present the related notes to the opening balance sheet as at the beginning of the preceding period.
- When the entity changes the presentation or classification of items in its financial statements, the entity shall reclassify comparative amounts unless reclassification is impracticable.
- When the entity reclassifies comparative amounts, the entity shall disclose:
 - ◆ the nature of the reclassification;
 - ◆ the amount of each item or class of items that is reclassified; and
 - ◆ the reason for the reclassification.
- When it is impracticable to reclassify comparative amounts, an entity shall disclose:
 - ◆ the reason for not reclassifying the amounts, and
 - ◆ the nature of the adjustments that would have been made if the amounts had been reclassified.

1.7.8 Consistency of presentation

An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

- it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or
- an Ind AS requires a change in presentation.

Example 8

A significant acquisition or disposal, or a review of the presentation of the financial statements, might suggest that the financial statements need to be presented differently. An entity changes the presentation of its financial statements only if the changed presentation provides information that is reliable and more relevant to users of the financial statements and the revised structure is likely to continue, so that comparability is not impaired. When making such changes in presentation, an entity reclassifies its comparative information.



1.8 STRUCTURE AND CONTENT

Ind AS 1 requires particular disclosures in the balance sheet or in the statement of profit and loss, or in the statement of changes in equity and requires disclosure of other line items either in those statements or in the notes. Ind AS 7, Statement of Cash Flows, sets out requirements for the presentation of cash flow information.

1.8.1 Identification of Financial Statements

- An entity shall clearly identify the financial statements and distinguish them from other information in the same published document. Ind AS apply only to financial statements, and not necessarily to other information presented in an annual report, a regulatory filing, or another document though they may be useful to users.
- An entity shall display the following information prominently:
 - ◆ the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period
 - ◆ whether the financial statements are of an individual entity or a group of entities;
 - ◆ the date of end of reporting date or the period covered by the financial statements or notes
 - ◆ the presentation currency
 - ◆ the level of rounding used in presenting amounts in the financial statements.
 - ◆ An entity meets above requirements by presenting appropriate headings for pages, statements, notes, columns and the like. Judgement is required in determining the best way of presenting such information.

For example, when an entity presents the financial statements electronically separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood.

- ◆ An entity often makes financial statements more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the entity discloses the level of rounding and does not omit material information.

As per Schedule III of the Companies Act 2013, depending upon the total income of the company, the figures appearing in the financial statements shall be rounded off as below:

- Less than one hundred crore rupees - To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
- One hundred crore rupees or more- To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

1.8.2 Balance Sheet

At a minimum, the balance sheet shall include following line items:

a	Property, plant and equipment
b	Investment property
c	Intangible assets
d	Financial assets (excluding amounts shown under (e, h & i))
e	Investments accounted for using the equity method
f	Biological assets
g	Inventories
h	Trade and other receivables
i	Cash and cash equivalents
j	The total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'
k	Trade and other payables
l	Provisions
m	Financial liabilities (excluding amounts shown under k and l)
n	Liabilities and assets for current tax, as defined in Ind AS 12 'Income Taxes'
o	Deferred tax liabilities and deferred tax assets, as defined in Ind AS 12

p	Liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105
q	Non-controlling interests, presented within equity
r	Issued capital and reserves attributable to owners of the parent

Additional line items, headings and subtotals in the balance sheet should be presented when such presentation is relevant to an understanding of the entity's financial position.

The descriptions of the line items, and the order in which they are shown, can be adapted according to the entity's nature and its transactions.

Example 9

Financial institutions would amend the descriptions of line items to provide information that is relevant to the operations of financial institutions.

1.8.2.1 Distinction between Current / Non-current

Entities preparing Ind AS financial statements are required to present the face of the balance sheet, differentiating between current and non-current assets and between current and non-current liabilities.

When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- a) no more than twelve months after the reporting period, and
- b) more than twelve months after the reporting period.

When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities in the balance sheet provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected

to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.

When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).

Note:

1. Financial institutions may present assets and liabilities in increasing or decreasing order of liquidity if the presentation is reliable and more relevant than a current / non-current presentation. This is because such entity does not supply goods or services within a clearly identifiable operating cycle.
2. An entity is permitted to present some of its assets and liabilities using a current / non-current classification and others in order of liquidity. The need for a mixed basis of presentation might arise when an entity has diverse operations.

1.8.2.2 Current Assets

An entity shall classify an asset as current when:

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
- (b) it holds the asset primarily for the purpose of trading;
- (c) it expects to realise the asset within twelve months after the reporting period; or
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current.

This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

An extract from the annual report of Reliance Industries Limited for the year ended 31st March, 2022:

Notes to the Standalone Financial Statements for the year ended 31st March, 2022

B.2 Summary of Significant Accounting Policies

(a) Current and Non-current Classification

The Company presents assets and liabilities in the Balance Sheet based on Current/ Non-Current classification.

An asset is treated as current when it is –

- Expected to be realised or intended to be sold or consumed in normal operating cycle;*
- Held primarily for the purpose of trading;*
- Expected to be realised within twelve months after the reporting period, or*
- Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.*

All other assets are classified as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

1.8.2.3 Operating Cycle

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading.

For example

- Some financial assets classified as held for trading in accordance with Ind AS 109
- Current portion of non-current financial assets.

Examples 10 -13

10. An entity produces whisky from barley, water and yeast in a 24-month distillation process. At the end of the reporting period the entity has one month's supply of barley and yeast raw materials, 800 barrels of partly distilled whisky and 200 barrels of distilled whisky.

All raw materials (barley and yeast) work in process (partly distilled whisky) and finished goods (distilled whisky) are inventories. The raw materials are expected to be realised (ie turned into cash after being processed into whisky) in the entity's normal operating cycle. Therefore, even though the realisation is expected to take place more than twelve months after the end of the reporting period, the raw materials, work in progress and finished goods are current assets.

- 11. An entity owns a machine with which it manufactures goods for sale. It also owns the building in which it carries out its commercial activities.**

The machine and the building are non-current assets because:

- ◆ they are not cash or cash equivalents;
- ◆ they are not expected to be realised or consumed in the entity's normal operating cycle;
- ◆ they are not held for the purpose of trading; and
- ◆ they are not expected to be realised within twelve months of the end of the reporting period.

- 12. On 31st December 20X2, an entity replaced a machine in its production line. The replaced machine was sold to a competitor for ₹ 3,00,000. Payment is due 15 months after the end of the reporting period.**

The receivable is a non-current asset because:

- ◆ it is not cash or a cash equivalent;
- ◆ it is not expected to be realised or consumed in the entity's normal operating cycle;
- ◆ it is not held for the purpose of trading; and
- ◆ it is not expected to be realised within twelve months of the end of the reporting period.

Note: If payment was due in less than twelve months from the end of the reporting period, it would have been classified as a current asset.

- 13. On 1st April, 20X2, XYZ Ltd invested ₹ 15,00,000 surplus funds in corporate bonds that bear interest at 8 percent per year. Interest is payable on the corporate bonds on 1st April, of each year. The principal is repayable in three annual instalments of ₹ 5,00,000 starting from 1st April, 20X3.**

In its statement of financial position at 31st March, 20X3, the entity must present the ₹ 1,20,000 accrued interest and ₹ 5,00,000 current portion of the non-current loan (i.e. the portion repayable on 31st March, 20X3) as current assets because they are expected to be realised within twelve months of the end of the reporting period.

The instalments of ₹ 10,00,000 due later than twelve months after the end of the reporting period is presented as a non-current asset because it is not cash or a cash equivalent as it is not expected to be realised or consumed in the entity's normal operating cycle, it is not held for the purpose of trading and it is not expected to be realised within twelve months of the end of the reporting period.

Illustration 5

X Ltd. provides you the following information:

Raw material stock holding period : 3 months

Work-in-progress holding period : 1 month

Finished goods holding period : 5 months

Debtors collection period : 5 months

You are requested to compute the operating cycle of X Ltd.

Solution

The operating cycle of X Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period = 3 + 1 + 5 + 5 = 14 months.

Illustration 6

Inventory or trade receivables of X Ltd. are normally realised in 15 months. How should X Ltd. classify such inventory / trade receivables: current or non-current if these are expected to be realised within 15 months?

Solution

These should be classified as current.

Illustration 7

B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery.

(a) What is the length of operating cycle?

(b) How should it treat its inventory and debtors?

Solution

(a) The length of the operating cycle will be 16 months.

(b) Assuming the inventory and debtors will be realised within normal operating cycle, i.e., 16 months, both the inventory as well as debtors should be classified as current.

1.8.2.4 Current Liabilities

- An entity shall classify a liability as current when:
 - (a) it expects to settle the liability in its normal operating cycle;
 - (b) it holds the liability primarily for the purpose of trading;
 - (c) the liability is due to be settled within twelve months after the reporting period; or
 - (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An extract from the annual report of Reliance Industries Limited for the year ended 31st March, 2022:

Notes to the Standalone Financial Statements for the year ended 31st March, 2022

B.2 Summary of Significant Accounting Policies

(a) Current and Non-Current Classification

The Company presents assets and liabilities in the Balance Sheet based on Current/ Non-Current classification.

A liability is current when:

- *It is expected to be settled in normal operating cycle;*
- *It is held primarily for the purpose of trading;*
- *It is due to be settled within twelve months after the reporting period, or*
- *There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.*

The Company classifies all other liabilities as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

- An entity shall classify all other liabilities as non-current.

- Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle.
- An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.
- The same normal operating cycle applies to the classification of an entity's assets and liabilities.
- When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.
- Other current liabilities which are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading.

Examples are some financial liabilities classified as held for trading in accordance with Ind AS 109, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables.

- Financial liabilities that provide financing on a long-term basis (i.e. are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities.
- An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:
 - ◆ the original term was for a period longer than twelve months, and
 - ◆ an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.
- If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.
- When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, the entity does not classify the liability as current, even if the lender agreed, after the reporting period

and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

- However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

Illustration 8

On 1st April, 20X3, Charming Ltd issued 1,00,000 ₹ 10 bonds for ₹ 10,00,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at ₹ 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

Solution

Charming Ltd must present ₹ 80,000 accrued interest and ₹ 1,00,000 current portion of the non-current bond (i.e. the portion repayable on 1st April, 20X4) as current liabilities. The ₹ 9,00,000 due later than 12 months after the end of the reporting period is presented as a non-current liability.

Illustration 9

X Ltd provides you the following information:

Raw material stock holding period : 3 months

Work-in-progress holding period : 1 month

Finished goods holding period : 5 months

Debtors collection period : 5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

Solution

In this case, the operating cycle of X Ltd. is 14 months. Since the trade payables are expected to be settled within the operating cycle i.e. 12.5 months, they should be classified as a current.

Illustration 10

Entity A has two different businesses, real estate and manufacturing of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Solution

As per paragraph 66(a) of Ind AS 1, an asset should be classified as current if an entity expects to realise the same, or intends to sell or consume it in its normal operating cycle. Similarly, as per paragraph 69(a) of Ind AS 1, a liability should be classified as current if an entity expects to settle the liability in its normal operating cycle. In this situation, where businesses have different operating cycles, classification of asset/liability as current/non-current would be in relation to the normal operating cycle that is relevant to that particular asset / liability. It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

Illustration 11

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

- (a) *Electricity Deposit*
- (b) *Tender Deposit/Earnest Money Deposit [EMD]*
- (c) *GST Deposit paid under dispute or GST payment under dispute.*

Solution

- (a) **Electricity Deposit** - At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realise the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a non-current asset.
- (b) **Tender Deposit/Earnest Money Deposit [EMD]** - Generally, tender deposit / EMD are paid for participation in various bids. They normally become recoverable if the entity does not win the bid. Bid dates are known at the time of tendering the deposit. But until the date of the actual bid, one is not in a position to know if the entity is winning the bid or otherwise.

Accordingly, depending on the terms of the deposit if entity expects to realise the deposit within a period of twelve months, it should be classified as current otherwise non-current.

- (c) **GST Deposit paid under dispute or GST payment under dispute** -Classification of GST deposit paid to the Government authorities in the event of any legal dispute, which is under protest would depend on the facts of the case and the expectation of the entity to realise the same within a period of twelve months. In the case the entity expects these to be realised within 12 months, it should classify such amounts paid as current otherwise these should be classified as non-current.

Illustration 12

Paragraph 69(a) of Ind AS 1 states “An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle”. An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payment upfront and credits the amount so received to “Income Received in Advance”. How should this “Income Received in Advance” be classified, i.e., current or non-current?

Solution

Ind AS 1 provides “Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity’s normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.”

In accordance with the above, income received in advance would be classified as current liability since it is a part of the working capital, which the entity expects to earn within its normal operating cycle.

Illustration 13

An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

- (a) *How should such loan be classified in the balance sheet of the entity?*
- (b) *Will the answer be different if the new facility is agreed upon after the end of the reporting period?*

- (c) *Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?*
- (d) *Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?*

Solution

- (a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non-current.
- (b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.
- (c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.
- (d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Illustration 14

In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by 24th March 20X2, failing which the loan becomes payable on demand. As on 24th March 20X2, the entity has not been able to get the promoter's contribution. On 25th March, 20X2, the entity approached the bank and obtained a grace period up to 30th June, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on 31st March, 20X2.

- (a) *As on 31st March, 20X2, how should the entity classify the loan?*

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the compliance date extended up to 30th June, 20X2 for getting promoter's contribution. In this case will the loan classification as on 31st March, 20X2 be different from (a) above?

Solution

- (a) Paragraph 75 of Ind AS 1, inter alia, provides, "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March 20X2, the loan will be classified as current.
- (b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March 20X2, the loan will retain its classification as non-current.

Illustration 15

OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd.

How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?

Solution

The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period.

MN Ltd would classify the loan as current because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.

The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

1.8.2.5 Information to be provided in the Balance Sheet or in the notes

- An entity shall disclose, either in the balance sheet or in the notes, further sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.
- The detail provided in sub-classifications depends on the requirements of Ind AS and on the size, nature and function of the amounts involved. The disclosures vary for each item, for example:
 - (i) items of property, plant and equipment are disaggregated into classes in accordance with Ind AS 16;
 - (ii) receivables are disaggregated into amounts receivable from trade customers, receivables from related parties, prepayments and other amounts;
 - (iii) inventories are disaggregated, in accordance with Ind AS 2, Inventories, into classifications such as merchandise, production supplies, materials, work in progress and finished goods;
 - (iv) provisions are disaggregated into provisions for employee benefits and other items; and
 - (v) equity capital and reserves are disaggregated into various classes, such as paid-in capital, share premium and reserves.
- An entity shall disclose the following, either in the balance sheet or in the statement of changes in equity which is part of the balance sheet, or in the notes:
 - (i) for each class of share capital:
 - (a) the number of shares authorised;
 - (b) the number of shares issued and fully paid, and issued but not fully paid;
 - (c) par value per share, or that the shares have no par value;
 - (d) a reconciliation of the number of shares

- (e) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
 - (f) shares in the entity held by the entity or by its subsidiaries or associates; and
 - (g) shares reserved for issue under options and contracts for the sale of shares, including terms and amounts; and
- (ii) a description of the nature and purpose of each reserve within equity.
- An entity whose capital is not limited by shares e.g., a company limited by guarantee, shall disclose information, showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

Illustrated format of Balance Sheet

Balance Sheet (with hypothetical figures given for ease in understanding)

₹ '000

	As at 31 st March 20X6	As at 31 st March 20X5
Assets		
Non-current Assets		
Property, plant and equipment	1,37,048	97,023
Capital work in progress	17,450	3,100
Investment property	7,419	7,179
Goodwill	8,670	4,530
Other Intangible Assets	12,033	10,895
Intangible assets under development	2,365	1,965
Financial assets		
Investments	38,576	32,416
Loans	1,033	850
Trade Receivables	3,238	2,376
Deferred tax assets (net)	4,598	2,774
Other non-current assets	<u>21,586</u>	<u>10,565</u>
Total Non-Current Assets (A)	<u>2,54,016</u>	<u>1,73,673</u>

Current Assets			
Inventories		67,878	61,062
Financial assets			
Loans		623	546
Trade receivables		30,712	30,078
Derivative instruments			
Cash and cash equivalents		25,031	7,035
Investments		10,695	9,170
Other financial assets		2,856	2,093
Prepayments		<u>459</u>	<u>543</u>
		1,38,254	1,10,527
Assets classified as held for sale		<u>220</u>	<u>19,310</u>
Total Current Assets	(B)	<u>1,38,474</u>	<u>1,29,837</u>
Total Assets	(A+B)	<u>3,92,490</u>	<u>3,03,510</u>

	As at 31 st March 20X6	As at 31 st March 20X5
Equity and liabilities		
Equity		
Equity share capital	22,400	12,600
Other equity		
Equity component of compound financial instruments	372	
Reserves and surplus	2,16,092	1,60,796
Other reserves	<u>4,233</u>	<u>3,215</u>
Equity attributable to equity holders of the parent	2,43,097	1,76,611
Non-Controlling interest	<u>24,742</u>	<u>16,248</u>
Total equity	(C) <u>2,67,839</u>	<u>1,92,859</u>

Non-current liabilities		
Financial liabilities		
Borrowings	41,455	35,565
Other financial liabilities	1,670	199
Long term provision	241	91
Deferred Income - Government grants	2,352	2,550
Net employee defined benefit liabilities	7,296	5,076
Deferred tax liabilities (net)	12,085	9,864
Other non-current liabilities		
Total non-current liabilities (D)	<u>65,099</u>	<u>53,345</u>
Current Liabilities		
Financial liabilities		
Borrowings	2,807	2,685
Trade payables (Other than micro enterprises and small enterprises)	38,011	28,977
Other current financial liabilities	8,909	8,837
Deferred income - Government grants	938	1,017
Employee benefit obligations	430	378
Deferred revenue	4,152	3,986
Liabilities for current tax (net)	2,803	1,905
Provisions	1,502	531
Liabilities directly associated with the assets classified as held for distribution		<u>8,990</u>
Total current liabilities (E)	<u>59,552</u>	<u>57,306</u>
Total liabilities (F=D+E)	<u>1,24,651</u>	<u>1,10,651</u>
Total equity and liabilities (C+F)	<u>3,92,490</u>	<u>3,03,510</u>

1.8.3 Statement of Profit and Loss

- The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:
 - (a) profit or loss;
 - (b) total other comprehensive income;
 - (c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.
- An entity shall present (in case of consolidated statement of profit and loss) the following items as allocation of profit or loss and other comprehensive income for the period:
 - (a) profit or loss for the period attributable to:
 - (i) non-controlling interests, and
 - (ii) owners of the parent.
 - (b) comprehensive income for the period attributable to:
 - (i) non-controlling interests, and
 - (ii) owners of the parent.

1.8.3.1 Information to be presented in the profit or loss section of the Statement of Profit and Loss

In addition to items required by other Ind AS, the profit or loss section of the statement of profit and loss should include line items that present the following amounts for the period:

- (a) revenue, presenting separately interest revenue calculated using the effective interest method;
- (b) gains and losses arising from the derecognition of financial assets measured at amortised cost
- (c) finance costs;
- (d) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109
- (e) share of the profit or loss of associates and joint ventures accounted for using the equity method;
- (f) if financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference

between the previous amortised cost of the financial asset and its fair value at the reclassification date;

- (g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognized in other comprehensive income that is reclassified to profit or loss
- (h) tax expense;
- (i) a single amount for the total discontinued operations

1.8.3.2 Information to be presented in the Other Comprehensive Income section

- The other comprehensive income section should present line items for the amounts of other comprehensive income classified by nature and grouped into those that, in accordance with other Ind AS:
 - (i) will not be reclassified subsequently to profit or loss; and
 - (ii) will be reclassified subsequently to profit or loss when specific conditions are met.
- An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.
- When an entity presents subtotals, those subtotals shall:
 - (a) be comprised of line items made up of amounts recognised and measured in accordance with Ind AS;
 - (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
 - (c) be consistent from period to period; and
 - (d) not be displayed with more prominence than the subtotals and totals required in Ind AS for the statement of profit and loss.
- An entity shall present the line items in the statement of profit and loss that reconcile any sub totals presented with the subtotals or totals required in Ind AS for such statement.
- An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes.

1.8.3.3 Profit or loss for the period

With regard to profit or loss for the period, the Standard requires the recognition of all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise.

Illustrative format of Statement of Profit and Loss (only profit or loss section of statement of profit and loss)

Statement of Profit and Loss for the year ended 31st March 20X6

	31 st March 20X6	31 st March 20X5
	₹ '000	₹ '000
Revenue from operations	6,33,124	4,86,316
Other Income	<u>6,704</u>	<u>6,676</u>
Total Income	<u>6,39,828</u>	<u>4,92,992</u>
Expenses		
Cost of raw material consumed	2,43,929	2,34,262
Purchase of stock-in-trade	56,300	51,700
(Increase)/decrease in inventories of finished goods, Stock-in-Trade and work-in-progress	2,895	(2,587)
Employee benefits expenses	80,998	69,962
Finance costs	3,085	2,963
Depreciation and amortisation expense	10,147	8,534
Impairment of non-current assets	480	790
Other expenses	<u>15,308</u>	<u>9,065</u>
Total Expense	<u>4,13,142</u>	<u>3,74,689</u>
Profit/(loss) before exceptional items and tax	2,26,686	1,18,303
Exceptional items	<u>(2,856)</u>	<u>—</u>
Profit / (loss) before tax from operations	2,23,830	1,18,303

a) Current tax	5,388	4,474
b) Deferred tax	<u>427</u>	<u>(746)</u>
Income tax expense	<u>5,815</u>	<u>3,728</u>
Profit / (loss) for the year	<u>2,18,015</u>	<u>1,14,575</u>
Profit for the year attributable to*		
Equity holders of the parent	2,11,475	1,11,138
Non-controlling interest	6,540	3,437

* To be given in case of consolidated statement of profit and loss.

1.8.3.4 Other comprehensive income for the period

- With regard to other comprehensive income for the period, the Standard requires to disclose the amount of income tax relating to each item of other comprehensive income, including reclassification adjustments, either in the statement of profit and loss or in the notes.
- An entity may present items of other comprehensive income either:
 - (a) net of related tax effects, or
 - (b) before related tax effects with one amount shown for the aggregate amount of income tax relating to those items.
- The Standard further prescribes that an entity should disclose reclassification adjustments relating to components of other comprehensive income.
- Other Ind AS specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments.
- A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss.

Components of Other Comprehensive Income (OCI)

changes in revaluation surplus

remeasurements of defined benefit plans

gains and losses arising from translating the financial statements of a foreign

gains and losses from investments in equity instruments designated at fair value through OCI

gains and losses on financial assets measured at fair value through OCI

the effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through OCI

for particular liabilities designated as at FVTPL, the amount of the change in fair value that is attributable to changes in the liability's credit risk

changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value

changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument

Example 14

Gains realised on the disposal of financial assets are included in profit or loss of the current period. These amounts may have been recognised in other comprehensive income as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive income in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

The following table depicts some of the items which are taken to OCI (numbers are illustrative only): ₹ in lakhs

	Cash flow Hedge reserve	FVTOCI reserve	Foreign currency translation reserve	Revaluation reserve	Retained earnings	Total
Net Investment hedge			2,340			2,340
Foreign Exchange translation reserve			(2,950)			(2,950)
Currency Forward contracts	(7,680)					(7,680)
Reclassified to statement of profit or loss	3,385					3,385
Commodity forward contract	(1,850)					(1,850)
Gain / (loss) on FVTOCI financial assets		(480)				(480)
Re-measurement gains (losses) on defined benefit plans					3,085	3,085
Revaluation of land and buildings	_____	_____	_____	7,100	_____	7,100
	<u>(6,145)</u>	<u>(480)</u>	<u>(610)</u>	<u>7,100</u>	<u>3,085</u>	<u>2,950</u>

- An entity may present reclassification adjustments in the statement of profit and loss or in the notes. An entity presenting reclassification adjustments in the notes presents the items of other comprehensive income after any related reclassification adjustments.

- Reclassification adjustments arise, for example, on disposal of a foreign operation (see Ind AS 21), and when some hedged forecast cash flows affect profit or loss (see paragraph 6.5.11(d) of Ind AS 109 in relation to cash flow hedges).
- Reclassification adjustments do not arise on changes in revaluation surplus recognised in accordance with Ind AS 16 or Ind AS 38 or on re-measurements of defined benefit plans recognised in accordance with Ind AS 19. These components are recognised in other comprehensive income and are not reclassified to profit or loss in subsequent periods. Changes in revaluation surplus may be transferred to retained earnings in subsequent periods as the asset is used or when it is derecognised (see Ind AS 16 and Ind AS 38). In accordance with Ind AS 109, reclassification adjustments do not arise if a cash flow hedge or the accounting for the time value of an option (or the forward element of a forward contract or the foreign currency basis spread of a financial instrument) result in amounts that are removed from the cash flow hedge reserve or a separate component of equity, respectively, and included directly in the initial cost or other carrying amount of an asset or a liability. These amounts are directly transferred to assets or liabilities.

Illustrative format of other Comprehensive Income

	31.3.20X6	31.3.20X5
	₹ '000	₹ '000
Other comprehensive income to be reclassified to profit and loss in subsequent periods		
Net gain on hedge of a net investment	467	300
Income tax effect	<u>(156)</u>	<u>(100)</u>
	<u>311</u>	<u>200</u>
Exchange differences on translation of foreign operations	(590)	(281)
Income tax effect	<u>0</u>	<u>0</u>
	<u>(590)</u>	<u>(281)</u>
Net movement on cash flow hedges	(1757)	80
Income tax effect	<u>528</u>	<u>(22)</u>
	<u>(1229)</u>	<u>58</u>
Net gain / (loss) through FVTOCI debt securities	(115)	7

Income tax effect	<u>36</u>	<u>(2)</u>
	<u>(79)</u>	<u>5</u>
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	(1587)	(18)
Other comprehensive income not to be reclassified to profit or loss in subsequent periods		
Re-measurement gains /(losses) on defined benefit plans	886	(933)
Income tax effect	<u>(269)</u>	<u>278</u>
	<u>617</u>	<u>(655)</u>
Revaluation of land and building	2030	
Income tax effect	<u>(610)</u>	
	<u>1420</u>	<u>0</u>
Net loss / (gain) through FVTOCI equity securities	(24)	
Income tax effect	<u>7</u>	
	<u>(17)</u>	
Net other comprehensive income not to be classified to profit or loss in subsequent periods	<u>2020</u>	<u>(655)</u>
Other comprehensive income for the year, net of tax	<u>433</u>	<u>(673)</u>
Total comprehensive income for the year attributable to*		
Equity holders of the parent	2,11,908	1,10,465
Non-controlling interest	6,540	3,437

*To be given in case of consolidated statement of profit and loss.

1.8.3.5 Information to be presented in the Statement of Profit and Loss or in the Notes

- When items of income or expense are material, an entity shall disclose their nature and amount separately.

- Circumstances that would give rise to the separate disclosure of items of income and expense include:
 - (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
 - (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of investments;
 - (e) discontinued operations;
 - (f) litigation settlements; and
 - (g) other reversals of provisions.
- An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.

Revenue		X
Other income		X
Changes in inventories of finished goods and work in progress	X	
Raw materials and consumables used	X	
Employee benefits expense	X	
Depreciation and amortisation expense	X	
Other expenses	<u>X</u>	
Total expenses		<u>(X)</u>
Profit before tax		<u>X</u>

1.8.4 Statement of Changes in Equity

An entity shall present a statement of changes in equity which includes all changes in equity. It includes both - relating to performance and owner changes in equity (from transactions and events that increase or decrease equity but are not part of performance). The statement of changes in equity includes the following information:

- a. total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;
- b. for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8;
- c. for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change resulting from:
 - profit or loss;
 - each item of other comprehensive income;
 - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and
 - any item recognised directly in equity such as amount recognised directly in equity as capital reserve with Ind AS 103.

1.8.4.1 Information to be presented in the statement of changes in equity or in the notes.

- An entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item.
- An entity shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share.
- Ind AS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transition provisions in another Ind AS require otherwise. Ind AS 8 also requires restatements to correct errors to be made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an Ind AS requires retrospective adjustment of another component of equity.
- Para 106(b) requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

Format of Statement of changes in equity for the year ended 31 st March 20X6*				
₹				
	Share capital	Translation reserve	Retained earnings	Total
Equity as at 31st March 20X5 (A)	<u>1,041</u>	<u>(47,382)</u>	<u>2,65,266</u>	<u>2,18,925</u>
Profit for the year			28,461	28,461
Other comprehensive income for the year		<u>(3,399)</u>	<u>(5,535)</u>	<u>(8,934)</u>
Total comprehensive income for the year (B)		<u>(3,399)</u>	<u>22,926</u>	<u>19,527</u>
Dividend paid to shareholders of the parent			(17,817)	(17,817)
Equity compensation plans			15	15
Reduction in share capital	<u>(51)</u>		<u>(26,427)</u>	<u>(26,478)</u>
Total transactions (C)	<u>(51)</u>		<u>(44,229)</u>	<u>(44,280)</u>
Equity as at 31st March, 20X6 (A+B+C)	<u>990</u>	<u>(50,781)</u>	<u>2,43,963</u>	<u>1,94,172</u>

*For the purpose of convenience, the movement has been given only for one year. However as per the requirement, the similar reconciliation is also required from 31st March, 20X4 to 31st March, 20X5 as comparatives in the Statement of changes in equity.

1.8.5 Statement of Cash Flows

- Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.
- An entity should present a statement of cash flows in accordance with Ind AS 7, Statement of Cash Flows.

1.8.6 Notes

1.8.6.1 Structure

The notes shall:

- a. present information about the basis of preparation of the financial statements and the specific accounting policies used;
- b. disclose the information required by Ind AS that is not presented elsewhere in the financial statements; and
- c. provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

An entity shall present notes in a systematic manner. In determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements.

An entity shall cross-reference each item in the balance sheet, in the statement of changes in equity, in the statement of profit and loss, and statement of cash flows to any related information in the notes.

Examples of systematic ordering or grouping of the notes include:

- (a) giving prominence to the areas of its activities that the entity considers to be most relevant to an understanding of its financial performance and financial position, such as grouping together information about particular operating activities;
- (b) grouping together information about items measured similarly such as assets measured at fair value; or
- (c) Notes may be in the following order:
 - (i) statement of compliance with Ind AS;
 - (ii) material accounting policy information;
 - (iii) supporting information for items presented in the balance sheet and in the statement of profit and loss, and in the statements of changes in equity and of cash flows, in the order in which each statement and each line item is presented; and
 - (iv) other disclosures, including:
 - (1) contingent liabilities (see Ind AS 37) and unrecognised contractual commitments; and

- (2) non-financial disclosures, eg the entity's financial risk management objectives and policies (see Ind AS 107).

An entity may present notes providing information about the basis of preparation of the financial statements and specific accounting policies as a separate section of the financial statements.

1.8.6.2 Disclosure of accounting policies

An entity shall disclose material accounting policy information. Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

Accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Not all accounting policy information relating to material transactions, other events or conditions is itself material.

An entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and:

- (a) the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements;
- (b) the entity chose the accounting policy from one or more options permitted by Ind AS
- (c) the accounting policy was developed in accordance with Ind AS 8 in the absence of an Ind AS that specifically applies;
- (d) the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions; or
- (e) the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one Ind AS to a class of material transactions.

Accounting policy information that focuses on how an entity has applied the requirements of the Ind AS to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised information, or information that only duplicates or summarises the requirements of the Ind AS.

If an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

An entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other Ind AS.

An entity shall disclose, along with material accounting policy information or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

1.8.6.3 Sources of estimation uncertainty

An entity must disclose, in the notes, information about the assumptions made concerning the future, and other important sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Disclosures about nature of such assets and their carrying amount as at the end of the reporting period should also be made.

1.8.6.4 Capital

An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Examples 15 -17

- 15.** For the purpose of the Group's capital management, capital includes issued equity capital, convertible preference shares, share premium and all other equity reserves attributable to the equity holders of the parent. The primary objective of the Group's capital management is to maximise the shareholder value.

The Group manages its capital structure and makes adjustments in light of changes in economic conditions and the requirements of the financial covenants. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. The Group monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Group's policy is to keep the gearing ratio between 20% and 40%. The Group includes within net debt, interest bearing loans and borrowings, trade and other payables, less cash and cash equivalents, excluding discontinued operations.

	31.3.20X6	31.3.20X5
Borrowings other than convertible preference shares	1,44,201	1,57,506
Trade payables	1,26,489	1,36,563
Other payables	13,506	12,693
Less : Cash and cash equivalents	<u>(1,18,362)</u>	<u>(1,05,615)</u>
Net debt	<u>1,65,834</u>	<u>2,01,147</u>
Convertible preference shares	20,001	19,038
Equity	<u>4,29,600</u>	<u>3,37,000</u>
Total Capital	<u>4,49,601</u>	<u>3,56,038</u>
Capital and net debt	<u>6,15,435</u>	<u>5,57,185</u>
Gearing ratio	27	36

In order to achieve this overall objective, the Group's capital management, amongst other things, aims to ensure that it meets financial covenants attached to the interest-bearing loans and borrowings that define capital structure requirements. Breaches in meeting the financial covenants would permit the bank to immediately call loans and borrowings. There have been no breaches in the financial covenants of any interest-bearing loans and borrowing in the current period. No changes were made in the objectives, policies or processes for managing capital during the years ended 31st March 20X6 and 31st March 20X5.

16. Capital Allocation Policy: The Board reviewed and approved a revised Capital Allocation Policy of the Company after taking into consideration the strategic and operational cash requirements of the Company in the medium term.

The key aspects of the Capital Allocation Policy are:

1. The Company's current policy is to pay dividends of up to 50% of post-tax profits of the Financial Year. Effective from Financial Year 20X1, the Company expects to payout up to 70% of the free cash flow* of the corresponding Financial Year in such manner (including by way of dividend and/or share buyback) as may be decided by the Board from time to time, subject to applicable laws and requisite approvals, if any.

2. In addition to the above, the Board has identified an amount of upto ₹ 13,000 crore (\$2 billion)** to be paid out to shareholders during Financial Year 20X1, in such manner (including by way of dividend and/ or share buyback), to be decided by the Board, subject to applicable laws and requisite approvals, if any. Further announcements in this regard will be made, as appropriate, in due course

*Free cash flow is defined as net cash provided by operating activities less capital expenditure as per the consolidated statement of cash flows prepared under Ind AS.

**USD/Rupee exchange rate as on 31st March, 20X0 was 65.

17. The groups' objective when managing capital are to:

- Safeguard their ability to continue as a going concern, so that they can continue to provide returns to shareholders and benefits for other stakeholders, and
- Maintain an optimum capital structure to reduce the cost of capital

In order to maintain or adjust the capital structure, the group may adjust the amounts of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. Consistent with others in the industry, the group monitors capital on the basis of the following gearing ratio: Net debt divided by the Total equity (as shown in balance sheet including Non-Controlling Interest)

During 20X5, the group's strategy which was unchanged from 20X4 was to maintain a gearing ratio within 20% to 30% and credit rating of A. The credit rating was unchanged and the gearing ratio was within the limits as follows:

	31 st March 20X5	31 st March 20X4
Net debt	3,384	3,447
Total equity	16,035	11,762
Net debt to equity	21%	29%

1.8.6.5 Puttable financial instruments classified as equity

For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

- a. summary quantitative data about the amount classified as equity;

- b. its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- c. the expected cash outflow on redemption or repurchase of that class of financial instruments; and
- d. information about how the expected cash outflow on redemption or repurchase was determined.

1.8.6.6 Other disclosures

An entity must disclose the amount of dividends proposed or declared before the financial statements were approved for issue but not recognised as a distribution to owners during the period, and the related amount per share and the amount of any cumulative preference dividends not recognised.

Ind AS 1 requires certain other disclosures, if not disclosed elsewhere in information published with the financial statements:

- a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);
- b) a description of the nature of the entity's operations and its principal activities;
- c) the name of the parent and the ultimate parent of the group; and
- d) if it is a limited life entity, information regarding the length of its life.

(a) An extract from the annual report of Tata Consultancy Services Limited for the year ended 31st March, 2022:

Notes forming part of Standalone Financial Statements

1) Corporate information

Tata Consultancy Services Limited (referred to as "TCS Limited" or "the Company") provides IT services, consulting and business solutions and has been partnering with many of the world's largest businesses in their transformation journeys. The Company offers a consulting-led, cognitive powered, integrated portfolio of IT, business and engineering services and solutions. This is delivered through its unique Location-Independent Agile delivery model, recognised as a benchmark of excellence in software development.

The Company is a public limited company incorporated and domiciled in India. The address of its corporate office is TCS House, Raveline Street, Fort, Mumbai - 400001. As at 31st March, 2022, Tata Sons Private Limited, the holding company owned 72.27% of the Company's equity share capital.

The Board of Directors approved the standalone financial statements for the year ended 31st March, 2022 and authorised for issue on 11th April, 2022.

(b) An extract from the annual report of Tata Consultancy Services Limited for the year ended 31st March, 2022:

Overview and notes to the standalone financial statements

1. Overview

1.1 Company overview

Infosys Limited ("the Company" or Infosys) provides consulting, technology, outsourcing and next-generation digital services, to enable clients to execute strategies for their digital transformation. Infosys strategic objective is to build a sustainable organization that remains relevant to the agenda of clients, while creating growth opportunities for employees and generating profitable returns for investors. Infosys strategy is to be a navigator for our clients as they ideate, plan and execute on their journey to a digital future.

The Company is a public limited company incorporated and domiciled in India and has its registered office at Electronic city, Hosur Road, Bengaluru 560100, Karnataka, India. The Company has its primary listings on the BSE Ltd. and National Stock Exchange of India Limited. The Company's American Depositary Shares (ADS) representing equity shares are listed on the New York Stock Exchange (NYSE).

The Standalone financial statements are approved for issue by the Company's Board of Directors on 13th April 2022.

Illustration 16

A Limited has prepared the following draft balance sheet as on 31st March 20X1: (₹ in crores)

Particulars	31st March, 20X1	31st March, 20X0
ASSETS		
Cash	250	170

Cash equivalents	70	30
Non-controlling interest's share of profit for the year	160	150
Dividend declared and paid by A Limited	90	70
Accounts receivable	2,300	1,800
Inventory at cost	1,500	1,650
Inventory at fair value less cost to complete and sell	180	130
Investment property	3,100	3,100
Property, plant and equipment (PPE) at cost	5,200	4,700
Total	12,850	11,800
	₹	₹
CLAIMS AGAINST ASSETS		
Long term debt (₹ 500 crores due on 1 st January each year)	3,300	3,885
Interest accrued on long term debt (due in less than 12 months)	260	290
Share Capital	1,130	1,050
Retained earnings at the beginning of the year	1,875	1,740
Profit for the year	1,200	830
Non-controlling interest	830	540
Accumulated depreciation on PPE	1,610	1,240
Provision for doubtful receivables	200	65
Trade payables	880	790
Accrued expenses	15	30
Warranty provision (for 12 months from the date of sale)	600	445
Environmental restoration provision (restoration expected in 20X6)	765	640
	35	25
Provision for accrued leave (due within 12 months)	150	230
Dividend payable		
Total	12,850	11,800

Prepare a consolidated balance sheet using current and non-current classification in accordance with Ind AS 1. Assume operating cycle is 12 months

Solution

A Limited
Consolidated Balance Sheet as at 31st March 20X1

(₹ in crores)

Particulars	Note	31.3.20X1	31.3.20X0
ASSETS			
Non-current assets			
(a) Property, plant and equipment	1	3,590	3,460
(b) Investment property		<u>3,100</u>	<u>3,100</u>
Total non-current assets		<u>6,690</u>	<u>6,560</u>
Current assets			
(a) Inventory	2	1,680	1,780
(b) Financial assets			
(i) Trade and other receivables	3	2,100	1,735
(ii) Cash and cash equivalents	4	<u>320</u>	<u>200</u>
Total current assets		<u>4,100</u>	<u>3,715</u>
Total assets		<u>10,790</u>	<u>10,275</u>
EQUITY & LIABILITIES			
Equity attributable to owners of the parent			
Share capital		1,130	1,050
Other Equity	5	2,825	2,350
Non-controlling interests		<u>830</u>	<u>540</u>
Total equity		<u>4,785</u>	<u>3,940</u>
LIABILITIES			
Non-current liabilities			
(a) Financial Liabilities			
Borrowings - Long-term debt	6	2,800	3,385

(b) Provisions			
Long-term provisions (environmental restoration)		<u>765</u>	<u>640</u>
Total non-current liabilities		<u>3,565</u>	<u>4,025</u>
Current liabilities			
(a) Financial Liabilities			
(i) Trade and other payables (Other than micro enterprises and small enterprises)	7	895	820
(ii) Current portion of long-term debt	8	500	500
(iii) Interest accrued on long-term debt		260	290
(iv) Dividend payable		150	230
(b) Provisions			
(i) Warranty provision		600	445
(ii) Other short-term provisions		<u>35</u>	<u>25</u>
Total current liabilities		<u>2,440</u>	<u>2,310</u>
Total liabilities		<u>6,005</u>	<u>6,335</u>
Total equity and liabilities		<u>10,790</u>	<u>10,275</u>

Working Notes:

Notes	Particulars	Basis	Calculation ₹ crores	Amount ₹ crores
1	Property, plant and equipment	Property, plant and equipment (PPE) at cost <i>less</i> Accumulated (depreciation on PPE	5,200 – 1,610 (4,700 – 1,240)	3,590 (3,460)
2	Inventory	Inventory at cost <i>add</i> Inventory at fair value less cost to complete and sell	1,500 + 180 (1,650 + 130)	1,680 (1,780)

3	Trade and other receivables	Accounts receivable less Provision for doubtful receivables	2,300 – 200 (1,800 – 65)	2,100 (1,735)
4	Cash and cash equivalents	Cash and Cash equivalents	250 + 70 (170 + 30)	320 (200)
5	Other Equity	Retained earnings at the beginning of the year add Profit for the year less Non-controlling interest's share of profit for the year less Dividend declared by A Limited	1,875 + 1,200 – 160 – 90 (1,740 + 830 – 150 – 70)	2,825 (2,350)
6	Long-term debt	Long-term debt less Due on 1 st January each year	3,300 – 500 (3,885 – 500)	2,800 (3,385)
7	Trade & other payables	Trade payables add Accrued expenses	880 + 15 (790 + 30)	895 (820)
8	Current portion of long-term debt	Due on 1 st January each year	- -	500 (500)

Note: Figures in brackets represent the figures for comparative year.



1.9 SIGNIFICANT DIFFERENCES IN IND AS 1 VIS-À-VIS AS 1

Ind AS 1 deal with presentation of financial statements, whereas AS 1 deal only with the disclosure of accounting policies. The scope of Ind AS 1 is thus much wider and some of its requirements are contained in other AS e.g. AS 5 and, therefore, line by line comparison of the differences between Ind AS 1 and AS 1 is not possible. Therefore, the differences between Ind AS 1 and Indian GAAP are divided into following parts and summarised below.

S.No.	Particulars	Ind AS 1	AS 1
I.	Part 1 Ind AS 1 requirement not covered in any AS		
1.	Complete set of Financial Statements	Ind AS 1 prescribes what comprises a complete set of financial statements such as balance sheet, statement of profit and loss, statement of changes in equity, statement of cash flows, notes, comprising significant accounting policies, and comparative information in respect of preceding period.	Not covered in any AS
2.	Purpose and General Features of Financial Statements	Ind AS 1 lays down purpose of financial statements and general feature of financial statements such as True and Fair view and compliance with Ind AS. An enterprise shall make an explicit statement in the financial statements of compliance with all the Indian Accounting Standards. Further, Ind AS 1 allows deviation from a requirement of an accounting standard in case the management concludes that compliance with Ind AS will be misleading and if the regulatory framework requires or does not prohibit such a departure.	Not covered in any AS
3.	Off-setting	Ind AS 1 state that an entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.	Not covered in any AS
4.	Frequency of reporting	Ind AS 1 requires an entity to present a complete set of financial statements (including comparative information) at least annually.	Not covered in any AS
5.	Structure and Contents	Ind AS 1 requires an entity	Not covered in any AS

S.No.	Particulars	Ind AS 1	AS 1
		- to clearly identify the financial statements and distinguish them from other information in the same published document. - To give information about the name of the entity, whether financial statements are of individual entity of group of entities, presentation currency and level of rounding off.	
6.	Balance sheet	- Prescribes certain line items to be presented in the balance sheet and permits presentation of additional line items. - Ind AS 1 requires presentation and provides criteria for classification of Current / Non- Current assets / liabilities. - Ind AS 1 requires presentation of balance sheet as at the beginning of the earliest period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in the financial statements, or when it reclassifies items in its financial statements.	Not covered in any AS
7.	Statement of profit and loss	Ind AS 1 requires that an entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed	Not covered in any AS

S.No.	Particulars	Ind AS 1	AS 1
		directly by the other comprehensive income section. - Ind AS 1 prohibits presentation of any item as 'Extraordinary Item' in the statement of profit and loss or in the notes. - Ind AS 1 requires classification of expenses to be presented based on nature of expenses.	
8.	Reclassification of items	Ind AS 1 requires disclosure of nature, amount and reason for reclassification in the notes to financial statements.	Not covered in any AS
9.	Statement of Changes in Equity	Ind AS 1 requires the financial statements to include a 'Statement of Changes in Equity' to be shown as a separate statement, which, inter alia, includes reconciliation between opening and closing balance for each component of equity.	Not covered in any AS
10.	Comparative information	As per Ind AS 1, an entity shall include certain comparative information for understanding the current period's financial statements.	Not covered in any AS
11.	Classification of long-term loan arrangement	Ind AS 1 clarifies that long-term loan arrangement need not be classified as current on account of breach of a material provision, for which the lender has agreed to waive before the approval of financial statements for issue. (Paragraph 74 of Ind AS 1)	Not covered in any AS

S.No.	Particulars	Ind AS 1	AS 1
II.	Part 2 Ind AS 1 requirements vis-a-vis AS 1		
1.	Fundamental accounting assumptions	Ind AS 1 requires adherence to accrual basis of accounting.	AS 1 only requires disclosure if this fundamental accounting assumption, among others like going concerns and consistency, is not followed by the entity.
2.	Rectification of accounting policies	Ind AS 1 explicitly states that an entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.	
3.	Sources of estimation uncertainty	Ind AS 1 requires to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.	



1.10 CARVE OUT IN IND AS 1 FROM IAS 1

As per IFRS

IAS 1 requires that in case of a non-current loan liability, if any condition of the loan agreement is breached on or before the reporting date, such loan liability should be classified as current, even if the breach is rectified after the balance sheet date.

Carve Out

Ind AS 1 clarifies that where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes

payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach. Consequent to this, requirements of paragraph 76 of IAS 1 to treat such events as non-adjusting events are also deleted.

Reason

Under Indian banking system, a long-term loan agreement generally contains a large number of conditions. Some of these conditions are substantive, such as, recalling the loan in case interest is not paid, and some conditions are procedural and not substantive, such as, submission of insurance details where the entity has taken the insurance but not submitted the details to the lender at the end of the reporting period. Generally, in case of any procedural breach, a loan is generally not recalled. Also, in many cases, a breach is rectified after the balance sheet date and before the approval of financial statements. Carve out has been made as it is felt that if the breach is rectified after the balance sheet date but before the approval of the financial statements, it would be appropriate that the users are informed about the true nature of liabilities being non-current liabilities instead of current liabilities.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.
 - (a) Will the inventory and the trade receivables be current in nature?
 - (b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

2. In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by 24th March, 20X2, failing which the loan becomes payable on demand. As on 24th March, 20X2, the entity has not been able to get the promoter's contribution. On 25th March, 20X2, the entity approached the bank and obtained a grace period upto 30th June, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on 31st March.

- (a) As on 31st March, 20X2, how should the entity classify the loan?
- (b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the compliance

date extended upto 30th June, 20X2 for getting promoter's contribution. In this case will the loan classification as on 31st March, 20X2 be different from (a) above?

3. Company A has taken a long-term loan from Company B. In the month of December 20X1, there was a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on 31st March, 20X2. In the month of May 20X2, the company started negotiation with company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non-current.

4. Entity A has undertaken various transactions in the financial year ended 31st March, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1. ₹

Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

5. XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended 31st March, 20X1, the accounts department is not sure about the treatment / presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.

(ii)	Is it mandatory to add the word “standalone” before each of the components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in ₹. Is it necessary to write in the financial statements that the financial statements have been presented in ₹.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

Evaluate the above matters with respect to preparation and presentation of a general-purpose financial statement.

6. A Company presents financial results for three years (i.e., one for current year and two comparative years) internally for the purpose of management information every year in addition to the general-purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purposes. During the current year, management thought why not they should present third year statement of profit and loss also in the general-purpose financial statements. It will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

- (i) Can management present the third statement of profit and loss as an additional comparative in the general-purpose financial statements?
 - (ii) If management present third statement of profit and loss in the general-purpose financial statement as comparative, is it necessary that this statement should- be compliant of Ind AS?
 - (iii) Can management present third statement of profit and loss only as additional comparative in the general-purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?
7. A company, while preparing the financial statements for financial year 20X1-20X2, erroneously booked excess revenue of ₹ 10 crore. The total revenue reported in financial year 20X1-20X2 was ₹ 80 crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in financial year 20X1-20X2 which

it now wants to correct in the financial statements. However, the management of the company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

- (i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?
 - (ii) The company wants to correct the errors during financial year 20X2-20X3 by giving impact in the figures of current year only. Is the contention of the management, correct?
8. XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e., 31st March, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2:

S. No.	Items/transactions
(1)	The company has some trade receivables which are due after 15 months from the date of the balance sheet. So, the company expects that the payment will be received within the period of operating cycle.
(2)	The company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the company does not expect that it will be able to pay these payables within the operating cycle because the nature of business is such that generally projects get delayed and payments from customers also get delayed.
(3)	The company was awarded a contract of ₹ 100 crore on 31 st March, 20X2. As per the terms of the contract, the company made a security deposit of 5% of the contract value with the customer, of ₹ 5 crore on 31 st March, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.
(4)	The company has also given certain contracts to third parties and have received security deposits from them of ₹ 2 crore on 31 st March, 20X2 which are repayable on completion of the contract but if contract is cancelled before the

contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:

- (i) The company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?
 - (ii) The company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the company. Does the decision of presenting the same as non-current is correct?
 - (iii) Can the security deposit of ₹ 5 crore made by the company with the customers be presented as current?
 - (iv) Can the security deposit of ₹ 2 crore taken by the company from contractors be presented as non-current?
9. Is offsetting permitted under the following circumstances?
- (a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?
 - (b) Whether profit on sale of an asset against loss on sale of another asset can be offset?
 - (c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset?

Answers

1. Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.
 - (a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

- (b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.
2. (a) Ind AS 1, inter alia, provides, “An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.” In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March, 20X2, the loan will be classified as current.
- (b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March, 20X2, the loan will retain its classification as non-current.
3. As per para 74 of Ind AS 1 “Presentation of Financial Statements”, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

In the given case, Company B (the lender) agreed for not to demand payment but only after the reporting date and the financial statements were approved for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20X2 but could not agree before June 20X2 when financial statements were approved for issuance.

Hence, the liability should be classified as current in the financial statement as at 31st March, 20X2.

4. Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1 (₹)

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1 (₹)

Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000

5. (i) Yes, an entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. (Refer Para 16 of Ind AS 1)
- (ii) No, but need to disclose in the financial statement that these are individual financial statements of the Company. (Refer Para 51(b) of Ind AS 1)
- (iii) Yes, Para 51(d) of Ind AS 1 inter alia states that an entity shall display the presentation currency, as defined in Ind AS 21 prominently, and repeat it when necessary for the information presented to be understandable.
- (iv) No, as per Para 38 of Ind AS 1, except when Ind AS permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

6. (i) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.
- (ii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.
- (iii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.
7. (i) No, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:
- (a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
- (b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.
- (ii) No, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period. (Refer Para 40A of Ind AS 1)
8. (i) Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)
- (ii) No, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

- (iii) No, because the amount will be received after the operating cycle of the Company. (Refer Para 66 of Ind AS 1)
 - (iv) No, because the amount may be required to be paid before completion of the contract in case the contract is cancelled. (Refer Para 69 of Ind AS 1).
9. (a) As per paragraph 33 of Ind AS 1, offsetting is permitted only when the offsetting reflects the substance of the transaction.

In this case, the agreement/arrangement, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.

- (b) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be presented on net basis. However, gains or losses should be presented separately if they are material.
- (c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

In accordance with the above, the receivable and payable should be offset against each other and net amount is presented in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

UNIT 2: INDIAN ACCOUNTING STANDARD 34: INTERIM FINANCIAL REPORTING

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ☐ State the objective and scope of Ind AS 34
- ☐ Define the relevant terms used in the standard
- ☐ Elaborate the contents of interim financial report
- ☐ Prescribe minimum content of Interim Financial Report
- ☐ Account for the significant events and transactions while preparing the interim financial report
- ☐ Recommend principles of recognition and measurement in complete or condensed financial statement for an interim period
- ☐ Prepare the interim financial report of an entity
- ☐ Differentiate between Ind AS 34 and AS 25.

UNIT OVERVIEW

Contents of an Interim Financial Report

Minimum
Components
of Interim
Financial
Report

Significant
Events and
Transactions

Other
Disclosures

Materiality

Recognition and Measurement

Same
Accounting
Policies as
Annual

Revenues
Received
Seasonally,
Cyclically, or
Occasionally

Costs incurred
Unevenly during
the Financial
Year

Use of Estimates

Restatement of Previously
Reported Interim Periods

Disclosure in Annual
Financial Statements

Interim Financial
Reporting and
Impairment



2.1 INTRODUCTION

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



2.2 OBJECTIVE

The objective of this Standard is to prescribe

- a) the minimum content of an interim financial report
- b) the principles for recognition and measurement in complete or condensed financial statements for an interim period.



2.3 SCOPE

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



2.4 DEFINITIONS

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

2. **Interim financial report** means a financial report containing either a complete set of financial statements (as described in Ind AS 1, Presentation of Financial Statements), or a set of condensed financial statements (as described in this Standard) for an interim period.



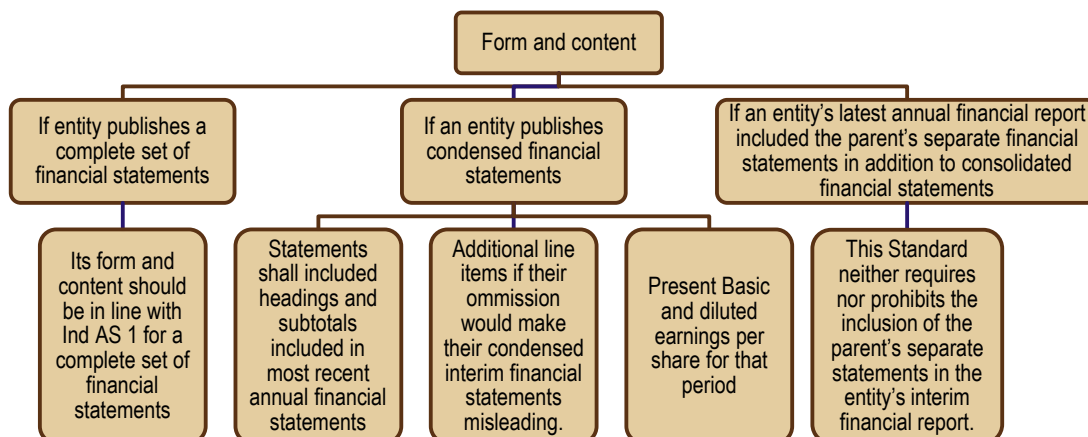
2.5 CONTENTS OF AN INTERIM FINANCIAL REPORT

- An Interim Financial Report shall include, at minimum, the following:

A condensed balance sheet
A condensed statement of profit and loss
A condensed statement of changes in equity
A condensed statement of cash flows
Notes, material accounting policy information and other explanatory information

- In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements.
- The interim financial report focuses on new activities, events, and circumstances and does not duplicate information previously reported.
- Nothing in this Standard is intended to prohibit or discourage an entity from publishing a complete set of financial statements (as described in Ind AS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. Nor does this Standard prohibit or discourage an entity from including in condensed interim financial statements more than the minimum line items or selected explanatory notes set out in this Standard.

2.5.1 Form and Content of Interim financial report



2.5.2 Significant events and transactions

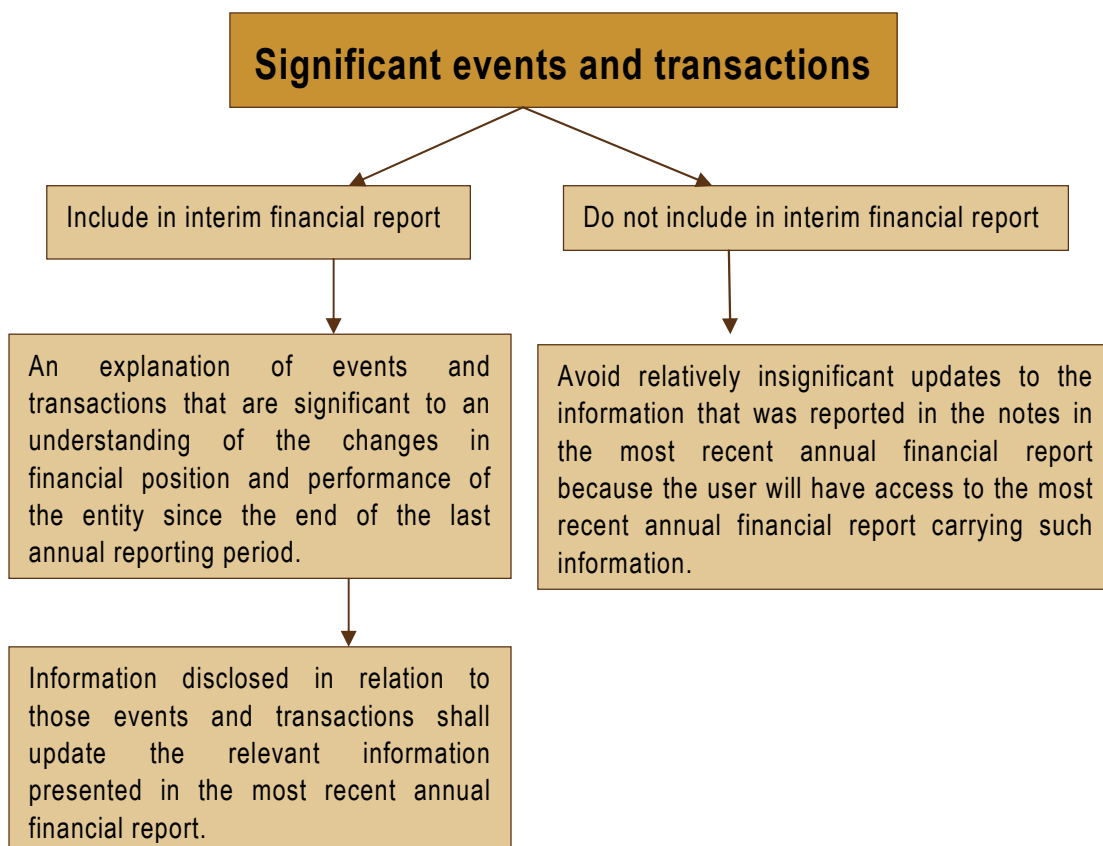
- An entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.
- Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report.
- A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report.

The following is a list of events and transactions for which disclosures would be required if they are significant: (The below list is not exhaustive)

1. the write-down of inventories to net realisable value and the reversal of such write-down;
2. recognition of a loss from the impairment of financial assets, property, plant and equipment, intangible assets, assets arising from contracts with customers, or other assets, and the reversal of such an impairment loss;
3. the reversal of any provisions for the costs of restructuring;
4. acquisitions and disposals of items of property, plant and equipment;

5. commitments for the purchase of property, plant and equipment;
6. litigation settlements;
7. corrections of prior period errors;
8. changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;
9. any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period;
10. related party transactions;
11. transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments;
12. changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and
13. changes in contingent liabilities or contingent assets.

- Individual Ind AS provide guidance regarding disclosure requirements for many of the items listed above. When an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.



2.5.3 Other disclosures

The information shall normally be reported on a financial year-to-date basis. In addition to disclosing significant events and transactions, an entity shall include the following information, in the notes to its interim financial statements. The following disclosures shall be given either in the interim financial statements or incorporated by cross-reference from the interim financial statements to some other statement (such as management commentary or risk report) that is available to users of the financial statements on the same terms as the interim financial statements and at the same time. If users of the financial statements do not have access to the information incorporated by cross-reference on the same terms and at the same time, the interim financial report is incomplete.

- a) a statement that the same accounting policies and methods of computation are followed in the interim financial statements. If those recently used policies or methods have been changed, a description of the nature and effect of the change should also be given.

b)	explanatory comments about the seasonality or cyclicity of interim operations.
c)	the nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence.
d)	the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years.
e)	issues, repurchases and repayments of debt and equity securities.
f)	dividends paid (aggregate or per share) separately for ordinary shares and other shares.
g)	the following segment information (disclosure of segment information is required in an entity's interim financial report only if Ind AS 108, <i>Operating Segments</i> , requires that entity to disclose segment information in its annual financial statements):
i.	revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.
ii.	inter segment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.
iii.	a measure of segment profit or loss.
iv.	a measure of total assets and liabilities for a particular reportable segment if such amounts are regularly provided to the chief operating decision maker and if there has been a material change from the amount disclosed in the last annual financial statements for that reportable segment.
v.	a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss.
vi.	a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation.
h)	events after the interim period that have not been reflected in the financial statements

for the interim period.

- i) the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by Ind AS 103, *Business Combinations*.
- j) for financial instruments, the disclosures about fair value of Ind AS 113, *Fair Value Measurement*, and Ind AS 107, *Financial Instruments: Disclosures*.
- k) for entities becoming, or ceasing to be, investment entities, as defined in Ind AS 110, *Consolidated Financial Statements*, the disclosures in Ind AS 112, *Disclosure of Interests in Other Entities*.
- l) the disaggregation of revenue from contracts with customers required by Ind AS 115, *Revenue from Contracts with Customers*.

Other Disclosures

Shall be given (Refer the list in para 16A of Ind AS 34)

Either

in the interim
financial statements

Or

incorporated by cross-reference from the interim financial
statements to some other statement (such as management
commentary or risk report)

Statements should be available to users of the financial statements on the same terms as the interim financial statements and at the same time **otherwise the interim financial statements shall be considered as incomplete**

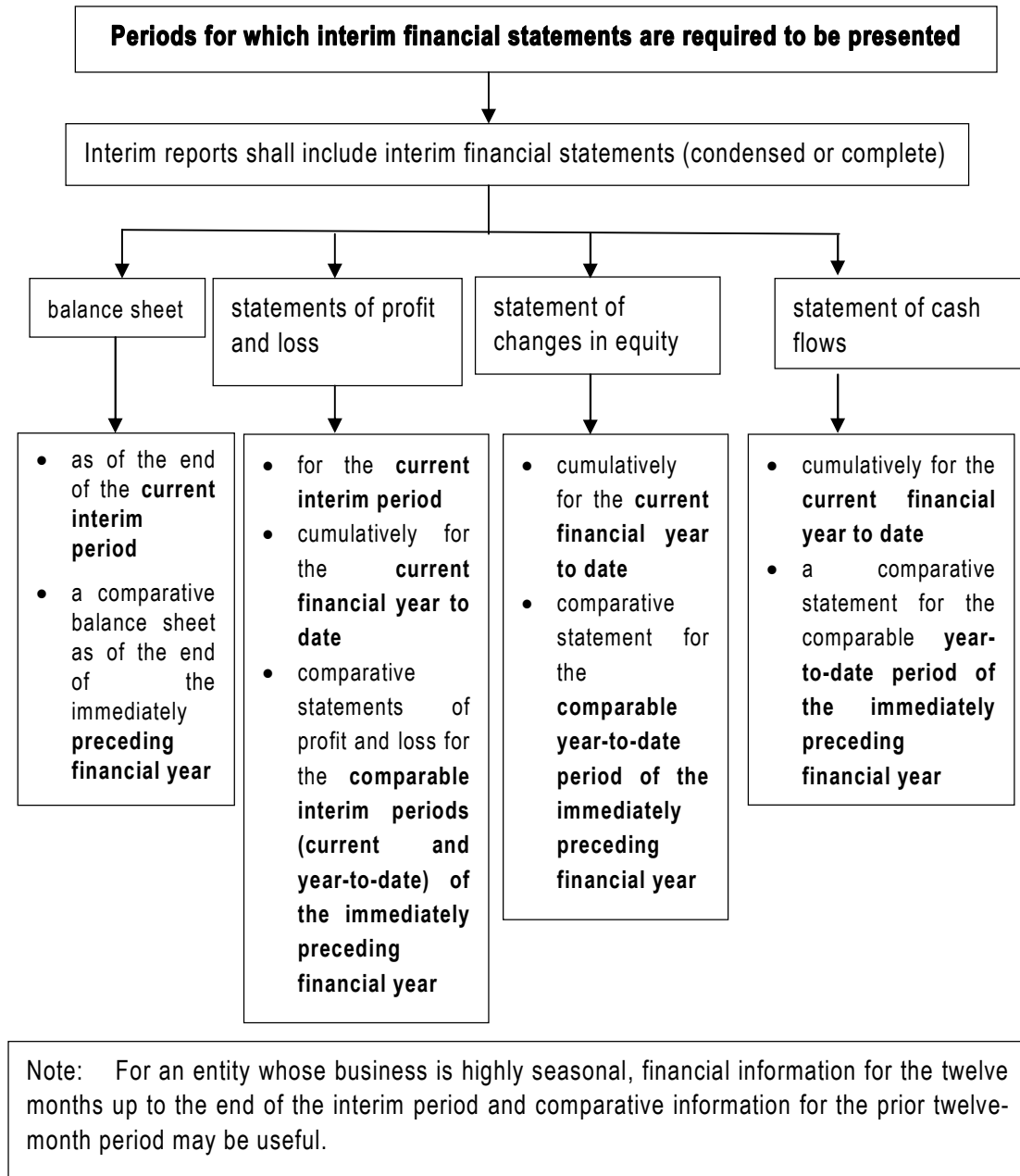
The information shall normally be **reported on a financial year-to-date basis**.

2.5.4 Periods for which interim financial statements are required to be presented

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

- (a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.
- (b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.
- (c) statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.
- (d) statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period may be useful.



Following is the illustrative example to understand the periods for which interim financial statements are required to be presented.

Scenario (a) Entity publishes interim financial reports half-yearly

The entity's financial year ends 31 March (Financial year). The entity will present the following financial statements (condensed or complete) in its half-yearly interim financial report as of 30 September 20X2:

Name of the component	Current period	Comparative period
Balance sheet as at	30 September 20X2	31 March 20X2
Statement of profit and loss : 6 months ending	30 September 20X2	30 September 20X1
Statement of cash flows: 6 months ending	30 September 20X2	30 September 20X1
Statement of changes in equity: 6 months ending	30 September 20X2	30 September 20X1

Scenario (b) Entity publishes interim financial reports quarterly

The entity's financial year ends 31 March (Financial year). The entity will present the following financial statements (condensed or complete) in its quarterly interim financial report as of 30 September 20X2:

Name of the component	Current periods	Comparative periods
Balance sheet as at	30 September 20X2	31 March 20X2
Statement of profit and loss : 6 months ending; and 3 months ending	30 September 20X2; and 30 September 20X2	30 September 20X1; and 30 September 20X1
Statement of cash flows: 6 months ending	30 September 20X2	30 September 20X1
Statement of changes in equity: 6 months ending	30 September 20X2	30 September 20X1

2.5.5 Materiality

- In deciding how to recognise, measure, classify, or disclose an item for interim financial

reporting purposes, materiality shall be assessed in relation to the interim period financial data.

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



2.6 DISCLOSURE IN ANNUAL FINANCIAL STATEMENTS

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



2.7 RECOGNITION AND MEASUREMENT

S. No.	Criteria	Recognition and Measurement
1	Same accounting policies as annual	1. An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. 2. The frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of

		its annual results. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis. 3. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.
2	Revenues received cyclically, occasionally or seasonally	1. Revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year. Example: Dividend revenue, royalties, and government grants. 2. Certain entities earn more revenue in certain interim periods of a financial year than other interim periods. Such revenues are recognised when they occur. Example: seasonal revenues of retailers
3	Costs incurred unevenly during the financial year	Costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.
4	Use of estimates	1. To ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed. 2. The preparation of interim financial reports requires a greater use of estimation methods than annual financial reports.

Employer payroll taxes and insurance contributions

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

Major planned periodic maintenance or overhaul

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

Provisions

A provision is recognised when an entity has no realistic alternative but to make a transfer of economic benefits as a result of an event that has created a legal or constructive obligation. The amount of the obligation is adjusted upward or downward, with a corresponding loss or gain recognised in profit or loss, if the entity's best estimate of the amount of the obligation changes.

This Standard requires that an entity apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

Year-end bonuses

The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.

A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. Ind AS 19, *Employee Benefits* provides guidance.

Variable lease payments

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

Intangible assets

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

Vacations, holidays, and other short-term compensated absences

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

Other planned but irregularly occurring costs

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

Measuring interim income tax expense

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

This is consistent with the basic concept set out in the Standard that the same accounting

recognition and measurement principles shall be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Interim period income tax expense is calculated by applying to an interim period's pre-tax income the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate. That estimated average annual rate would reflect a blend of the progressive tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. Ind AS 12, *Income Taxes* provides guidance on substantively enacted changes in tax rates. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 28 of this Standard. The Standard requires disclosure of a significant change in estimate.

To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. Similarly, if different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across jurisdictions or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

Contractual or anticipated purchase price changes

Volume rebates or discounts and other contractual changes in the prices of raw materials, labour, or other purchased goods and services are anticipated in interim periods, by both the payer and the recipient, if it is probable that they have been earned or will take effect. Thus, contractual rebates and discounts are anticipated but discretionary rebates and discounts are not anticipated because the resulting asset or liability would not satisfy the conditions in the Conceptual Framework for Financial Reporting that an asset must be a resource controlled by the entity as a result of a past event and that a liability must be a present obligation whose settlement is expected to result in an outflow of resources.

Depreciation and amortisation

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

Inventories

Inventories are measured for interim financial reporting by the same principles as at financial year-end. Ind AS 2, *Inventories* establishes standards for recognising and measuring

inventories. Inventories pose particular problems at the end of any financial reporting period because of the need to determine inventory quantities, costs, and net realisable values. Nonetheless, the same measurement principles are applied for interim inventories. To save cost and time, entities often use estimates to measure inventories at interim dates to a greater extent than at the end of annual reporting periods. Following are examples of how to apply the net realisable value test at an interim date and how to treat manufacturing variances at interim dates:

- **Net realisable value of inventories**

The net realisable value of inventories is determined by reference to selling prices and related costs to complete and dispose at interim dates. An entity will reverse a write-down to net realisable value in a subsequent interim period only if it would be appropriate to do so at the end of the financial year.

- **Interim period manufacturing cost variances**

Price, efficiency, spending, and volume variances of a manufacturing entity are recognised in the statement of profit and loss at interim reporting dates to the same extent that those variances are recognised in the statement of profit and loss at financial year-end. Deferral of variances that are expected to be absorbed by year-end is not appropriate because it could result in reporting inventory at the interim date at more or less than its portion of the actual cost of manufacture.

Foreign currency translation gains and losses

Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year-end.

Ind AS 21, *The Effects of Changes in Foreign Exchange Rates* specifies how to translate the financial statements for foreign operations into the presentation currency, including guidelines for using average or closing foreign exchange rates and guidelines for recognising the resulting adjustments in profit or loss or in other comprehensive income. Consistently with Ind AS 21, the actual average and closing rates for the interim period are used. Entities do not anticipate some future changes in foreign exchange rates in the remainder of the current financial year in translating foreign operations at an interim date.

If Ind AS 21 requires translation adjustments to be recognised as income or expense in the period in which they arise, that principle is applied during each interim period. Entities do not defer some foreign currency translation adjustments at an interim date if the adjustment is expected to reverse before the end of the financial year.

Inventories

Full stock-taking and valuation procedures may not be required for inventories at interim dates, although it may be done at financial year-end. It may be sufficient to make estimates at interim dates based on sales margins.

Provisions

Determination of an appropriate amount of a provision (such as a provision for warranties, environmental costs, and site restoration costs) may be complex and often costly and time-consuming. Entities sometimes engage outside experts to assist in the annual calculations. Making similar estimates at interim dates often entails updating of the prior annual provision rather than the engaging of outside experts to do a new calculation.

Pensions

Ind AS 19, *Employee Benefits* requires that an entity determine the present value of defined benefit obligations and the market value of plan assets at the end of each reporting period and encourages an entity to involve a professionally qualified actuary in measurement of the obligations. For interim reporting purposes, reliable measurement is often obtainable by extrapolation of the latest actuarial valuation.

Contingencies

The measurement of contingencies may involve the opinions of legal experts or other advisers. Formal reports from independent experts are sometimes obtained with respect to contingencies. Such opinions about litigation, claims, assessments, and other contingencies and uncertainties may or may not also be needed at interim dates.

Inter-company reconciliations

Some inter-company balances that are reconciled on a detailed level in preparing consolidated financial statements at financial year-end might be reconciled at a less detailed level in preparing consolidated financial statements at an interim date.

Illustration 1

Company A has reported ₹ 60,000 as pre tax profit in first quarter and expects a loss of ₹ 15,000 each in the subsequent quarters. It has a corporate tax slab of 20 percent on the first ₹ 20,000 of annual earnings and 40 per cent on all additional earnings. Calculate the amount of tax to be shown in each quarter.

Solution

Amount of income tax expense reported in each quarter would be as below:

Expected total Income = ₹ 15,000 [60,000 - (15,000 x 3)]				
Expected tax as per slabs = 15,000 x 20% = ₹ 3,000				
Average Annual Income tax rate = 3,000 / 15,000 = 20%				
	Q1	Q2	Q3	Q4
Profit / (Loss) before tax	60,000	(15,000)	(15,000)	(15,000)
Tax charge / (credit)	12,000	(3,000)	(3,000)	(3,000)

Illustration 2

ABC Ltd. presents interim financial report quarterly. On 1.4.20X1, ABC Ltd. has carried forward loss of ₹ 600 lakhs for income-tax purpose for which deferred tax asset has not been recognized. ABC Ltd. earns ₹ 900 lakhs in each quarter ending on 30.6.20X1, 30.9.20X1, 31.12.20X1 and 31.3.20X2 excluding the carried forward loss. Income-tax rate is expected to be 40%. Calculate the amount of tax expense to be reported in each quarter.

Solution

Amount of income tax expense reported in each quarter would be as below:

The estimated payment of the annual tax on earnings for the current year:	
₹ 3,000* x 40 / 100 = ₹ 1,200 lakhs.	
*(3,600 lakhs - ₹ 600 lakhs) = ₹ 3,000 lakhs	
Average annual effective tax rate = (1,200 / 3,600) × 100 = 33.33%	
Tax expense to be shown in each quarter = 900 x 33.33% = ₹ 300 lakhs	

Illustration 3

Innovative Corporation Private Limited (or "ICPL") is dealing in seasonal product and the sales pattern of the product, quarter wise is as under during the financial year 20X1-20X2:

Qtr. I	Qtr. II	Qtr. III	Qtr. IV
ending 30 June	ending 30 September	ending 31 December	ending 31 March
10%	10%	60%	20%

For the first quarter ending on 30 June, 20X1, ICPL has provided the following information :

Particulars	Amounts (in crore)
Sales	70
Employees benefits expenses	25
Administrative and other expenses	12
Finance cost	4

ICPL while preparing interim financial report for first quarter wants to defer ₹ 16 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and that the expenditures are uniform throughout all quarters

Calculate the result of first quarter as per Ind AS 34 and comment on the company's view.

Solution

Result of the first quarter ending 30 June

Particulars	Amounts (in crore)
Sales	<u>70</u>
Total Revenue (A)	<u>70</u>
Less: Employees benefits expenses	(25)
Administrative and other expenses	(12)
Finance cost	<u>(4)</u>
Total Expense (B)	<u>(41)</u>
Profit (A-B)	29

Note- As per Ind AS 34, the income and expense should be recognized when they are earned and incurred respectively. Seasonal incomes will be recognized when they occur. Therefore, the argument of ICPL is not correct considering the principles of Ind AS 34.

Illustration 4

Fixed production overheads for the financial year is ₹ 10,000. Normal expected production for the year, after considering planned maintenance and normal breakdown, also considering the future demand of the product is 2,000 MT. It is considered that there are no quarterly / seasonal variations. Therefore, the normal expected production for each quarter is 500 MT and the fixed production overheads for the quarter are ₹ 2,500.

Actual production achieved	Quantity (In MT)
First quarter	400
Second quarter	600
Third quarter	500
Fourth quarter	<u>400</u>
Total	<u>1,900</u>

Presuming that there are no quarterly / seasonal variation, calculate the allocation of fixed production overheads for all the four quarters as per Ind AS 34 read with Ind AS 2. Will the quarterly results affect the annual results?

Solution

If it is considered that there is no quarterly / seasonal variation, therefore normal expected production for each quarter is 500 MT and fixed production overheads for the quarter are ₹ 2,500.

Fixed production overhead to be allocated per unit of production in every quarter will be ₹ 5 per MT (Fixed overheads / Normal production).

Quarters	Allocations
First Quarter	➤ Actual fixed production overheads = ₹ 2,500 ➤ Fixed production overheads based on the allocation rate of ₹ 5 per unit allocated to actual production = ₹ 5 x 400 = ₹ 2,000

	➤ Unallocated fixed production overheads to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 = ₹ 500
Second Quarter	➤ Actual fixed production overheads on year-to-date basis = ₹ 5,000 ➤ Fixed production overheads to be absorbed on year-to-date basis = $1,000 \times ₹ 5 = ₹ 5,000$ ➤ Earlier, ₹ 500 was not allocated to production in the 1st quarter. To give effect to the entire ₹ 5,000 to be allocated in the second quarter, as per Ind AS 34, ₹ 500 are reversed by way of a credit to the statement of profit and loss of the 2nd quarter.
Third Quarter	➤ Actual production overheads on year-to-date basis = ₹ 7,500 ➤ Fixed production overheads to be allocated on year-to-date basis = $1,500 \times 5 = ₹ 7,500$ ➤ There is no under or over recovery of allocated overheads. Hence, no further action is required.
Fourth Quarter	➤ Actual fixed production overheads on year-to-date basis = ₹ 10,000 ➤ Fixed production overheads to be allocated on year-to-date basis $1,900 \times 5 = ₹ 9,500$ ➤ ₹ 500, i.e., [$₹ 2,500 - (₹ 5 \times 400)$] unallocated fixed production overheads in the 4th quarter, are to be expensed off as per the principles of Ind AS 2 and Ind AS 34 by way of a charge to the statement of profit and loss. ➤ Unallocated productions overheads for the year ₹ 500 (i.e ₹ 10,000 – ₹ 9,500) are expensed in the Statement of profit and loss as per Ind AS 2.

The cumulative result of all the quarters would also result in unallocated overheads of ₹ 500, thus, meeting the requirements of Ind AS 34 that the quarterly results should not affect the measurement of the annual results.



2.8 RESTATEMENT OF PREVIOUSLY REPORTED INTERIM PERIODS

A change in accounting policy, other than one for which the transition is specified by a new

Ind AS, shall be reflected by:

- (a) restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with Ind AS 8; or
- (b) when it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years to apply the new accounting policy prospectively from the earliest date practicable.

Under Ind AS 8, a change in accounting policy is reflected by retrospective application, with restatement of prior period financial data as far back as is practicable. However, if the cumulative amount of the adjustment relating to prior financial years is impracticable to determine, then under Ind AS 8 the new policy is applied prospectively from the earliest date practicable.

The effect of this along with respect to interim periods shall be that within the current financial year any change in accounting policy is applied either retrospectively or, if that is not practicable, prospectively, from no later than the beginning of the financial year.



2.9 INTERIM FINANCIAL REPORTING AND IMPAIRMENT

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

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

Illustration 5

ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of ₹ 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

- (i) *Bad debts of ₹ 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.*
- (ii) *Additional depreciation of ₹ 4,50,000 resulting from the change in the method of*

depreciation.

- (iii) Exceptional loss of ₹ 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.
- (iv) ₹ 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

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

Solution

In the instant case, the quarterly net profit has not been correctly stated. As per Ind AS 34, *Interim Financial Reporting*, the quarterly net profit should be adjusted and restated as follows:

- (i) The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.
- (ii) Recognising additional depreciation of ₹ 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.
- (iii) Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of ₹ 28,000 incurred during the third quarter should be recognized in the same quarter. Hence ₹ 14,000 which was deferred should be deducted from the profits of third quarter only.
- (iv) As per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated or deferred only when:
 - (i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and
 - (ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of ₹ 5,00,000 is not correct as expenditures are uniform throughout all quarters.

Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be ₹ 14,36,000 (₹ 20,00,000 - ₹ 50,000 - ₹ 14,000 - ₹ 5,00,000).



2.10 SIGNIFICANT DIFFERENCES IN IND AS 34 VIS-À-VIS AS 25

S. No.	Particular	Ind AS 34	AS 25
1.	Disclosures	Ind AS 34 requires disclosure by way of an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.	AS 25 does not specifically requires such disclosure.
2.	<i>Reversal of Impairment Loss</i>	Ind AS 34 prohibits reversal of impairment loss recognised in a previous interim period in respect of goodwill (in harmony with paragraph 124 of Ind AS 36, which prohibits reversal of impairment loss recognised for goodwill in a subsequent period) or an investment in either an equity instrument or a financial asset carried at cost. Ind AS 34 includes Appendix A which addresses the interaction between the requirements of Ind AS 34 and the recognition of impairment losses on goodwill in Ind AS 36 and the effect of that interaction on subsequent interim and annual financial statements	There is no such specific prohibition in the AS 25.
3.	<i>Inclusion of the Parent's Separate</i>	Ind AS 34 states that it neither requires nor prohibits the inclusion of the parent's separate statements	Under AS 25, if an entity's annual financial report included the consolidated financial

	<i>Statements and the Consolidated Financial Statements in the Entity's Interim Report</i>	in the entity's interim report if an entity's annual financial report included the parent's separate financial statements in addition to consolidated financial statements.	statements in addition to the separate financial statements, the interim financial report should include both the consolidated financial statements and separate financial statements, complete or condensed.
4.	<i>Accounting Policies</i>	Ind AS 34 additionally requires the information in respect of methods of computation followed.	AS 25 requires the Notes to interim financial statements, (if material and not disclosed elsewhere in the interim financial report), to contain a statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or, in case of change in those policies, a description of the nature and effect of the change.
5.	<i>Contingent Liabilities and Contingent Assets</i>	Ind AS 34 requires furnishing of information on both contingent liabilities and contingent assets, if they are significant.	AS 25 requires furnishing of information on contingent liabilities only.
6.	<i>Interim Financial Statements prepared on Complete Basis</i>	Ind AS 34 requires that, where an interim financial report has been prepared in accordance with the requirements of Ind AS 34, that fact should be disclosed. Further, an interim financial report should not be described as complying with Ind AS unless it complies with all of the requirements	AS 25 does not contain these requirements.

		of Ind AS. (The latter statement is applicable when interim financial statements are prepared on complete basis instead of 'condensed basis').	
7.	<i>Transitional provision</i>	Ind AS 34 does not have this transitional provision.	Under AS 25, when an interim financial report is presented for the first time in accordance with that Standard, an entity need not present, in respect of all the interim periods of the current financial year, comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year and comparative cash flow statement for the comparable year-to-date period of the immediately preceding financial year.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

- The entity's financial year ends on 31st March. What are the "reporting periods" for which financial statements (condensed or complete) in the interim financial report of the entity as on 30th September, 20X1 are required to be presented, if:

- Entity publishes interim financial reports quarterly
- Entity publishes interim financial reports half-yearly.

- Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income 33,00,000
(inclusive of Estimated Capital Gains of ₹ 8,00,000)

Estimated Income of Quarter I is ₹ 7,00,000, Quarter II is ₹ 8,00,000, Quarter III (including Estimated Capital Gains of ₹ 8,00,000) is ₹ 12,00,000 and Quarter IV is ₹ 6,00,000.

Tax Rates:	On Capital Gains	12%
	On Other Income: First ₹ 5,00,000	30%
	Balance Income	40%

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

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct or

not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

4. Due to decline in market price in second quarter, Happy India Ltd. incurred an inventory loss. The Market price is expected to return to previous levels by the end of the year. At the end of year, the decline had not reversed. When should the loss be reported in interim statement of profit and loss of Happy India Ltd.?
5. An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at ₹10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

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

6. PQR Ltd. is preparing its interim financial statements for quarter 3 of the year. How the following transactions and events should be dealt with while preparing its interim financials:
 - (i) It makes employer contributions to government-sponsored insurance funds that are assessed on an annual basis. During Quarter 1 and Quarter 2 larger amount of payments for this contribution were made, while during the Quarter 3 minor payments were made (since contribution is made upto a certain maximum level of earnings per employee and hence for higher income employees, the maximum income reaches before year end).
 - (ii) The entity intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs that will be incurred for this work.
 - (iii) The company has a practice of declaring bonus of 10% of its annual operating profits every year. It has a history of doing so.

Answers

1. Paragraph 20 of Ind AS 34, Interim Financial Reporting states as follows:

"Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

- a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.
- b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the

comparable interim periods (current and year-to-date) of the immediately preceding financial year.

- c) statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.
- d) statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

Accordingly, periods for which interim financial statements are required to be presented are provided herein below:

(i) Entity publishes interim financial reports quarterly

The entity will present the following financial statements (condensed or complete) in its interim financial report of 30th September, 20X1:

Balance sheet at	30 th September 20X1	31 st March 20X1	-	-
Statement of profit and loss for	3 months ended 30 th September 20X1	3 months ended 30 th September 20X0	6 months ended 30 th September 20X1	6 months ended 30 th September 20X0
Statement of changes in equity for	6 months ended 30 th September 20X1	6 months ended 30 th September 20X0		
Statement of cash flows for	6 months ended 30 th September 20X1	6 months ended 30 th September 20X0	-	-

(ii) Entity publishes interim financial reports half-yearly

The entity's financial year ends 31st March. The entity will present the following financial statements (condensed or complete) in its half-yearly interim financial report of 30th September, 20X1:

Balance sheet at	30 th September, 20X1	31 st March, 20X1
Statement of profit and loss for	6 months ending 30 th September, 20X1	6 months ending 30 th September, 20X0

Statement of changes in equity for	6 months ending 30 th September 20X1	6 months ending 30 th September 20X0
Statement of cash flows for	6 months ending 30 th September 20X1	6 months ending 30 th September 20X0

2. As per para 30(c) of Ind AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	₹
Estimated annual income exclusive of estimated capital gain (33,00,000 – 8,00,000) (A)	<u>25,00,000</u>
Tax expense on other income:	
30% on ₹ 5,00,000	1,50,000
40% on remaining ₹ 20,00,000	<u>8,00,000</u>
(B)	<u>9,50,000</u>
Weighted average annual income tax rate = $\frac{B}{A} = \frac{9,50,000}{25,00,000} = 38\%$	

Tax expense to be recognised in each of the quarterly reports

		₹
Quarter I - ₹ 7,00,000 x 38%		2,66,000
Quarter II - ₹ 8,00,000 x 38%		3,04,000
Quarter III - ₹ (12,00,000 - 8,00,000) x 38%	1,52,000	
₹ 8,00,000 x 12%	<u>96,000</u>	2,48,000
Quarter IV - ₹ 6,00,000 x 38%		<u>2,28,000</u>
		<u>10,46,000</u>

3. As illustrated in para 30 (c) of Ind AS 34 'Interim financial reporting', income tax expense is **recognised in each interim period** based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Accordingly, the management's contention that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is not correct. Since the effective tax rate or average annual income tax rate is already given in the question as 30%, the income tax expense will be recognised in each interim quarter based on this rate only. The following table shows the correct income tax expense to be reported each quarter in accordance with Ind AS 34:

Period	Pre-tax earnings (in ₹)	Effective tax rate	Tax expense (in ₹)
First Quarter	1,50,000	30%	45,000
Second Quarter	(50,000)	30%	(15,000)
Third Quarter	(50,000)	30%	(15,000)
Fourth Quarter	(50,000)	30%	(15,000)
Annual	0		0

4. Loss should be recognised in the second quarter of the year.

5. Table showing computation of tax charge:

	Quarter ending 31 st March, 2019	Quarter ending 30 th June, 2019	Quarter ending 30 th September, 2019	Quarter ending 31 st December, 2019	Year ending 31 st December, 2019
	₹	₹	₹	₹	₹
Profit before tax	10,000	10,000	10,000	10,000	40,000
Tax charge	(2,500)	(3,000)	(3,000)	(3,000)	(11,500)
	7,500	7,000	7,000	7,000	28,500

Since an entity's accounting year is not same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

6. Paragraph 28 of Ind AS 34, Interim Financial Reporting states that an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements.

Further, paragraphs 32 and 33 of Ind AS 34, Interim Financial Reporting state that for assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end would not qualify at interim dates either. Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised otherwise not. The Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

Considering the above guidance, while preparing its interim financials, the transactions and events of the given case should be dealt with as follows:

- (i) If employer contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised using an estimated average annual effective contribution rate in its interim financial statements, even though a large portion of the payments have been made early in the financial year. Accordingly, it should work out an average effective contribution rate and account for the same accordingly, in its interim financials.
- (ii) The cost of a planned overhaul expenditure that is expected to occur in later part of the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.
- (iii) A bonus is anticipated for interim reporting purposes, if and only if,
 - (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and
 - (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance in this regard.

A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements.

Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements. In the instant case, bonus liability of 10% of operating profit for the year to date may be accrued.

In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

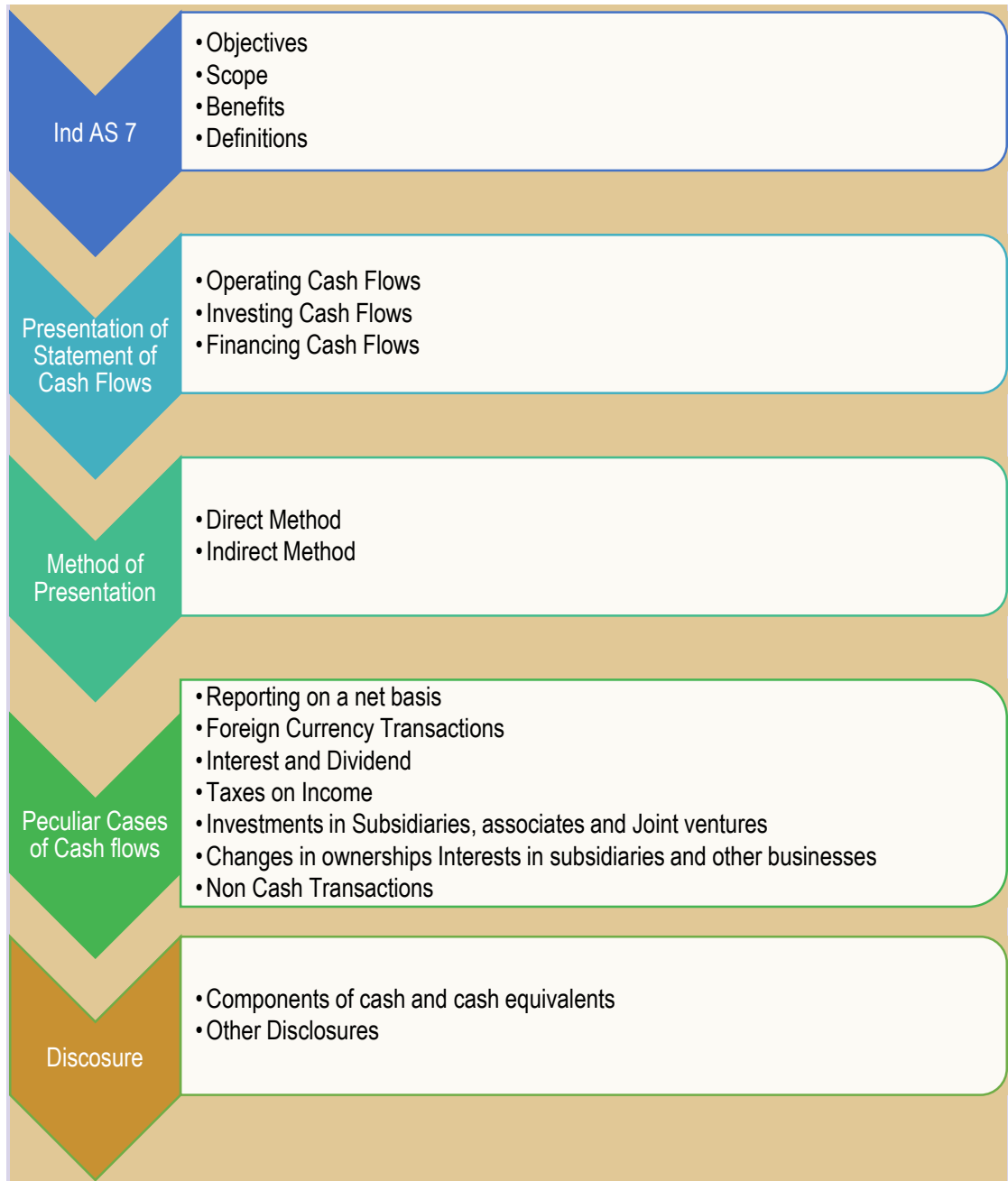
UNIT 3: INDIAN ACCOUNTING STANDARD 7: STATEMENT OF CASH FLOWS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ☐ Understand the meaning of cash flow statement
- ☐ Describe the objective and scope of issuance of Ind AS 7
- ☐ Define the relevant terms used in the Ind AS
- ☐ Classify the types of cash flows into operating, investing and financing activities
- ☐ Distinguish between direct and indirect method of presentation of cash flows under the operating activity
- ☐ Identify the provision applicable to various peculiar situations of cash flows
- ☐ Disclose the necessary information as required in the standard
- ☐ Differentiate between Ind AS 7 and AS 3.

UNIT OVERVIEW





3.1 INTRODUCTION

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

The information on cash flows is useful in assessing sources of generating and deploying cash and cash equivalents during the reporting period. The statement of cash flows can be used for comparison with earlier reporting periods of the same entity as well as comparison with other entities for the same reporting period.

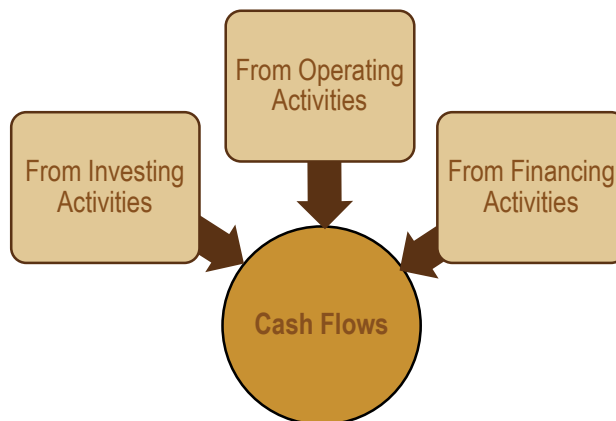
Ind AS 7, Statement of Cash Flows, prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period.



3.2 MEANING OF STATEMENT OF CASH FLOWS

Cash flow statement, in simple words is a statement, which provides the details about how the cash is generated by an entity during the particular reporting period and how it is applied. While doing so, it takes into consideration the opening balances of cash and cash equivalents, adds the cash generated, deducts the cash payments and reconciles it with closing balances of cash and cash equivalents. The cash flows are classified into following three main categories:

- (a) Cash flows from Operating Activities
- (b) Cash flows from Investing Activities
- (c) Cash flows from Financing Activities



The simplified example of cash flow statement, for understanding purpose is given below

Particulars	Amount (₹)
Cash flow from Operating Activities	10,000
Cash flow used in Investing Activities	(2,000)
Cash flow used in Financing Activities	<u>(4,000)</u>
Net Cash Generated during the year	4,000
Add: Cash and Cash Equivalents at the beginning of the year	<u>13,000</u>
Cash and Cash Equivalents at the end of the year (which will also tally with the cash and cash equivalents given in the balance sheet)	<u>17,000</u>

Thus, one can see that at the beginning of the year, the **opening balance** of cash and cash equivalent was ₹ 13,000. During the year, the business **generated (inflow)** cash from its main operations ₹ 10,000. Thus, the entity had ₹ 23,000 at its disposal. Out of it, the entity has **used (outflow)** ₹ 2,000 for additional investments and ₹ 4,000 for financing activities. Therefore, at the end of the year, the entity is left with the balance of ₹ 17,000.



3.3 OBJECTIVE

Ind AS 7, has specified the following objectives of Statement of Cash Flows:

3.3.1 To provide information about historical changes in cash and cash equivalents

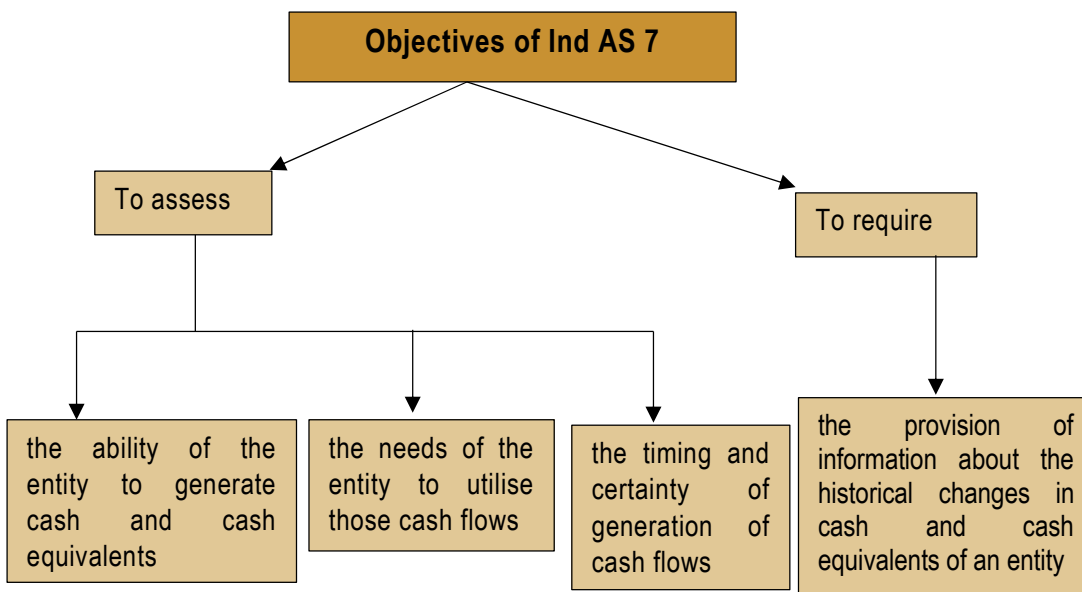
Cash flow statement aims at providing the information about how the cash has been generated during the year and for what purposes has it been utilised. The information will be provided for current year and immediate previous year.

3.3.2 To assess the ability to generate cash and cash equivalents

Cash flow statement is intended to provide the stakeholders about the efficiency of the company in generating cash and cash equivalents. Some companies may look profitable as per profit and loss account but whether they have enough cash for payment of their debts and creditors has to be assessed by using cash flow statement. It is useful in examining the relationship between profitability and net cash flow and the impact of changing prices.

3.3.3 To understand the timing and certainty of their generation

The historical analysis of statement of cash flow can set a trend regarding the years in which company could generate fair amount of cash flows and the probability of generating it.



3.4 BENEFITS OF CASH FLOW INFORMATION

3.4.1 Provides information enabling evaluation of changes in net assets and financial structure (Liquidity and solvency)

Cash flow statement reconciles the opening balances of cash and cash equivalents with the closing balances of cash and cash equivalents, giving the reasons for the changes happened during the year. Thus, it provides a clear picture of cash inflows and out flows that have taken place during the reporting period.

3.4.2 Assesses the ability to manage the cash

The stakeholders get an idea about what is the source of generation of cash and how it is used for. The information gives a fair idea about the efficiency and ability of the company to generate cash.

For example, suppose there is negative cash flow from operations. It denotes that company is unable to generate cash from its main business activity, which is not a favourable situation.

Cash flow statements can also throw light on whether company could generate sufficient cash or not.

For example, company wants to expand its production capacity. The cash flow statement can indicate whether company could generate the required cash from their operations, or whether company has generated the funds from share capital or whether company has taken a loan for the same.

3.4.3 Assess and compare the present value of future cash flows

The past trends of cash flows will help the company to predict about future cash flows. Such information is useful while evaluating the projects on capital budgeting or valuation of shares. Thus, it forms the base for future projects and can be discounted using discounting techniques.

3.4.4 Compares the efficiency of different entities

Accounting profits of various entities may have different assumptions, policies and definitions. However, cash flows will be calculated by using the same technique and finally all differing assumptions across the companies will melt down and entity will reach to a common comparable base of cash and cash equivalents.



3.5 SCOPE

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

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

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

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



3.6 DEFINITIONS

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

1. **Cash** comprises cash on hand and demand deposits.

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



3.7 CASH AND CASH EQUIVALENTS

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

1. **Purpose:** Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.
2. **Known amount of cash:** This means that the cash amount that will be received on redemption should be known at the time of the initial investment. It is not sufficient that the instrument itself is readily convertible into cash and has a determinable market value. Instead, it means that, at the time of the initial investment, the entity is satisfied that the risk of changes in value is insignificant and that therefore the amount of cash to be received on redemption is known.
3. **Liquidity and Risk:** For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.
4. **Equity investments** are excluded from cash equivalents unless they are, in substance, cash equivalents.
5. **Bank borrowings** are generally considered to be financing activities. However, the bank overdrafts may be an integral part of an entity's cash management in which case they will be included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn. .
6. **Cash Management:** Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Illustration 1

Company has provided the following information regarding the various assets held by company on 31st March 20X1. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provided in Ind AS 7:

Sr.No.	Name of the Security	Additional Information
1.	Fixed deposit with SBI	12%, 3 years maturity on 1 st January 20X4
2.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30 th June 20X1
3.	Redeemable Preference shares in ABC Ltd	Acquired on 31 st January 20X1 and the redemption is due on 30 th April 20X1
4.	Cash balances at various banks	All branches of all banks in India
5.	Cash balances at various banks	All international branches of Indian banks
6.	Cash balances at various banks	Branches of foreign banks outside India
7.	Bank overdraft of SBI Fort branch	Temporary overdraft, which is payable on demand
8.	Treasury Bills	90 days maturity

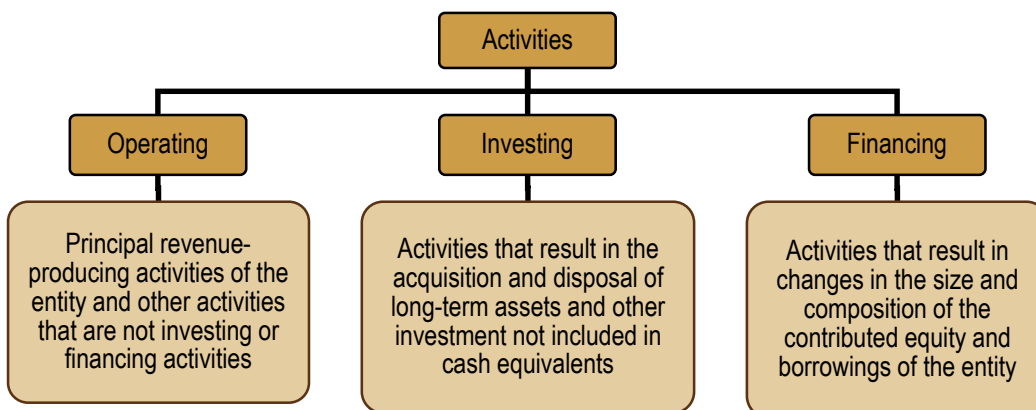
Solution

Sr. No.	Name of the Security	Decision
1.	Fixed deposit with SBI	Not to be considered – long term
2.	Fixed deposit with HDFC	Exclude as original maturity is not less than 90 days from the date of acquisition
3.	Redeemable Preference shares in ABC Ltd.	Include as due within 90 days from the date of acquisition
4.	Cash balances at various banks	Include
5.	Cash balances at various banks	Include
6.	Cash balances at various banks	Include
7.	Bank overdraft of SBI Fort branch	Include (Assumed as integral part of an entity's cash management)
8.	Treasury Bills	Include



3.8 PRESENTATION OF STATEMENT OF CASH FLOWS

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



3.8.1 Operating Activities

- Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity ie from operations of the business. Therefore, they are, in general, the result of the transactions and events that enter into the determination of profit or loss.

Examples of cash flows from operating activities are:

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

Illustration 2

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

Sr. No.	Nature of Transaction
1	Receipt from sale of mobile phones
2	Purchases of mobile phones from various companies
3	Employees expenses paid
4	Advertisement expenses paid
5	Credit sales of mobile
6	Miscellaneous charges received from customers for repairs of mobiles
7	Loss due to decrease in market value of the closing stock of old mobile phones
8	Payment to suppliers of mobile phones
9	Depreciation on furniture of sales showrooms
10	Interest paid on cash credit facility of the bank
11	Profit on sale of old computers and printers, in exchange of new laptop and printer
12	Advance received from customers
13	Sales Tax and excise duty paid

Solution

Sr. No.	Nature of Transaction	Included / Excluded with reason
1	Receipt from sale of mobile phones	Include – main revenue generating activity
2	Purchases of mobile phones from various companies	Include – expenses related to main operations of business
3	Employees expenses paid	Include – expenses related to main operations of business
4	Advertisement expenses paid	Include – expenses related to main operations of business
5	Credit sales of mobile	Do not include – Credit transaction will not be included in cash flow (receipts from customers will be included)
6	Misc. charges received from customers for repairs of mobiles	Include – supplementary revenue generating activity
7	Loss due to decrease in market value of the closing stock of old mobile phones	Do not include - Non cash transaction

8	Payment to suppliers of mobile phones	Include – cash outflow related to main operations of business
9	Depreciation on furniture of sales showrooms	Do not include – non cash item
10	Interest paid on cash credit facility of the bank	Do not include – cost of finance
11	Profit on sale of old computers and printers, in exchange of new laptop and printer	Do not include – non cash item
12	Advance received from customers	Include – Related to operations of business
13	Sales tax and excise duty paid	Include – related to operations of business

- The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows or not. If the cash flow from operations is positive, it will be treated as positive indicator whereas negative cash flow from operations will denote that company's ability to generate the revenue from its main operations is very weak. The companies in the initial stage of their business or the companies which are facing economic problems will generally have the negative cash flow from operations.
- Cash flow from operations are used to maintain the operating capability of the entity, pay dividends and make new investment without recourse to external sources of financing. Therefore, it is necessary to assess how much cash is generated by the business from operations? Are they sufficient to take care of their future investment plans? Can loans be repaid in time without default from such cash flows? Is there sufficient amount for payment of preference dividend? Is anything left for equity shareholders after making all these payments? Answers to all these questions will depend on whether the entity has generated enough cash or not.

3.8.1.1 Certain Specific Issues

1. **Profit/ Loss on Sale of Assets** : Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities.
2. **Properties built for let out** : Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

3.8.2 Investing Activities

Investment means sacrifice of current resource in a view to get more returns in future. All entities need some amount of investment for their future survival.

Ind AS 7 states that investing activities represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

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

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

Illustration 3

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

S. No.	Nature of transaction paid
1	Interest received on loans
2	Interest paid on Deposits

3	<i>Deposits accepted</i>
4	<i>Loans given to customers</i>
5	<i>Loans repaid by the customers</i>
6	<i>Deposits repaid</i>
7	<i>Commission received</i>
8	<i>Lease rentals paid for various branches</i>
9	<i>Service tax paid</i>
10	<i>Furniture purchased for new branches</i>
11	<i>Implementation of upgraded banking software</i>
12	<i>Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi</i>
13	<i>New cars purchased from Honda dealer, in exchange of old cars and remaining amount paid in cash</i>
14	<i>Provident fund paid for the employees</i>
15	<i>Issued employee stock options</i>

Solution

Sr. No.	Nature of transaction paid	Operating / Investing / Not to be considered
1	Interest received on loans	Operating – Main revenue generating activity
2	Interest paid on Deposits	Operating – Main expenses of operations
3	Deposits accepted	Operating – in case of financial institutes
4	Loans given to customers	Operating – in case of financial institutes
5	Loans repaid by the customers	Operating – in case of financial institutes
6	Deposits repaid	Operating – in case of financial institutes
7	Commission received	Operating – Main revenue generating activity
8	Lease rentals paid for various branches	Operating – Main expenses of operations
9	Service tax paid	Operating – Main expenses of operations
10	Furniture for new branches	Investing – Assets purchased
11	Implementation of upgraded banking software	Investing – Purchased for long term purpose
12	Purchase of shares in 100%	Investing – strategic investment

	subsidiary for opening a branch in Abu Dhabi	
13	New cars purchased from Honda dealer, in exchange of old cars and cash payment	Investing-for cash payment
14	Provident fund paid for the employees	Operating
15	Issued employee stock options	Not to be considered. No cash flow

3.8.3 Financing Activities

During the life time of the entity, it needs money for long term investments as well as for working capital purpose. Company can raise the capital by way of equity or loans. Thus, the cash flows related to raising of funds and redemption of funds will be covered under Cash flows from financing activities. The cost of capital is also generally covered under the Financing Activity.

Ind AS 7 states that the cash flows from Financing activity are useful in predicting claims on future cash flows by providers of capital to the entity.

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

Illustration 4

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

Sr. No.	Nature of transaction
1	Issued preference shares
2	Purchased the shares of 100% subsidiary company
3	Dividend received from shares of subsidiaries
4	Dividend received from other companies

5	<i>Bonus shares issued</i>
6	<i>Purchased license for manufacturing of special drugs</i>
7	<i>Royalty received from the goods patented by the company</i>
8	<i>Rent received from the let out building (letting out is not main business)</i>
9	<i>Interest received from loans and advances given</i>
10	<i>Dividend paid</i>
11	<i>Interest paid on security deposits</i>
12	<i>Purchased goodwill</i>
13	<i>Acquired the assets of a company by issue of equity shares (not parting any cash)</i>
14	<i>Interim dividends paid</i>
15	<i>Dissolved the 100% subsidiary and received the amount in final settlement</i>

Solution

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

Illustration 5

An entity has entered into a factoring arrangement and received money from the factor. Examine the said transaction and state how should it be presented in the statement of cash flows?

Solution

Under factoring arrangement, it needs to be assessed whether the arrangement is recourse or non-recourse.

Recourse factoring:

The cash received is classified as a financing cash inflow as the entity continues to recognize the receivables and the amount received from the factor is indeed a liability. The substance of the arrangement is financing, as the entity retains substantially all of the risk and rewards of the factored receivables.

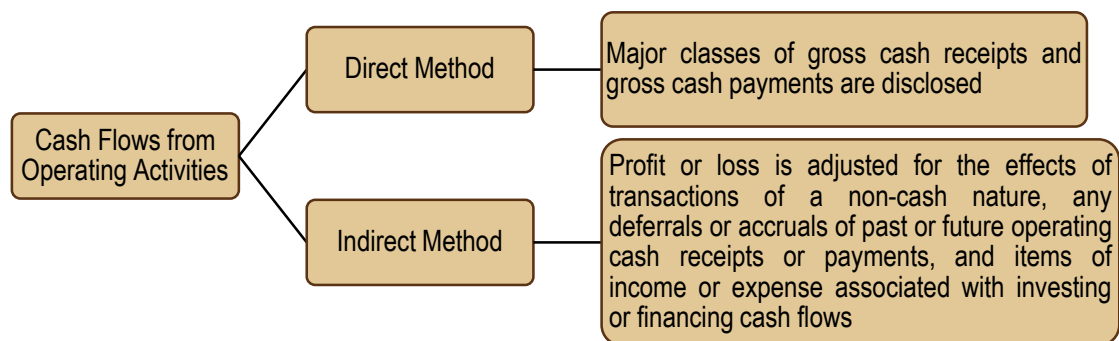
When the cash is collected by the factor, the liability and the receivables are de-recognized. It is acceptable for this to be disclosed as a non-cash transaction, because the settlement of the liability and the factored receivables does not result in cash flows. The net impact of these transactions on the cash flow statement is to present a cash inflow from financing, but there is no operating cash flow from the original sale to the entity's customers.

Non-recourse factoring:

Where an entity de-recognises the factored receivables and receives cash from the factor, the cash receipt is classified as an operating cash inflow. This is because the entity has received cash in exchange for receivables that arose from its operating activities.



3.9 REPORTING CASH FLOWS FROM OPERATING ACTIVITIES



- An entity shall report cash flows from operating activities using either:
 - (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
 - (b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.
- Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:
 - (a) from the accounting records of the entity; or
 - (b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the statement of profit and loss for:
 - (i) changes during the period in inventories and operating receivables and payables;
 - (ii) other non-cash items; and
 - (iii) other items for which the cash effects are investing or financing cash flows.

Analysis

Direct method starts with cash revenue / income / receipts of the company. All the cash expenses will be deducted from such cash revenue. The cash profit will be adjusted for the cash flows arising from investing and financing activities. Non-cash expenses / losses / gains will not be considered. The payments to suppliers and receipts from customers are also taken into consideration. The resultant figure would be cash flow from operating activity. The exercise would be similar to converting the income and expenditure account (accrual system) into receipt and payment (cash system), with certain adjustments. Thus, if we consider the vertical operating statement, direct method will have (TOP down) approach of presentation.

- Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:
 - (a) changes during the period in inventories and operating receivables and payables;
 - (b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and
 - (c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Analysis

Indirect method is reverse of direct method. It starts with the accounting profit after tax as given in profit and loss accounts. Thereafter, the profit will be adjusted for non-cash items, losses and gains on investing and financing activities, interest and dividends, collection and payments to debtors / creditors etc. Accordingly, the cash from operating activity will be derived. Thus indirect method will have (Bottom up) approach.

Note: Under both the methods the amount of cash flow from Operating activities need to be necessarily same. It's only the approach for presentation which differs.

Illustration 6

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

Operating statement of ABC Ltd. for the year ended 31.3.20X2

Particulars	₹
Sales	5,00,000.00
Less: Cost of goods sold	3,50,000.00
Administration & Selling Overheads	55,000.00
Depreciation	7,000.00
Interest Paid	3,000.00
Loss on sale of asset	<u>2,000.00</u>
Profit before tax	83,000.00
Tax	<u>(30,000.00)</u>
Profit After tax	<u>53,000.00</u>

Balance Sheet as on 31st March

	20X2	20X1
Assets		
Non-current Assets		
Property, Plant and Equipment	75,000.00	65,000.00
Investment	12,000.00	10,000.00
Current Assets		
Inventories	12,000.00	13,000.00
Trade receivables	10,000.00	7,000.00
Cash and cash equivalents	<u>6,000.00</u>	<u>5,000.00</u>

Total	<u>1,15,000.00</u>	<u>1,00,000.00</u>
Equity and Liabilities		
Shareholders' Funds	60,000.00	50,000.00
Non-current Liabilities	33,000.00	35,000.00
Current Liabilities		
Trade Payables	12,000.00	8,000.00
Payables for Expenses	<u>10,000.00</u>	<u>7,000.00</u>
Total	<u>1,15,000.00</u>	<u>1,00,000.00</u>

Solution**1. Cash flow from Operations by Direct Method**

Particulars	₹	See Note
Cash Sales	4,97,000.00	1
Less: Cash Purchases	3,45,000.00	2
Overheads	52,000.00	3
Interest	-	Financing
Depreciation	-	Non cash item
Loss on sale of asset	-	Investing item
Cash profit	<u>100,000.00</u>	
Less: Tax	<u>(30,000.00)</u>	
Cash profit after tax	<u>70,000.00</u>	

Note No 1 - Cash Receipts from Sales and Trade receivables

Particulars	₹
Sales	5,00,000.00
Add : Opening Trade receivables	7,000.00
Less : Closing Trade receivables	<u>(10,000.00)</u>
Cash Receipts	<u>4,97,000.00</u>

Note No 2 :- Payment to Trade Payables for Purchases

Particulars	₹
Cost of goods sold	3,50,000.00
Closing inventories	12,000.00
Less: Opening inventories	<u>(13,000.00)</u>
Purchases	3,49,000.00
Add: Opening Trade Payables	8,000.00

Less: Closing Trade Payables	(12,000.00)
Payment to creditors	<u>3,45,000.00</u>
Particulars	₹
Overheads	55,000.00
Add: Opening payables	7,000.00
Less: Closing payables	(10,000.00)
Payment for Overheads	<u>52,000.00</u>

2. Cash flow from Operations by Indirect Method

Indirect Method	₹
Profit After Tax	53,000.00
Add back/(Less): Depreciation	7,000.00
Loss on sale of asset	2,000.00
Interest paid	3,000.00
Decrease in Inventory	1,000.00
Increase in Trade Receivables	(3,000.00)
Increase in Trade Payables	4,000.00
Increase in Payables for expenses	<u>3,000.00</u>
Net cash generated from operating activities	<u>70,000.00</u>

Note: Cash flow derived from operations ₹ 70,000 is same in both Direct Method and Indirect Method.



3.10 REPORTING CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

An entity is required to report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are permitted to be reported on a net basis.



3.11 REPORTING CASH FLOWS ON A NET BASIS

If nothing is specifically mentioned, then as per Ind AS 7, the cash flows will be presented on Gross Basis. Gross basis means the receipts would be shown separately and the payments will be shown separately.

Example 1

If in the year 20X1-20X2, some land is purchased for ₹ 2.5 crores and another land is sold for ₹ 3.5 crores then while presenting the information, entity shall show separately outflow of ₹ 2.5 crores and inflow of ₹ 3.5 crores.

The above base has following exceptions

1. Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

- (a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity;

Examples of cash receipts and payments referred to in paragraph 22(a) are:

- the acceptance and repayment of demand deposits of a bank;
- funds held for customers by an investment entity; and
- rents collected on behalf of, and paid over to, the owners of properties.

- (b) Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayment of:

- principal amounts relating to credit card customers;
- the purchase and sale of investments; and
- other short-term borrowings, for example, those which have a maturity period of three months or less.

2. Cash flows arising from each of the following activities of a financial institution maybe reported on a net basis:

- (a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- (b) the placement of deposits with and withdrawal of deposits from other financial institutions; and
- (c) cash advances and loans made to customers and the repayment of those advances and loans.



3.12 FOREIGN CURRENCY CASH FLOWS

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

Example 2

Suppose the money is received on account of exports on 15th January 20X1 in US\$. The company prepares the accounts in rupees. In such case the exchange rate between USD and Rupee as on 15th January 20X1 need to be applied for conversion.

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

3.12.1 Treatment of foreign exchange differences arising from unsettled transactions relating to operating activities

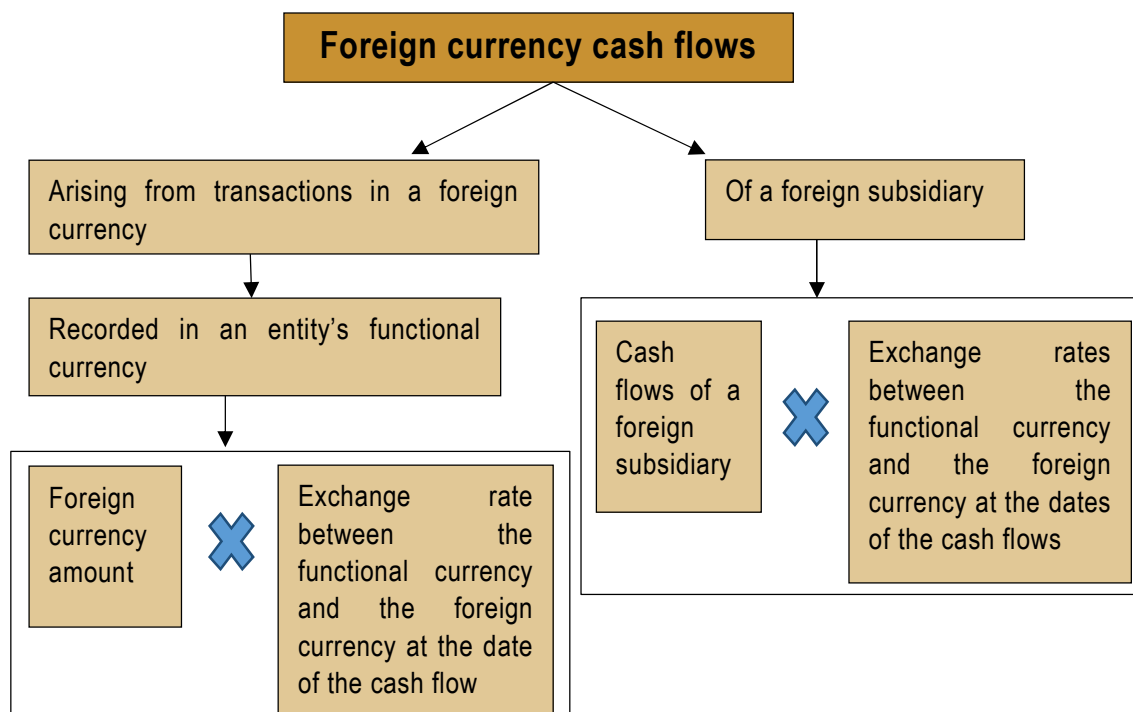
Under indirect method of preparation of statement of cash flows, the exchange differences that arise on translation at the balance sheet date, for monetary items that form part of operating activities, will require no adjustment in the reconciliation of profit to net cash flow from operating activities.

Example 3

Entity A (Indian Company) purchased goods for resale from France during January for EUR 10,000 (Exchange rate: 1 EUR = ₹ 70) on a credit period of 4 months. It accounted for the purchase of inventory at ₹ 7,00,000 (10,000 x 70). On 31st March, the exchange rate has changed to 1 EUR = ₹ 65. This would mean an unrealised gain due to exchange fluctuation of ₹ 50,000 (since the payables will be recorded at ₹ 6,50,000 (at closing exchange rate).

Assuming that the inventory is unsold at that date, the movement is reported as under:

Profit	₹ 50,000
Less: Increase in Inventory	₹ (7,00,000)
Add: Increase in Payables	₹ <u>6,50,000</u>
Net Cash flows from operating activities	₹ <u>0</u>



Note:

1. Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21.
2. A weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary
3. Ind AS 21 does not permit use of the exchange rate at the end of the reporting period when translating the cash flows of a foreign subsidiary



3.13 INTEREST AND DIVIDENDS

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

	Financing company	Other company
Interest paid	Cash flows arising from operating activities	Cash flows from financing activities
Interest and dividends received	Cash flows arising from operating activities	Cash flows from investing activities
Dividends paid	Cash flows from financing activities	Cash flows from financing activities

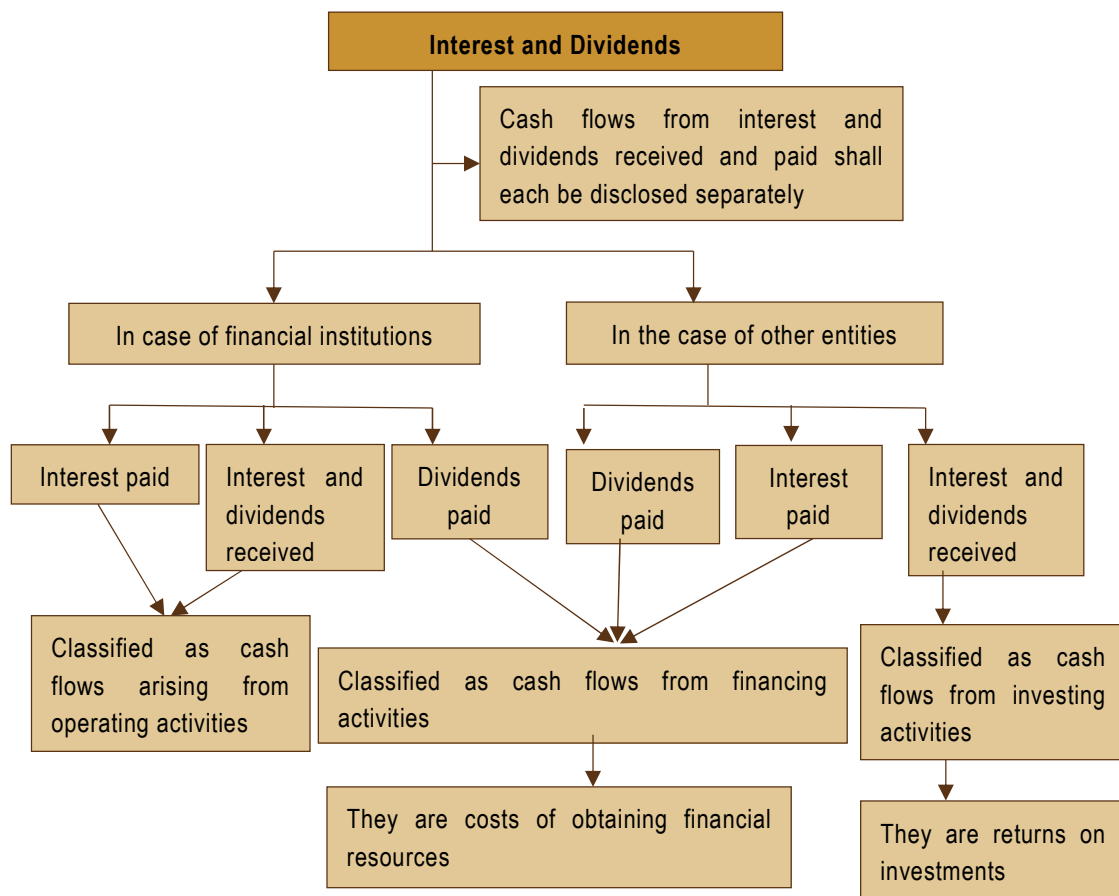


Illustration 7

A firm invests in a five-year bond of another company with a face value of ₹ 10,00,000 by paying ₹ 5,00,000. The effective rate is 15%. The firm recognises proportionate interest income in its income statement throughout the period of bond.

Based on the above information answer the following question:

- How the interest income will be treated in cash flow statement during the period of bond?
- On maturity, whether the receipt of ₹ 10,00,000 should be split between interest income and receipts from investment activity.

Solution

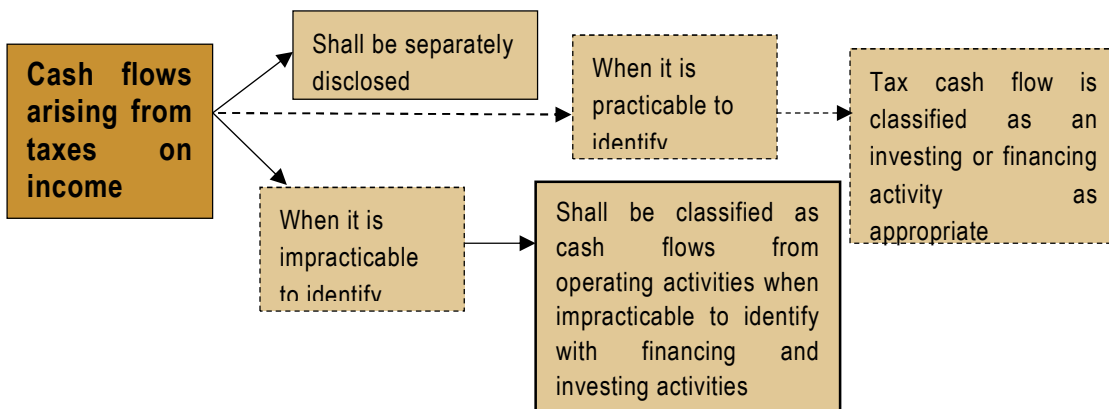
Interest income will be treated as income over the period of bond in the income statement. However, there will be no cash flow in these years because no cash has been received. On maturity, receipt of ₹ 10,00,000 will be classified as investment activity with a bifurcation of interest income & money received on redemption of bond.



3.14 TAXES ON INCOME

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

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



Note: When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Illustration 8

X Limited has paid an advance tax amounting to ₹ 5,30,000 during the current year. Out of the above paid tax, ₹ 30,000 is paid for tax on long term capital gains.

Under which activity the above said tax be classified in the cash flow statements of X Limited?

Solution

Cash flows arising from taxes on income should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. In the case of X Limited, the tax amount of ₹ 30,000 is specifically related with investing activities. ₹ 5,00,000 to be shown under operating activities. ₹ 30,000 to be shown under investing activities.



3.15 INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

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

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

Investments in subsidiaries, associates and joint ventures	When accounted for by use of the equity or cost method	an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.
	When reporting its interest in an associate or a joint venture using the equity method	Includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.



3.16 CHANGES IN OWNERSHIP INTERESTS IN SUBSIDIARIES AND OTHER BUSINESSES

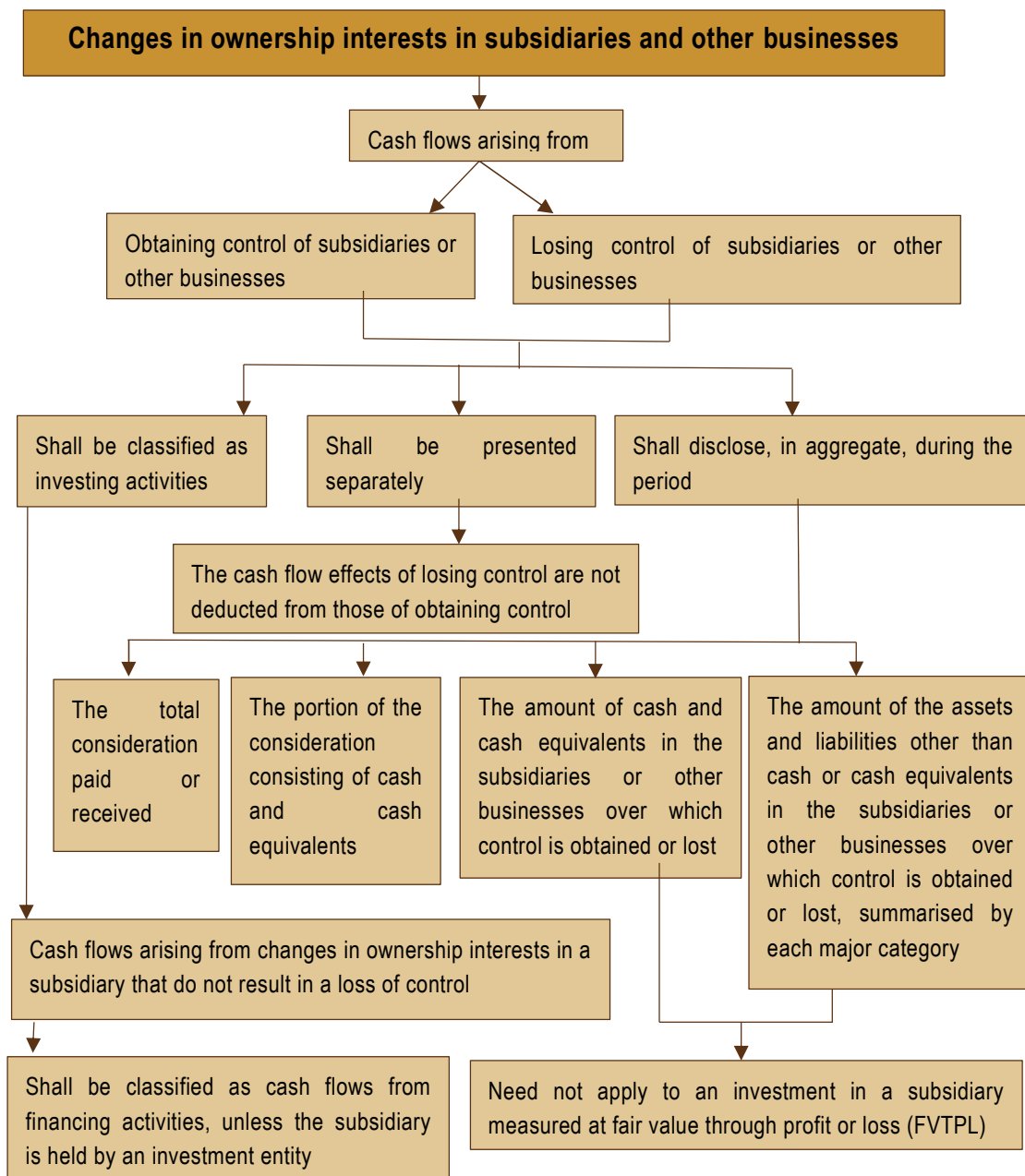
3.16.1 Classification of Cash Flows as Investing Activity

- The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.
- An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:
 - (a) the total consideration paid or received;
 - (b) the portion of the consideration consisting of cash and cash equivalents;
 - (c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and

- (d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.
- The separate presentation of the cash flow effects of obtaining or losing control of subsidiaries or other businesses as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of losing control are not deducted from those of obtaining control.
 - The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

3.16.2 Classification of Cash Flows as Financing Activity

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



3.17 NON-CASH TRANSACTIONS

- Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.

- Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.
- Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. Such non-cash items will not form part of the cash flow statement.

Examples of non-cash transactions are:

- (a) the acquisition of assets either by assuming directly related liabilities or by means of a lease;
- (b) the acquisition of an entity by means of an equity issue; and
- (c) the conversion of debt to equity

Illustration 9

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

Solution

Investing and financing transactions that do not require the use of cash and cash equivalents shall be excluded from a statement of cash flows. X Limited should classify cash payment of ₹ 2,00,000 under investing activities. The non-cash transactions –liabilities and asset should be disclosed in the notes to the financial statements.

3.17.1 Changes in liabilities arising from financing activities

- An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.
- To the extent necessary to satisfy the above requirement, an entity shall disclose the following changes in liabilities arising from financing activities:
 - (a) changes from financing cash flows;
 - (b) changes arising from obtaining or losing control of subsidiaries or other businesses;
 - (c) the effect of changes in foreign exchange rates;
 - (d) changes in fair values; and
 - (e) other changes.

- Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities.
- In addition, the disclosure requirement also applies to changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.
- One way to fulfil the disclosure requirement is by providing a reconciliation between the opening and closing balances in the balance sheet for liabilities arising from financing activities, including the changes identified.
- If an entity provides the disclosure required in combination with disclosures of changes in other assets and liabilities, it shall disclose the changes in liabilities arising from financing activities separately from changes in those other assets and liabilities.



3.18 COMPONENTS OF CASH AND CASH EQUIVALENTS

- An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.
- Company will provide a policy which it adopts in determining the composition of cash and cash equivalents (As per Ind AS 1).

It has been clarified, that there should not be a difference in the amount of cash and cash equivalent as per Ind AS 1 and as per Ind AS 7. However, as per Ind AS 7 “where bank overdrafts which are repayable on demand form an integral part of an entity’s cash management, **bank overdrafts are included as a component of cash and cash equivalents**. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.” Although Ind AS 7 permits bank overdrafts to be included as cash and cash equivalent, for the purpose of presentation in the balance sheet, it would not be appropriate to include bank overdraft in the line item cash and cash equivalents unless the netting off conditions as given in paragraph 42 of Ind AS 32, Financial Instruments: Presentation are complied with.

Bank overdraft, in the balance sheet, will be included within financial liabilities. Just because the bank overdraft is included in cash and cash equivalents for the purpose of Ind AS 7, does not mean that the same should be netted off against the cash and cash equivalent balance in the balance sheet. Instead Ind AS 7 requires a disclosure of the components of cash and cash equivalent and a reconciliation of amounts presented in the cash flow statements.

Another element on account of which there could be difference between the cash and cash equivalents presented in the balance sheet and the statement of cash flows is unrealised

gains or losses arising from changes in foreign currency exchange rates, which are not considered to be cash flows. The following illustration would explain the issue:

Illustration 10

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

Solution

For the purpose of statement of cash flows, the entity shall present the following:

	Amount (₹)
Profit before tax	100
Less: Unrealised exchange gain	<u>(100)</u>
Cash flow from operating activities	Nil
Cash flow from investing activities	Nil
Cash flow from financing activities	<u>Nil</u>
Net increase in cash and cash equivalents during the year	Nil
Add: Opening balance of cash and cash equivalents	<u>4,500</u>
Cash and cash equivalents as at the year-end	<u>4,500</u>

Reconciliation of cash and cash equivalents

Cash and cash equivalents as per statement of cash flows	4,500
Add: Unrealised gain on cash and cash equivalents	<u>100</u>
Cash and cash equivalents as per the balance sheet	<u>4,600</u>

If any changes in the policies take place, that will be dealt with as per the provisions of Ind AS 8.



3.19 OTHER DISCLOSURES

An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the group. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.

Additional information may be relevant to users in understanding the financial position and liquidity of an entity. It may include:

1. The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities.
2. The aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity it will help the stakeholders to know whether entity is paying proper attention for maintenance also;
3. The amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see Ind AS 108, *Operating Segments*). This will provide the idea about the company as a whole as well as the various parts of the company and their efficiencies.

Investing and financing transactions that do not require the use of cash or cash equivalents	shall be excluded from a statement of cash flows
	disclosed elsewhere in the financial statements
Components of cash and cash equivalents	disclose the components of cash and cash equivalents
	shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet
	discloses the policy which entity adopts in determining the composition of cash and cash equivalents.
Other disclosures	disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held and are not available for use by the group
	Note: The requirements shall be equally applicable to the entities in case of separate financial statements also.

Illustration 11

Following is the balance sheet of Kuber Limited for the year ended 31 March, 20X2 (₹ in lacs)

	20X2	20X1
ASSETS		
Non-current assets		
Property, plant and equipment	13,000	12,500

Intangible assets	50	30
Other financial assets	145	170
Deferred Tax Asset (net)	855	750
Other non-current assets	<u>800</u>	<u>770</u>
Total non-current assets	<u>14,850</u>	<u>14,220</u>
Current assets		
Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	<u>195</u>	<u>85</u>
Total current assets	<u>2,715</u>	<u>3,045</u>
Total assets	<u>17,565</u>	<u>17,265</u>
EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	<u>12,000</u>	<u>8,000</u>
Total equity	<u>12,300</u>	<u>8,300</u>
Liabilities		
Non-current liabilities		
Financial liabilities		
Long-term borrowings	2,000	5,000
Other non-current liabilities	<u>2,740</u>	<u>3,615</u>
Total non-current liabilities	<u>4,740</u>	<u>8,615</u>
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank overdraft	75	60
Other current liabilities	<u>300</u>	<u>200</u>
Total current liabilities	<u>525</u>	<u>350</u>
Total liabilities	<u>5,265</u>	<u>8,965</u>
Total equity and liabilities	<u>17,565</u>	<u>17,265</u>

Additional Information:

- (1) Profit after tax for the year ended March 31, 20X2 - ₹ 4,450 lacs
- (2) Interim dividend paid during the year - ₹ 450 lacs
- (3) Depreciation and amortisation charged in the statement of profit and loss during the current year are as under
 - (a) Property, Plant and Equipment - ₹ 500 lacs
 - (b) Intangible Assets - ₹ 20 lacs
- (4) During the year ended March 31, 20X2 two machineries were sold for ₹ 70 lacs. The carrying amount of these machineries as on March 31, 20X2 is ₹ 60 lacs.
- (5) Income taxes paid during the year ₹ 105 lacs
- (6) Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method.

Solution**Statement of Cash Flows**

		₹ in lacs
<i>Cash flows from Operating Activities</i>		
Net Profit after Tax	4,450	
Add: Tax Paid	<u>105</u>	
	4,555	
Add: Depreciation & Amortisation (500 + 20)	520	
Less: Gain on Sale of Machine (70-60)	(10)	
Less: Increase in Deferred Tax Asset (855-750)	<u>(105)</u>	
	4,960	
Change in operating assets and liabilities		
Add: Decrease in financial asset (170 - 145)	25	
Less: Increase in other non-current asset (800 - 770)	(30)	
Less: Increase in other current asset (195 - 85)	(110)	
Less: Decrease in other non-current liabilities (3,615 - 2,740)	(875)	
Add: Increase in other current liabilities (300 - 200)	100	
Add: Increase in trade payables (150-90)	<u>60</u>	
	4,130	
Less: Income Tax	<u>(105)</u>	

Cash generated from Operating Activities		4,025
<i>Cash flows from Investing Activities</i>		
Sale of Machinery	70	
Purchase of Machinery [13,000-(12,500 – 500-60)]	(1,060)	
Purchase of Intangible Asset [50-(30-20)]	(40)	
Sale of Financial asset - Investment (2,500 – 2,300)	<u>200</u>	
Cash outflow from Investing Activities		(830)
<i>Cash flows from Financing Activities</i>		
Dividend Paid	(450)	
Long term borrowings paid (5,000 – 2,000)	<u>(3,000)</u>	
Cash outflow from Financing Activities		(3,450)
Net Cash outflow from all the activities		(255)
Opening cash and cash equivalents (460 – 60)		<u>400</u>
Closing cash and cash equivalents (220 – 75)		<u>145</u>

Illustration 12

The relevant extracts of consolidated financial statements of A Ltd. are provided below:

Consolidated Statement of Cash Flows

	For the year ended (₹ in Lac)	
	31 st March 20X2	31 st March 20X1
Assets		
Non-Current Assets		
Property, Plant and Equipment	4,750	4,650
Investment in Associate	800	-
Financial Assets	2,150	1,800
Current Assets		
Inventories	1,550	1,900
Trade Receivables	1,250	1,800
Cash and Cash Equivalents	4,650	3,550
Liabilities		
Current Liabilities		
Trade Payables	1,550	3,610

**Extracts from Consolidated Statement of Profit and Loss
for the year ended 31st March 20X2**

Particulars	Amount (₹ in Lac)
Revenue	12,380
Cost of Goods Sold	(9,860)
Gross Profit	2,520
Other Income	300
Operating Expenses	(450)
Other expenses	(540)
Interest expenses	(110)
Share of Profit of Associate	<u>120</u>
Profit before Tax	<u>1,840</u>

The below information is relevant for A Ltd Group.

1. A Ltd had spent ₹ 30 Lac on renovation of a building. A Ltd charged the entire renovation cost to profit and loss account.
2. On 1st April 20X1, A Ltd acquired 100% shares in S Ltd, for cash of ₹ 300 Lac. Fair value of the assets acquired and liabilities assumed under the acquisition are as under:

Property, Plant and Equipment	140 Lac
Inventories	60 Lac
Trade Receivables	30 Lac
Cash and Cash Equivalents	<u>20 Lac</u>
Total Assets	250 Lac
Less: Trade Payables	<u>(50 Lac)</u>
Net Assets on acquisition	<u>200 Lac</u>

3. A Ltd.'s property, plant and equipment comprise the following:

Carrying amount on 1 st April 20X1	4,650 Lac
Addition (at cost) including assets in S Ltd.	800 Lac
Revaluation Surplus	80 Lac
Disposal (Sale) of Assets	(490 Lac)
Depreciation for the year	(290 Lac)
Carrying Amount on 31 st March 20X2	4,750 Lac

A Ltd constructed a machine that is a qualifying asset and incurred construction costs of ₹ 40 Lac that has been charged to other expenses. Of the interest cost of ₹ 110 Lac charged to profit or loss statement, ₹ 10 Lac includes interest cost on specific borrowings that need to be capitalized.

Property, plant and equipment was sold at 630 Lac. Gain on disposal is adjusted against operating expenses.

4. *A Ltd. purchased 30% interest in an Associate (G Ltd) for cash on 1st April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.*

5. *Impairment test was conducted on 31st March 20X2. The following were impaired as under:*

Goodwill impairment loss: ₹ 265 Lac

Intangible Assets impairment loss ₹ 900 Lac

The goodwill impairment relates to 100% subsidiaries.

Assume that interest cost is all paid in cash.

You are required to determine cash generated from operations for group reporting purposes for the year ended 31st March 20X2.

Solution

Extracts of Statement of Cash Flows for the year ended 31st March 20X2

Cash Flows from Operating Activities		Amount in ₹ Lacs
Profit before tax (W.N.1)		1,920
Less: Profit on Sale of PPE (630 - 490)		(140)
Add back: Depreciation		290
Impairment of Goodwill		265
Impairment of Intangible Assets		900
Less: Share of Profits of Associate (400 x 30%)		(120)
Add: Interest expense	[110 – 10]	100
Working Capital Changes (W.N.2):		
Add: Decrease in Trade Receivables		580
Add: Decrease in Inventories		410
Less: Decrease in Trade Payables		(2,110)
Cash generated from operations		<u>2,095</u>

Working Notes:**1. Profit before tax**

Amount in ₹ Lacs

Reported profit as per Profit or Loss Statement	1,840
Add back: Renovation costs charged as expense	30
Construction costs charged as expense	40
Borrowing costs to be capitalized	<u>10</u>
Revised Profit before tax	<u>1,920</u>

2. Changes in Trade Receivables

Amount in ₹ Lacs

Opening Balance	1,800
Add: Receivables of S Ltd.	<u>30</u>
	1,830
Less: Closing Balance	<u>(1,250)</u>
	<u>580</u>

3. Changes in Inventories

Amount in ₹ Lacs

Opening Balance	1,900
Add: Inventories of S Ltd.	<u>60</u>
	1,960
Less: Closing Balance	<u>(1,550)</u>
	<u>410</u>

4. Changes in Trade Payables

Amount in ₹ Lacs

Opening Balance	3,610
Add: Trade Payables of S Ltd.	<u>50</u>
	3,660
Less: Closing Balance	<u>(1,550)</u>
	<u>2,110</u>



3.20 EXTRACTS OF FINANCIAL STATEMENTS OF LISTED ENTITY

Following is the extract from the financial statements of the listed entity 'ITC Limited' for the financial year 2021-2022 with respect to 'Cash Flow Statement'.

Cash Flow Statement for the year ended 31st March, 2022

	For the year ended 31st March, 2022 (₹ in Crores)	For the year ended 31st March, 2021 (₹ in Crores)
A. Cash Flow from Operating Activities		
PROFIT BEFORE TAX	19829.53	17164.19
ADJUSTMENTS FOR:		
Depreciation and amortization expense	1652.15	1561.83
Share based payments to employees	32.51	27.15
Finance costs	41.95	47.47
Interest Income	(1004.59)	(1224.82)
Dividend Income	(857.46)	(723.94)
(Gain)/Loss on sale of property, plant and equipment, lease termination - Net	(59.05)	55.04
Doubtful and bad debts	10.64	25.98
Doubtful and bad advances, loans and deposits	1.15	33.04
Net (gain)/loss arising on financial instruments mandatorily measured at fair value through profit or loss	(524.19)	(1107.53)
Foreign currency translations and transactions - Net	11.07 (695.82)	(13.00) (1318.78)
OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES	19133.71	15845.41
ADJUSTMENTS FOR:		
Trade receivables, advances and other assets	(235.39)	(99.11)
Inventories	(526.90)	(1350.89)
Trade payables, other liabilities and provisions	946.39 184.10	1055.07 (394.93)
CASH GENERATED FROM OPERATIONS	19317.81	15450.48
Income tax paid	(4510.02)	(3956.62)
NET CASH FROM OPERATING ACTIVITIES	14807.79	11493.86

B. Cash Flow from Investing Activities		
Purchase of property, plant and equipment, Intangibles, ROU asset etc.	(1812.03)	(1582.09)
Sale of property, plant and equipment	137.22	2.66
Purchase of current investments	(60325.53)	(51625.18)
Sale/redemption of current investments	63554.78	56785.92
Payment towards business combination/contingent purchase consideration	(71.25)	(2189.22)
Investment in subsidiaries	(427.24)	(361.57)
Investment in associate	(1.87)	(1.87)
Purchase of non-current investments	(4777.02)	(1488.71)
Redemption proceeds of non-current investments	2731.24	1712.05
Dividend Income	857.46	723.94
Interest received	962.97	1199.36
Investment in bank deposits (original maturity more than 3 months)	(3525.01)	(3706.02)
Redemption/maturity of bank deposits (original maturity more than 3 months)	3617.42	6259.37
Investment in deposit with housing finance company	(3011.37)	(78.38)
Redemption/maturity of deposit with housing finance companies	578.82	844.43
Loans given	(12.51)	(2.12)
Loans realised	6.86	5.32
NET CASH FROM/(USED IN) INVESTING ACTIVITIES	(1517.06)	6497.89

Cash Flow Statement for the year ended 31st March, 2022

	For the year ended 31st March, 2022 (₹ in Crores)	For the year ended 31st March, 2021 (₹ in Crores)
C. Cash Flow from Financing Activities		
Proceeds from issue of share capital	291.82	290.65
Repayment of non-current borrowings	(0.35)	(2.26)
Payment of lease liabilities	(54.42)	(49.67)
Interest paid	(42.14)	(43.47)
Net increase in statutory restricted accounts balances	15.13	41.17
Dividend paid	(13547.07)	(18629.29)
Dividend distribution tax refund received	—	13.98
NET CASH USED IN FINANCING ACTIVITIES	(13337.03)	(18378.89)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(46.30)	(387.14)
OPENING CASH AND CASH EQUIVALENTS	231.28	561.35
CASH AND CASH EQUIVALENTS ACQUIRED ON BUSINESS COMBINATION [See Note 3 below]	—	57.07
CLOSING CASH AND CASH EQUIVALENTS	184.98	231.28

Notes:

- The above Cash Flow Statement has been prepared under the "Indirect Method" as set out in Ind AS - 7 "Statement of Cash Flows"
- CASH AND CASH EQUIVALENTS:**

Cash and cash equivalents as above	184.98	231.28
Unrealised gain/(loss) on foreign currency cash and cash equivalents	(0.01)	...
Cash and cash equivalents (Note 11)	<u>184.97</u>	<u>231.28</u>
- Cash and Cash Equivalents include ₹ Nil (2021 - ₹ 57.07 Crores) on acquisition of erstwhile Sunrise Foods Private Limited and its two wholly owned subsidiaries.
- Net Cash Flow from Operating Activities includes an amount of ₹ 340.96 Crores (2021- ₹ 368.18 Crores) spent towards Corporate Social Responsibility.

(Source: Annual Report 2021-2022 - 'ITC Limited')



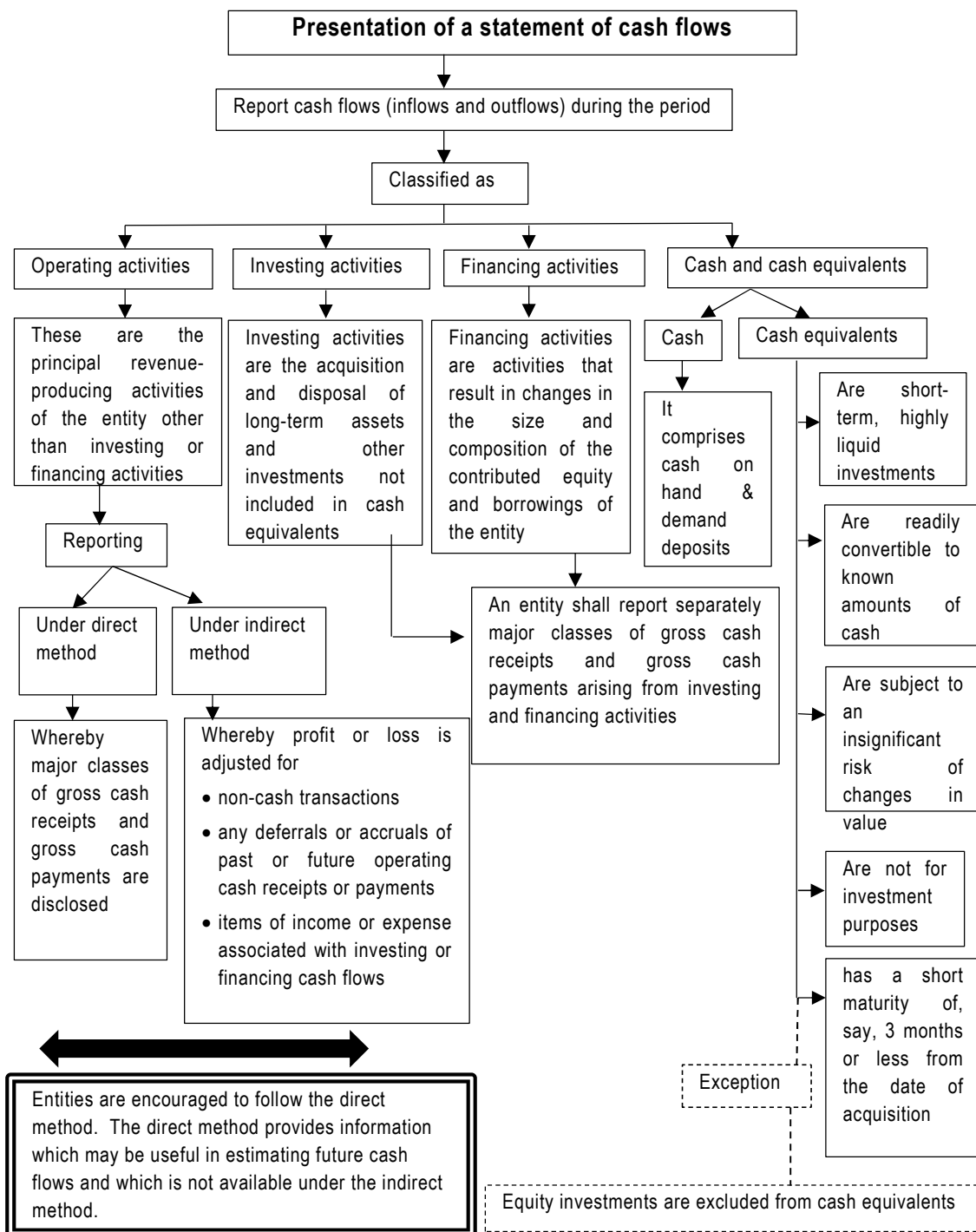
3.21 SIGNIFICANT DIFFERENCES IN IND AS 7 VIS-À-VIS AS 3

S.No.	Particulars	Ind AS 7	AS 3
1.	<i>Bank Overdraft Repayable on Demand</i>	Ind AS 7 specifically includes bank overdrafts which are repayable on demand as a part of cash and cash equivalents (Refer Para 8 of Ind AS 7)	AS 3 is silent on this aspect.
2.	<i>Treatment of Cash Payments in Specific Cases</i>	Ind AS 7 provides the treatment of cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business as cash flows from operating activities. Further, treatment of cash receipts from rent and subsequent sale of such assets as cash flow from operating activity is also provided. (Refer Para 14 of Ind AS 7)	AS 3 does not contain such requirements.
3.	<i>Examples of cash flows arising from financing activities</i>	Ind AS 7 includes following examples of cash flows arising from financing activities (paragraph 17 of Ind AS 7): (a) cash payments to owners to acquire or redeem the entity's shares; (b) cash proceeds from mortgages; (c) cash payments by a lessee for the reduction of the outstanding liability relating to a lease.	These examples are not mentioned in AS 3
4.	<i>Adjustment of the Profit or Loss for the Effects of Undistributed Profits of</i>	Ind AS 7 specifically requires adjustment of the profit or loss for the effects of 'undistributed profits of associates and non-controlling interests' while determining the net	AS 3 does not contain such requirements.

	<i>Associates and Non-controlling Interests</i>	cash flow from operating activities using the indirect method. (Refer Para 20(b) of Ind AS 7)	
5.	<i>Cash Flows associated with Extraordinary Activities</i>	Ind AS 7 does not contain this requirement.	AS 3 requires cash flows associated with extraordinary activities to be separately classified as arising from operating, investing and financing activities
6.	<i>Disclosure of the Amount of Cash and Cash Equivalents in Specific Situations</i>	Ind AS 7 requires an entity (except an investment entity) to disclose the amount of cash and cash equivalents and other assets and liabilities in the subsidiaries or other businesses over which control is obtained or lost (Refer Para 40(c) and (d) of Ind AS 7). It also requires to report the aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses in the statement of cash flows, net of cash and cash equivalents acquired or disposed of as a part of such transactions, events or changes in circumstances (Refer Para 42 of Ind AS 7).	AS 3 does not contain such requirements.
7.	<i>Cash Flows arising from Changes in Ownership Interests in a Subsidiary</i>	Ind AS 7 requires to classify cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control as cash flows from financing activities (Refer Para 42A and 42B of Ind AS 7).	AS 3 does not contain such a requirement.

8.	<i>Investment in an associate, joint venture or a subsidiary</i>	Ind AS 7 mentions the use of equity or cost method while accounting for an investment in an associate, joint venture or a subsidiary (refer paragraph 37 of Ind AS 7). It also specifically deals with the reporting of interest in an associate or a joint venture using equity method (refer paragraph 38 of Ind AS 7).	AS 3 does not contain such requirements.
9.	<i>Cash flows arising from transaction in a foreign currency</i>	With regard to cash flows arising from transaction in a foreign currency, Ind AS 7 requires it to be recorded in an entity's functional currency. Ind AS 7 also deals with translation of cash flows of a foreign subsidiary (refer paragraphs 25 to 27 of Ind AS 7)	AS 3 requires it to be recorded in an entity's 'reporting currency'. AS 3 does not deal with it.
10.	<i>Disclosure of changes in liabilities</i>	Ind AS 7 requires disclosure of changes in liabilities arising from financing activities, both changes i.e. changes arising from cash flows and non-cash changes.	AS 3 does not contain such requirement.
11.	<i>Disclosures</i>	Ind AS 7 requires more disclosures, i.e. additional information that may be relevant to understanding the financial position and liquidity of an entity (Refer Paragraph 50 of the Ind AS 7)	In comparison to Ind AS 7, AS 3 does not have that many disclosure requirements.

QUICK RECAP



FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. Use the following data of ABC Ltd. to construct a statement of cash flows using the direct and indirect methods: (Amount in ₹)

	20X2	20X1
Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	<u>(45,000)</u>	<u>(30,000)</u>
Total Assets	<u>3,42,000</u>	<u>3,27,500</u>
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	<u>59,000</u>	<u>60,500</u>
Total Liabilities & Equity	<u>3,42,000</u>	<u>3,27,500</u>
	20X2	
Sales	2,00,000	
Cost of Goods Sold	(1,23,000)	

Depreciation	(15,000)	
Insurance Expense	(11,000)	
Wages	<u>(50,000)</u>	
Net Profit	<u>1,000</u>	

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

During 20X2, ABC Ltd. paid ₹ 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

- From the following summary cash account of XYZ Ltd, prepare cash flow statement for the year ended March 31, 20X1 in accordance with Ind AS 7 using direct method.

Summary of Bank Account for the year ended March 31, 20X1

	₹ '000		₹ '000
Balance on 1.4.20X0	50	Payment to creditors	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Payroll	100
		Tax Payment	250
		Dividend	50
		Repayment of Bank loan	300
		Balance on 31.3.20X1	<u>150</u>
	<u>3,250</u>		<u>3,250</u>

- Z Ltd. has no foreign currency cash flow for the year 20X1. It holds some deposit in a bank in the USA. The balances as on 31.12.20X1 and 31.12.20X2 were US\$ 100,000 and US\$ 102,000 respectively. The exchange rate on December 31, 20X1 was US\$1 = ₹ 45. The same on 31.12.20X2 was US\$1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.20X2. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 20X1. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.20X2. How these transactions should be presented in cash flow for the year ended 31.12.20X2 as per Ind AS 7?
- Company A acquires 70% of the equity stake in Company B on July 20, 20X1. The consideration paid for this transaction is as below:
 - Cash consideration of ₹ 15,00,000
 - 200,000 equity shares having face of ₹ 10 and fair value of ₹ 15 per share.

On the date of acquisition, Company B has cash and cash equivalent balance of ₹ 2,50,000 in its books of account.

On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of ₹ 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7.

5. Entity A acquired a subsidiary, Entity B, during the year. Summarised information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information.

Consolidated Statement of Profit and Loss

	Amount (₹)
Revenue	3,80,000
Cost of sales	<u>(2,20,000)</u>
Gross profit	1,60,000
Depreciation	(30,000)
Other operating expenses	(56,000)
Interest cost	<u>(4,000)</u>
Profit before taxation	70,000
Taxation	<u>(15,000)</u>
Profit after taxation	<u>55,000</u>

Consolidated balance sheet

	20X2	20X1
Assets	Amount	Amount
	(₹)	(₹)
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	<u>18,000</u>	<u>—</u>
Total assets	<u>2,70,000</u>	<u>1,70,000</u>
Liabilities		
Trade payables	68,000	60,000

Income tax payable	12,000	11,000
Long term debt	<u>1,00,000</u>	<u>64,000</u>
Total liabilities	<u>1,80,000</u>	<u>1,35,000</u>
Shareholders' equity	<u>90,000</u>	<u>35,000</u>
Total liabilities and shareholders'	2,70,000	1,70,000

Other information

All of the shares of entity B were acquired for ₹ 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	Amount (₹)
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)
Goodwill	<u>18,000</u>
Cash consideration paid	<u>74,000</u>

Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

6. During the financial year 2019-2020, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:
- Capital gain tax of ₹ 20 crore on sale of office premises at a sale consideration of ₹ 100 crore.
 - Income Tax of ₹ 3 crore on Business profits amounting ₹ 30 crore (assume entire business profit as cash profit).
 - Dividend Distribution Tax of ₹ 2 crore on payment of dividend amounting ₹ 20 crore to its shareholders.
 - Income tax Refund of ₹ 1.5 crore (Refund on taxes paid in earlier periods for business profits).

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS.

7. From the following data of Galaxy Ltd., prepare statement of cash flows showing cash generated from Operating Activities using direct method as per Ind AS 7:

	31.3.20X2 (₹)	31.3.20X1 (₹)
Current Assets:		
Inventory	1,20,000	1,65,000
Trade receivables	2,05,000	1,88,000
Cash & cash equivalents	35,000	20,500
Current Liabilities:		
Trade payable	1,95,000	2,15,000
Provision for tax	48,000	65,000

Summary of Statement of Profit and Loss		₹
Sales	85,50,000	
Less: Cost of sales	<u>(56,00,000)</u>	29,50,000
Other Income		
Interest income	20,000	
Fire insurance claim received	<u>1,10,000</u>	<u>1,30,000</u>
		30,80,000
Depreciation	(24,000)	
Administrative and selling expenses	(15,40,000)	
Interest expenses	(36,000)	
Foreign exchange loss	<u>(18,000)</u>	<u>(16,18,000)</u>
Net Profit before tax and extraordinary income		14,62,000
Income Tax		<u>(95,000)</u>
Net Profit		<u>13,67,000</u>

Additional information:

- (i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.
 - (ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.
8. What will be the classification for following items in the statement of cash flows of both (i) Banks / Financial institutions and (ii) Other Entities?

S. No.	Particulars
1	Interest received on loans and advances given
2	Interest paid on deposits and other borrowings
3	Interest and dividend received on investments in subsidiaries, associates and in

	other entities
4	Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities
5	Finance charges paid by lessee under finance lease
6	Payment towards reduction of outstanding finance lease liability
7	Interest paid to vendor for acquiring fixed asset under deferred payment basis
8	Principal sum payment under deferred payment basis for acquisition of fixed assets
9	Penal interest received from customers for late payments
10	Penal interest paid to suppliers for late payments
11	Interest paid on delayed tax payments
12	Interest received on tax refunds

Answers

1. A. DIRECT METHOD

Cash flows from operating activities		20X2
Cash received from customers	2,07,500	
Cash paid for inventory	(1,24,000)	
Cash paid for insurance	(9,000)	
Cash paid for wages	<u>(53,000)</u>	
<i>Net cash flow from operating activities</i>		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issuance of debentures	13,000	
Proceeds from issue of equity	<u>4,000</u>	
<i>Net cash flows from financing activities</i>		<u>14,500</u>
Net decrease in cash and cash equivalents		(10,000)
Opening Cash Balance		<u>14,000</u>
Closing Cash Balance		<u>4,000</u>

B. INDIRECT METHOD

Cash flows from operating activities		20X2
Net Profit	1,000	
Adjustments for Depreciation	<u>15,000</u>	

	16,000	
Decrease in accounts receivable	7,500	
Decrease in prepaid insurance	2,000	
Increase in inventory	(3,000)	
Increase in accounts payable	2,000	
Decrease in wages payable	<u>(3,000)</u>	
<i>Net cash flow from operating activities</i>		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issue of debentures	13,000	
Proceeds from issue of equity	<u>4,000</u>	
<i>Net cash flows from financing activities</i>		<u>14,500</u>
Net decrease in cash and cash equivalents		(10,000)
Opening Cash Balance		<u>14,000</u>
Closing Cash Balance		<u>4,000</u>

Working Notes:**Fixed Assets Account**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	2,70,000	By Balance c/d	3,16,000
To Cash (Purchase of Fixed Assets)	<u>46,000</u>		
	<u>3,16,000</u>		<u>3,16,000</u>

Inventory Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	34,000	By Cost of goods sold	1,23,000
To Creditors account (credit purchase)	2,000	By Balance c/d	37,000
To Purchase (Bal. Figure)	<u>1,24,000</u>		
	<u>1,60,000</u>		<u>1,60,000</u>

Accounts Payable Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	18,000	By Balance b/d	16,000
		By Inventory Account (credit purchase) (Bal.Fig.)	2,000
	<u>18,000</u>		<u>18,000</u>

Equity Share Capital Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	88,000	By Balance b/d	84,000
		By Bank account (Proceeds from equity share issued)	4,000
	<u>88,000</u>		<u>88,000</u>

2.

XYZ Ltd.**Cash Flow Statement for the year ended March 31, 20X1 (Using the Direct Method)**

Cash flows from operating activities	₹ '000	₹ '000
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	<u>(200)</u>	
Cash generated from operations	500	
Income tax paid	<u>(250)</u>	
Net cash from operating activities		250
Cash flow from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	<u>100</u>	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	

Dividend paid	<u>(50)</u>	
<i>Net cash used in financing activities</i>		<u>(50)</u>
Net increase in cash		100
Cash at the beginning of the period		<u>50</u>
Cash at end of the period		<u>150</u>

3. The profit and loss account was credited by ₹ 1,00,000 (US \$ 2,000 × ₹ 50) towards interest income. It was credited by the exchange difference of US\$ 1,00,000 × (₹ 50 - ₹ 45) that is, ₹ 500,000. In preparing the cash flow statement, ₹ 5,00,000, the exchange difference, should be deducted from the 'net profit before taxes'. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference ₹ 5,00,000, should be added to the opening balance in note to cash flow statement.

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

4. As per para 39 of Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities.

As per para 42 of Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

As per para 42A of Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss. Such transactions are accounted for as equity transactions and accordingly, the resulting cash flows are classified in the same way as other transactions with owners.

Considering the above, for the financial year ended 31st March, 20X2 total consideration of ₹ 15,00,000 less ₹ 250,000 will be shown under investing activities as "Acquisition of the subsidiary (net of cash acquired)".

There will not be any impact of issuance of equity shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non-cash consideration.

Further, in the statement of cash flows for the year ended 31st March, 20X3, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.

5. This information will be incorporated into the Consolidated Statement of Cash Flows as follows:

Statement of Cash Flows for the year ended 20X2 (extract)

	Amount (₹)	Amount (₹)
Cash flows from operating activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (W.N. 1)	9,000	
Decrease in trade receivables (W.N. 2)	4,000	
Decrease in trade payables (W.N. 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	<u>(14,000)</u>	
<i>Net cash generated from operating activities</i>		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	<u>(72,000)</u>	
<i>Net cash outflow from investing activities</i>		(72,000)
Cash flows from financing activities		
Interest paid	<u>(4,000)</u>	
<i>Net cash outflow from financing activities</i>		<u>(4,000)</u>
Increase in cash and cash equivalents during the year		3,000
Cash and cash equivalents at the beginning of the year		<u>5,000</u>
Cash and cash equivalents at the end of the year		<u>8,000</u>

Working Notes:

1. Calculation of change in inventory during the year	₹
Total inventories of the Group at the end of the year	30,000
Inventories acquired during the year from subsidiary	<u>(4,000)</u>

	26,000
Opening inventories	<u>35,000</u>
Decrease in inventories	<u>9,000</u>

2. Calculation of change in Trade Receivables during the year	₹
Total trade receivables of the Group at the end of the year	54,000
Trade receivables acquired during the year from subsidiary	<u>(8,000)</u>
	46,000
Opening trade receivables	<u>50,000</u>
Decrease in trade receivables	<u>4,000</u>

3. Calculation of change in Trade Payables during the year	₹
Trade payables at the end of the year	68,000
Trade payables of the subsidiary assumed during the year	<u>(32,000)</u>
	36,000
Opening trade payables	<u>60,000</u>
Decrease in trade payables	<u>24,000</u>

6. Para 36 of Ind AS 7 inter alia states that when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Accordingly, the transactions are analysed as follows:

Particulars	Amount (in crore)	Activity
Sale Consideration	100	Investing Activity
Capital Gain Tax	(20)	Investing Activity
Business profits	30	Operating Activity
Tax on Business profits	(3)	Operating Activity
Dividend Payment	(20)	Financing Activity
Dividend Distribution Tax	(2)	Financing Activity
Income Tax Refund	<u>1.5</u>	Operating Activity
Total Cash flow	<u>86.5</u>	

Activity wise	Amount (in crore)
Operating Activity	28.5
Investing Activity	80
Financing Activity	(22)
Total	<u>86.5</u>

7. **Statement Cash Flows from operating activities**
of Galaxy Ltd. for the year ended 31st March 20X2 (Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from Trade receivables (W.N. 3)		85,33,000
Less: Cash paid to Suppliers (W.N.2)	55,75,000	
Payment for Administration and Selling expenses	15,40,000	
Payment for Income Tax (W.N.4)	1,12,000	(72,27,000)
		13,06,000
Adjustment for exceptional items (fire insurance claim)		1,10,000
Net cash generated from operating activities		14,16,000

Working Notes:

1. **Calculation of total purchases**

Cost of Sales = Opening stock + Purchases – Closing Stock

₹ 56,00,000 = ₹ 1,65,000 + Purchases – ₹ 1,20,000

Purchases = ₹ 55,55,000

2. **Calculation of cash paid to Suppliers**

Trade Payables

	₹		₹
To Bank A/c (balancing figure)	55,75,000	By Balance b/d	2,15,000
To Balance c/d	<u>1,95,000</u>	By Purchases (W.N. 1)	<u>55,55,000</u>
	<u>57,70,000</u>		<u>57,70,000</u>

3. Calculation of cash received from Customers

Trade Receivables

	₹		₹
To Balance b/d	1,88,000	By Bank A/c (balancing figure)	85,33,000
To Sales	<u>85,50,000</u>	By Balance c/d	<u>2,05,000</u>
	<u>87,38,000</u>		<u>87,38,000</u>

4. Calculation of tax paid during the year in cash

Provision for tax

	₹		₹
To Bank A/c (balancing figure)	1,12,000	By Balance b/d	65,000
To Balance c/d	<u>48,000</u>	By Profit and Loss A/c	<u>95,000</u>
	<u>1,60,000</u>		<u>1,60,000</u>

8. The following are the classification of various activities in the Statement of Cash Flows:

S. No.	Particulars	Classification for reporting cash flows	
		Banks / financial institutions	Other entities
1	Interest received on loans and advances given	Operating Activities	Investing activities
2	Interest paid on deposits and other borrowings	Operating Activities	Financing activities
3	Interest and dividend received on investments in subsidiaries, associates and in other entities	Investing activities	Investing activities
4	Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities	Financing activities	Financing activities
5	Finance charges paid by lessee under finance lease	Financing activities	Financing activities
6	Payment towards reduction of outstanding finance lease liability	Financing activities	Financing activities

7	Interest paid to vendor for acquiring fixed asset under deferred payment basis	Financing activities	Financing activities
8	Principal sum payment under deferred payment basis for acquisition of fixed assets	Investing activities	Investing activities
9	Penal interest received from customers for late payments	Operating Activities	Operating Activities
10	Penal interest paid to suppliers for late payments	Operating Activities	Operating Activities
11	Interest paid on delayed tax payments	Operating Activities	Operating Activities
12	Interest received on tax refunds	Operating Activities	Operating Activities

[illegible]

IND AS ON MEASUREMENT BASED ON ACCOUNTING POLICIES

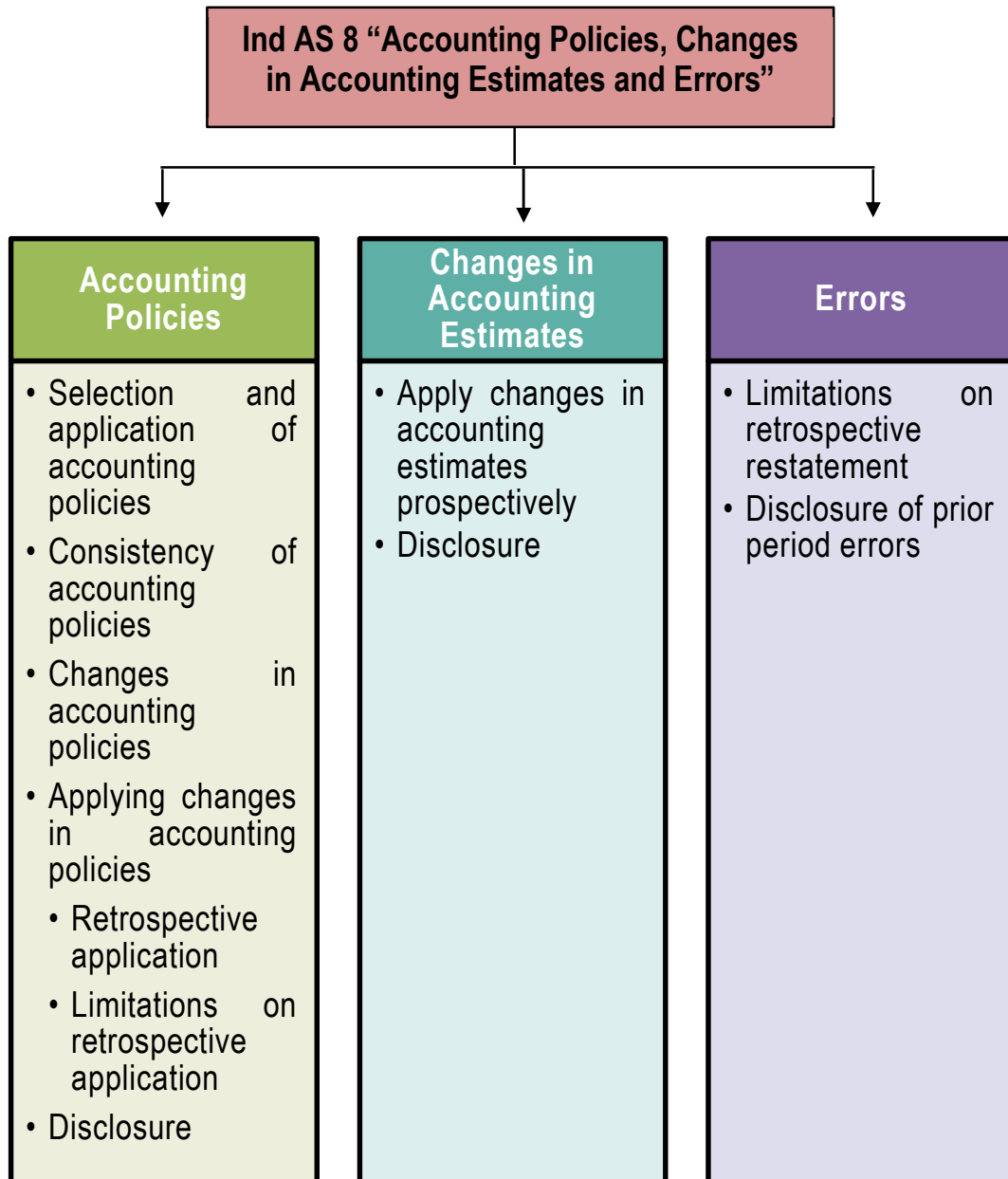


UNIT 1: INDIAN ACCOUNTING STANDARD 8 : ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- ☐ Apply the principles laid down for selection of accounting policies.
- ☐ Explain the treatment of changes in accounting policies, changes in accounting estimates and correction of prior period errors.
- ☐ Distinguish between accounting policies, estimates, changes in them and errors.
- ☐ Assess the limitations of giving retrospective effect while accounting.
- ☐ Judge the impracticability of a requirement for giving retrospective effect.

UNIT OVERVIEW 



1.1 INTRODUCTION

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

Accounting policies, estimates and correction of errors play a major role in the presentation of financial statements. That is why Ind AS 1 states that an entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material. If there is any change in accounting policies, that needs to be dealt with due diligence and not just by mere note or explanation.

Further, Ind AS 1 makes it mandatory for the entity to present a third balance sheet as at the beginning of the preceding period, if it applies an accounting policy retrospectively, which has a material effect on the information in the balance sheet at that date.

Further, Ind AS 1 provides detail guidance about the proper disclosure of accounting policies and estimates.

Therefore, in the current chapter we are going to see, how to select the accounting policies, how to make the changes in accounting policies if needed, how to deal with changes in the estimates, how to rectify errors, etc., as all these elements will have impact on the true and fair position of the financial statements.



1.2 OBJECTIVE

1.2.1 To prescribe the criteria for selecting and changing accounting policies

As per Ind AS 1, an entity is required to disclose the significant accounting policies. However, it does not specify which accounting policies are to be disclosed. Depending upon the nature of business and types of transactions, the entity is supposed to decide whether an accounting policy is to be disclosed. In this regard, Ind AS 1 lays emphasis on usefulness of the disclosure in assisting the users in understanding financial statements, nature of an entity's operations and expectations of users. Ind AS 8 further provides some criteria / guidelines which will facilitate the entity to take a decision on selection and application of accounting policies and also making changes in them.

1.2.2 To prescribe the accounting treatment and disclosure of changes in accounting policies

At certain times, there is a need to make the changes in the policies in the light of changing circumstances of business, changing nature of business, new guidelines issued by regulatory authorities, enforcement of new laws etc. In such cases, an entity needs guidance as to whether the changes need to be affected retrospectively or only prospectively and how to present and disclose the effect of the same in the financial statements. Ind AS 8 provides guidance to the entity in such areas.

1.2.3 To prescribe the accounting treatment and disclosure of changes in accounting estimates

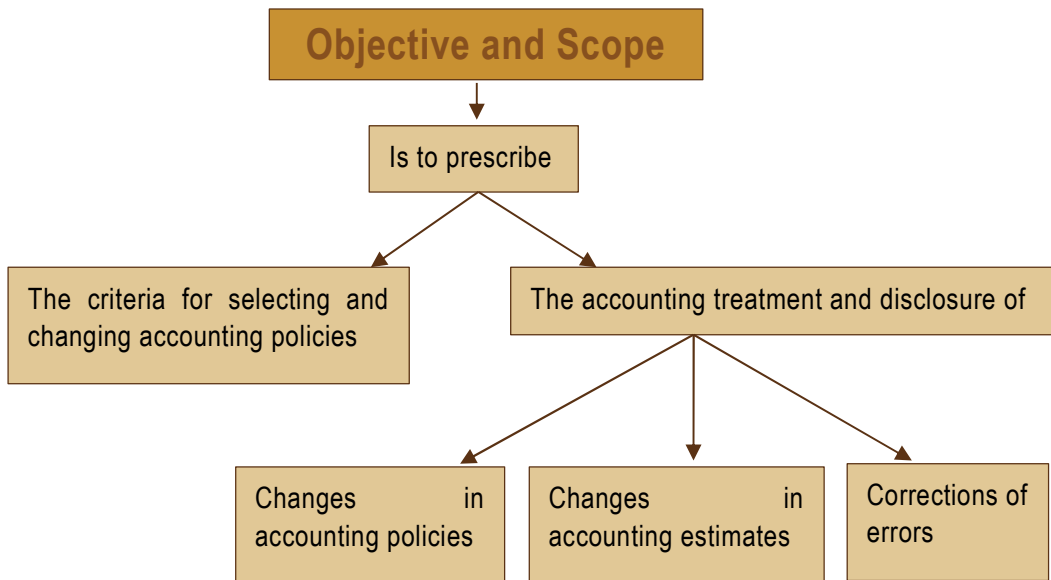
In business, there are many things which are uncertain. For example, how many trade receivables will turn bad? What will be the estimated life of property, plant and equipment? What will be the value of investments? Will the net realisable value of closing inventory be more or less than the actual realised value less actual costs of completion and actual costs necessary to make the sale? And so on. In such cases, the entity will have to make few assumptions and make an estimate. Ind AS 1 allows an entity to do the estimation. Ind AS 8 takes it further and deals with how to incorporate the changes in the accounting estimates already made in the past. Is it possible to change such estimates with changing circumstances and available new information? If yes, how would the entity incorporate the effect of the changes? Such questions are addressed in Ind AS 8.

1.2.4 To prescribe the accounting treatment and disclosure of corrections of errors

It is said that 'to err is human'. Making mistakes is an integral part of life and the possibility of having some errors in the financial statements already published cannot be ruled out. In such cases, the question arises as to how to rectify the errors and provide the true and fair position to the stakeholders of financial statements. Should the entity rectify the error by way of retrospective restatement or should it rectify the same in the current reporting period? Such questions are addressed in Ind AS 8.

1.2.5 To provide better base for inter-firm and intra-firm comparison

The standard is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities.



1.3 SCOPE

This standard shall be applied in

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

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

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



1.4 DEFINITIONS

1. **Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
2. **Accounting estimates** are monetary amounts in financial statements that are subject to measurement uncertainty.

3. **Indian Accounting Standards (Ind AS)** are Standards prescribed under Section 133 of the Companies Act, 2013 read with Companies (Indian Accounting Standards) Rules, 2015 (as amended from time to time).
4. **Material** – (As per Ind AS 1) Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:

- (a) information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;
- (b) information regarding a material item, transaction or other event is scattered throughout the financial statements;
- (c) dissimilar items, transactions or other events are inappropriately aggregated;
- (d) similar items, transactions or other events are inappropriately disaggregated; and
- (e) the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances.

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

The application of the concept of materiality is set out in two Standards. Ind AS 1 continues to specify its application to disclosures and Ind AS 8 specifies the application of materiality in applying accounting policies and correcting errors (including errors in measuring items).

5. **Prior period errors** are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:
 - (a) was available when financial statements for those periods were approved for issue; and
 - (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
6. **Retrospective application** is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
7. **Retrospective restatement** is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.
8. **Impracticable:** Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:
 - (a) the effects of the retrospective application or retrospective restatement are not determinable;
 - (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
 - (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
 - (ii) would have been available when the financial statements for that prior period were approved for issue from other information.
9. **Prospective application** of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

- (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and
- (b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.



1.5 ACCOUNTING POLICIES

1.5.1 Selection and application of accounting policies

When an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.

Ind AS 1 narrates the importance of accounting policies but Ind AS 8 goes a step further and gives guidance to the entity as to how to select and apply accounting policies.

Let us take few examples of accounting policies:

- (a) Basis of accounting – Cash or accrual or hybrid?
- (b) Method of determination of cost of inventories – FIFO or specific identification or Weighted Average?
- (c) What is included in cash equivalents and what is excluded from cash equivalents?
- (d) When should revenue be recognised?

Thus, one will notice that while preparing the financial statements, the entity has to make numerous assumptions and define the base for measurement of particular transactions, other events or conditions. If every entity follows a different base or a different rule or a different convention according to their convenience/ interpretation, then it will be impossible to compare the financial statements across entities having similar nature of business. Therefore, the role of Ind AS is very important in selection and application of the policies.

As per Ind AS 8, if any of the Ind AS already specifies the guidelines about following a particular policy then entity **must** follow that standard and apply the policy as per the guidance provided. Moreover, an entity can also refer to guidance notes which are published by ICAI, along with the relevant Ind AS, if there is an ambiguity or there is need to go into the depth of a particular transaction.

1.5.2 Is it compulsory to apply accounting policies?

- Ind AS set out accounting policies that result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply.
- Those policies need not be applied when the effect of applying them is immaterial.

- However, it is inappropriate to make, or leave uncorrected, immaterial departures from Ind AS to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Analysis

Ind AS leaves the judgement to the entity to decide whether it would be material or not material to apply any accounting policy. Users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

1.5.3 How to select and apply an accounting policy when specific Ind AS is not available on the particular transaction / condition / event?

- In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
 - (a) relevant to the economic decision-making needs of users; and
 - (b) reliable in that the financial statements:
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, i.e. free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.

Analysis

The businesses may have large variety of transactions in terms of their nature and size. Though Ind AS cover most of the transactions which are of general nature for any type of business, there is possibility of new business models coming into picture and new technologies changing the face of the business, resulting in some new and complex types of transactions. In such circumstances it will be difficult to find the appropriate accounting standard for such specific transactions.

Example 1

Before the wake of online transactions of capital markets, the trading of shares used to take place mainly through brokers and stock exchanges. However, OTC online terminals changed the face of the capital markets, giving direct access to the layman to trading transactions. Even if the basic nature of business was same, the technology changed the face of the business, and many giant financial institutions became the dominant players in the market as brokerage firms. In view of the changing circumstances, SEBI and ICAI have come up with new guidelines and new standards which will cater to the need of new business models, such as trading in derivatives. However, there was a period of transformation when new transactions were slowly creeping in, but the guidelines were in the preparatory phase.

In such circumstances, Ind AS 8 provides the following guiding principles for selecting and applying the accounting policies. The main two objectives to be kept in mind while making the decision for selecting an accounting policy would be:

- (i) **Whether it is relevant?** The basic purpose of presenting financial statements is to facilitate the economic decision making of the stakeholders, which would be based on the information provided in the financial statements. So, if the management is of the opinion that an accounting policy related to a particular transaction/ condition / event results in information that is going to help the users to make the economic decisions, then the entity must select and apply such accounting policy as it is relevant for decision making.
 - (ii) **Whether it is reliable?** The information will be said to be reliable if it makes a faithful representation, unbiased, prudent, complete in all material respects and it reflects substance of the transaction and is not presented solely with a purpose of adhering to the law.
- In making the judgement, management shall refer to, and consider the applicability of, the following sources in descending order:
 - (a) the requirements in Ind AS dealing with similar and related issues; and
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework).
 - Management may also first consider the most recent pronouncements of International Accounting Standards Board (IASB) and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources mentioned above.

Analysis

There is a need to have some authentic base for selecting and applying the accounting policy. Even if it is left to the judgement of the entity, there has to be some basis for making the judgement. It cannot be left to the personal opinions/ understanding/ intuitions of the people working for the entity. In view of this, Ind AS 8 requires that in absence of specific Ind AS, the entity should refer to the following material, in their descending order. Accordingly, Ind AS 8 provides the following list:

- (i) Check if there are any other Ind AS available which are dealing with **similar and related** issues
- (ii) Check the basic Conceptual Framework of Ind AS, which provides the general principles
- (iii) Check the pronouncements of International Accounting Standard Board
- (iv) Check the pronouncements of other standard setting bodies having a similar conceptual framework
- (v) Check the accounting literature and accepted industry practices.

1.5.4 Consistency of accounting policies

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate. If an Ind AS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Analysis

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

Examples 2 & 3

2. An entity has grouped its property, plant and equipment into four classes viz., land, factory building, plant and machinery and furniture. The entity may propose to apply revaluation model only to land. It need not apply this model to building or plant and machinery.
3. Ind AS 2 'Inventories' requires that inventory be valued at lower of cost and net realizable value. In identifying cost, it allows alternative cost formulas; FIFO and Weighted average.

The same cost formula must be applied to items of inventory having similar nature or use, but a different cost formula can be applied to a different classification of inventory.

1.5.5 Changes in accounting policies

- An entity shall change an accounting policy only if the change:
 - (a) is required by an Ind AS; or
 - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Example 4 - Voluntary change in accounting policy

As per Ind AS 27 'Separate Financial Statements', investment in subsidiaries, associates and joint ventures are accounted for in an entity's separate financial statements at cost or in accordance with Ind AS 109 (i.e., at fair value). The same accounting is required to be applied for each category of investment.

Assume that an entity decides to change its policy of measuring investment in subsidiaries (or associates or joint ventures) from cost to fair value in accordance with Ind AS 109, as this will result in the financial statements providing reliable and more relevant information.

This would constitute a voluntary change in accounting policy.

- Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the above criteria.

Analysis

Continuing with the same rationale, the frequent changes in accounting policies are not permitted by Ind AS 8. Frequent changes in accounting policies will make it impossible for a stakeholder to make the economic decisions properly.

For example, suppose an entity has been following the FIFO method of determination of cost for inventories. In the current year, it shifts from FIFO to weighted average method. Assuming that cost is less than NRV, it means the opening stock is valued at FIFO method whereas closing stock is valued at Weighted Average Method, if retrospective application of the change is impracticable. This will directly impact the gross profit measurement of the entity. Additionally, the opening inventories and closing inventories will not be comparable. Moreover, if the investment companies and banks are using the information for calculation of liquidity, then, the liquidity ratios based on opening inventory and closing inventory may

show major discrepancies. Thus, changing the base will not only affect the true and fair position of the financial statements but it will also affect the decision making of the stakeholders.

In view of the above, Ind AS 8 allows the entity to change the accounting policy only in following circumstances:

- (a) when the change is required by an Ind AS; or
 - (b) when the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
- The following are not changes in accounting policies:
 - (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and
 - (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.

Analysis

Ind AS 8 clearly states that if the entity applies an accounting policy which is different from the previous one to a transaction, other event or condition that differs in substance from a previously occurring transaction, other event or condition, the application of the new policy will not be considered as a change in accounting policy.

Example 5

A company owns several hotels and provides significant ancillary services to occupants of rooms. These hotels are, therefore, treated as owner-occupied properties and classified as property, plant and equipment in accordance with Ind AS 16. The company acquires a new hotel but outsources entire management of the same to an outside agency and remains as a passive investor. The selection and application of an accounting policy for this new hotel in line with Ind AS 40 is not a change in accounting policy simply because the new hotel rooms are also let out for rent. This is because the way in which the new hotel is managed differs in substance from the way other existing hotels have been managed so far.

Similarly, if an entity is not applying the accounting policy currently and starts applying the accounting policy newly, that will also not be treated as a change in accounting policy.

Example 6

An entity has classified as investment property, an owner-occupied property previously classified as part of property, plant and equipment where it was measured after initial recognition applying the revaluation model. Ind AS 40 on investment property permits only cost model. The entity now measures this investment property using the cost model. This is not a change in accounting policy.

- The initial application of a policy to revalue assets in accordance with Ind AS 16 'Property, Plant and Equipment', or Ind AS 38 'Intangible Assets', is a change in an accounting policy to be dealt with as a revaluation in accordance with Ind AS 16 or Ind AS 38, rather than in accordance with Ind AS 8.
- As per Ind AS 16, a change in depreciation method should be accounted for as a change in accounting estimate in accordance with Ind AS 8. Similarly, as per Ind AS 38, a change in amortisation method should be accounted for as a change in accounting estimate in accordance with Ind AS 8. These changes are, therefore, not changes in accounting policies.

Illustration 1

Can an entity voluntarily change one or more of its accounting policies?

Solution

A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8.

As per para 14 of Ind AS 8, an entity shall change an accounting policy only if the change:

- (a) is required by an Ind AS; or
- (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Para 15 of the standard states that the users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the above criteria.

Paragraph 14(b) lays down two requirements that must be complied with in order to make a voluntary change in an accounting policy. First, the information resulting from application of the changed (i.e., the new) accounting policy must be reliable. Second, the changed accounting policy must result in "more relevant" information being presented in the financial statements.

Whether a changed accounting policy results in reliable and more relevant financial information is a matter of assessment in the particular facts and circumstances of each case. In order to ensure that such an assessment is made judiciously (such that a voluntary change in an accounting policy does not effectively become a matter of free choice), paragraph 29 of Ind AS 8 requires an entity making a voluntary change in an accounting policy to disclose, inter alia, “the reasons why applying the new accounting policy provides reliable and more relevant information.”

Illustration 2

Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 20X1-20X2. During the financial year 20X2-20X3, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity ABC reclassified it from PPE to investment property in the financial year 20X2-20X3. Should Entity ABC account for the change as a change in accounting policy?

Solution

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

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.”

As per Ind AS 40, ‘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.”

As per the above definitions, whether a building is an item of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity. It is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa. Whether a building is in the nature of PPE or investment property is determined by applying the definitions of these terms from the perspective of that entity. Thus, the classification of a building as an item of property, plant and equipment or as an investment property is not a matter of an accounting policy choice.

Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is **not** a change in an accounting policy.

Illustration 3

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

Solution

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 21, 'functional currency' is the currency of the primary economic environment in which the entity operates.

Paragraphs 9-12 of Ind AS 21 list factors to be considered by an entity in determining its functional currency. It is recognised that there may be cases where the functional currency is not obvious. In such cases, Ind AS 21 requires the management to use its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions.

Paragraph 13 of Ind AS 21 specifically notes that an entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions. Thus, functional currency of an entity is not a matter of an accounting policy choice.

In view of the above, a change in functional currency of an entity does not represent a change in accounting policy and Ind AS 8, therefore, does not apply to such a change. Ind AS 21 requires that when there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

1.5.5.1 How to apply the changes in accounting policies?

While discussing the process for application of changes of accounting policies, Ind AS 8, deals with two situations:

1. An entity shall account for a change in accounting policy resulting from the initial application of an Ind AS in accordance with the specific transitional provisions, if any, in that Ind AS.

If a change in accounting policy is due to a new Ind AS, then, generally the standard itself provides the transitional provisions i.e., provisions applicable on initial application of the standard, such as method of application (retrospective or prospective or modified retrospective), availability of any transitional relief etc. In such cases, the entity needs to follow the transitional provisions accordingly.

2. When an entity changes an accounting policy upon initial application of an Ind AS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

If the change in accounting policy is made voluntarily or where the Ind AS is not containing transitional provisions, then the accounting policy needs to be applied retrospectively.

Note: Early application of an Ind AS is not a voluntary change in accounting policy.

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management may apply an accounting policy from the most recent pronouncements of IASB and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards.

If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

Suppose in absence of any specific Ind AS to a particular transaction, a company follows an accounting policy as per the relevant IFRS which addresses that transaction and, subsequently there is an amendment to that IFRS, then, the company may change its accounting policy as per that amendment. In such cases, it will be considered as if the company is making the change voluntarily and, accordingly, change in the accounting policy should be applied retrospectively.

Illustration 4

An entity developed one of its accounting policies by considering a pronouncement of an overseas national standard-setting body in accordance with Ind AS 8. Would it be permissible for the entity to change the said policy to reflect a subsequent amendment in that pronouncement?

Solution

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management may apply an accounting policy from the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy. As such a change is a voluntary change in accounting policy, it can be made only if it results in information that is reliable and more relevant (and does not conflict with the sources in Ind AS 8).

1.5.5.2 Retrospective application

When a change in accounting policy is applied retrospectively, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Analysis

The word retrospective application is defined in Ind AS 8 as applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied. This means that comparative information for all prior periods presented will be adjusted for the effect of change in the policy. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an Ind AS).

Example 7

An entity which is trading in goods (and not a manufacturer) was incorporated in the year 20X1-20X2 and is a regular user of Ind AS from that year. It has been using weighted average cost formula for determining cost of inventories. In 20X8-20X9, it decides to change the above accounting policy. It wants to use FIFO cost formula. The change in the policy is justified because that formula reflects the actual flow of inventories and, hence, provides reliable and more relevant information to the users of financial statements. The entity presents one year comparative period in its financial statements. Its purchase bills include freight etc., and quantities of inventories as on 1st April, 20X7 and 31st March, 20X8 are such that latest invoices for the relevant years can be attributed to them. Further, other purchase incidental expenses are immaterial. Due to these reasons, retrospective application of change in accounting policy is practicable.

The entity trades in goods, both purchases of stock-in-trade and increase/decrease in inventories of stock-in-trade will appear in the statement of profit and loss. This is because Ind AS 1 permits nature-wise presentation only, which is also the position in Schedule III to the Companies Act, 2013. The change in accounting policy, however, will affect only the carrying amount of inventories and consequently, increase/decrease in inventories, if cost is below NRV, but will not affect amount of purchases.

In the above situation, the entity should apply the change in the accounting policy retrospectively. For this purpose, the entity should recalculate inventory value at the lower of cost determined on FIFO basis and NRV as at 1st April, 20X7 and 31st March, 20X8. The difference between previously presented opening inventory value as at 1st April, 20X7 (which would have been presented in the balance sheet as at 31st March, 20X7) and the recalculated

value as on that date as above is the cumulative effect of change in accounting policy on the opening balance sheet for the comparative year 20X7-20X8. The difference between previously presented closing inventory value as at 31st March, 20X8 and the recalculated value as on that date as above is the cumulative effect of change in accounting policy on the closing balance sheet for the comparative year 20X7-20X8. The difference between the cumulative effects on the opening and closing balance sheets for the comparative year 20X7-20X8 as arrived at above is the period-specific effect of change in the policy for that comparative year. Accordingly, while preparing the financial statements for the year 20X8-20X9, the entity should adjust the opening inventory as at 1st April, 20X7 and adjust retained earnings on that date for the cumulative effect of change in accounting policy and restate comparative amount in respect of increase/decrease in inventories in the statement of profit and loss for the comparative year 20X7-20X8. This results in consequential restatement of profit or loss, total comprehensive income, closing balances of retained earnings and inventories for that comparative year. The said restated closing balances of retained earnings and inventories become opening balances of these items for the year 20X8-20X9, which is the year of change in accounting policy. Income tax effect due to change in accounting policy will be accounted for in accordance with Ind AS 12.

1.5.5.3 Limitations on retrospective application

- The intention of the standard is, as far as possible, that the companies should follow the same accounting policies consistently year after year to ensure the relevance and reliability of financial statements.
- There are some advantages of making the process of change in accounting policy so tedious as outlined below.
 - i. Companies will not make the frequent changes in their accounting policies just to do the window dressing of their financial statements.
 - ii. The comparison of financial statements over time and with other entities will be possible, in a reliable way.
- Having said this, there can be practical difficulties in making the retrospective changes in policies, when the company wants to change the policy.

Example 8

A company has been incorporated 25 years ago and since then doing the business on pan India basis. Now, is it supposed to incorporate the changes in accounting policy for last 25 years? Will it be practicable? Will it be worth doing it? Will it be material? Such questions arise when one wants to change the accounting policy, since voluntary change in policy is required to be applied retrospectively.

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

- The term 'Impracticability' is defined under Ind AS 8 as follows:

Impracticable - Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- (a) the effects of the retrospective application or retrospective restatement are not determinable;
 - (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
 - (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
 - (ii) would have been available when the financial statements for that prior period were approved for issue from other information.
- After going through the above-mentioned definition of impractical, it is clear that the Ind AS 8 does provide some relief if there are practical difficulties in applying the policy retrospectively.
 - Ind AS 8 talks about two types of effects which one need to understand:
 - i. Period Specific: Period specific means for each financial year.
 - ii. Cumulative: Cumulative is the sum total of the period specific effects.
 - When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, then the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.
 - Thus, if it is impracticable for an entity to change the policy from day 1, because it is impracticable to determine period-specific effects for one or more comparative prior periods presented, it can apply the changed policy from the earliest period for which it would be practicable to make the changes in policies retrospectively which may be the current period.

Example 9

In the example given in the section 1.5.5.2 above, if comparative information is presented for two years i.e., 20X6-20X7 and 20X7-20X8 and if it is not practicable to apply the changed policy retrospectively from 20X6-20X7, then, the entity can apply the changed policy retrospectively from 20X7-20X8. This may happen if it is not practicable to compute the inventory value in accordance with the changed policy as on 1st April, 20X6, for example, due to loss of latest purchase bills for the year 20X5-20X6 and computer records of the same are also lost.

In the above example, if comparative information is presented for one year and if it is not practicable to compute the opening inventory value as at 1st April, 20X7, the entity can apply the changed policy retrospectively from 20X8-20X9.

- When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing balance sheets for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually, the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an Ind AS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
- When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy retrospectively for any prior period.

Example 10

In 20X6, an entity changes its accounting policy with respect to determination of cost of its inventories from FIFO to weighted average cost formula. This change is made because management believes that weighted average cost formula results in better matching of cost with revenue. Further, weighted average cost formula is generally used by other entities whose business is similar to that of the entity and, hence, provides reliable and more relevant information to the users of the financial statements. This being a voluntary change, it has to be applied retrospectively. The entity had commenced operations in 20X1. No records of earlier years are available as a virus attack on server in 20X6 had wiped off all past records. It is not possible to recreate the records. It is therefore

impracticable to determine the cumulative effect of change in policy at the beginning of 20X6. The entity will apply the change in accounting policy prospectively from 20X6 only. Since the change in policy is applied prospectively from 20X6, the question of adjusting comparative information for any prior period(s) presented does not arise at all. Cost of closing inventories for 20X6 alone will be determined using weighted average cost formula. The carrying amount of closing inventories for 20X5 will simply be carried as carrying amount of opening inventories for 20X6. Cost of closing inventories for 20X5 determined on FIFO basis will be the starting point for applying weighted average cost formula during 20X6.

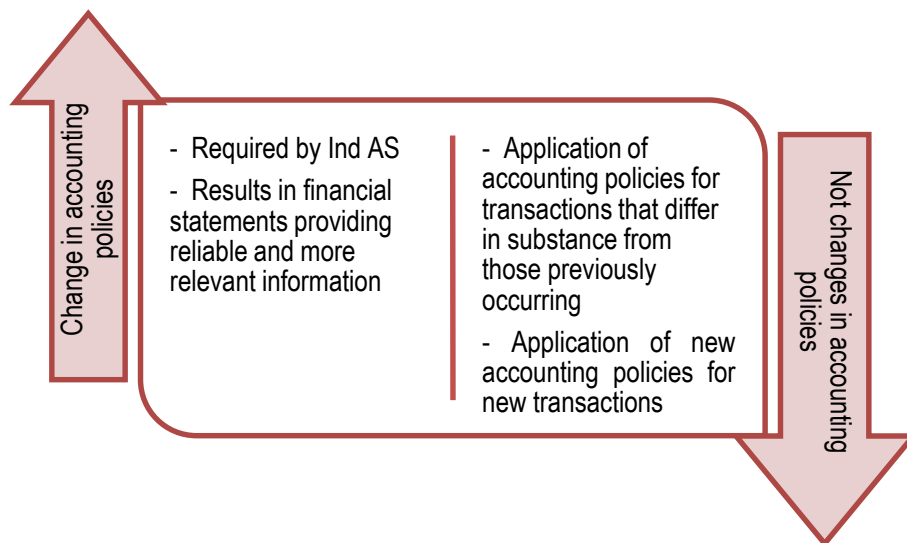


Illustration 5

Whether an entity can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?

Solution

Paragraph 29 of Ind AS 16 provides that an entity shall choose either the cost model or the revaluation model as its accounting policy for subsequent measurement of an entire class of PPE.

A change from revaluation model to cost model for a class of PPE can be made only if it meets the condition specified in Ind AS 8 paragraph 14(b) i.e. the change results in the financial statements providing reliable and more relevant information to the users of financial statements. For example, an unlisted entity planning IPO may change its accounting policy from revaluation model to cost model for some or all classes of PPE to align the entity's accounting policy with that of listed markets participants within that industry so as to enhance the comparability of its

financial statements with those of other listed market participants within the industry. Such a change – from revaluation model to cost model is not expected to be frequent.

Where the change in accounting policy from revaluation model to cost model is considered permissible in accordance with Ind AS 8 paragraph 14(b), it shall be accounted for retrospectively, in accordance with Ind AS 8.

1.5.6 Disclosure regarding the changes in accounting policies

- When initial application of an Ind AS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
 - (a) the title of the Ind AS;
 - (b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
 - (c) the nature of the change in accounting policy;
 - (d) when applicable, a description of the transitional provisions;
 - (e) when applicable, the transitional provisions that might have an effect on future periods;
 - (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
 - (i) for each financial statement line item affected; and
 - (ii) if Ind AS 33, 'Earnings per Share', applies to the entity, for basic and diluted earnings per share;
 - (g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
 - (h) if retrospective application required by paragraph 19(a) or (b) of Ind AS 8 is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.
- When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
 - (a) the nature of the change in accounting policy;

- (b) the reasons why applying the new accounting policy provides reliable and more relevant information;
- (c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
 - (i) for each financial statement line item affected; and
 - (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;
- (d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
- (e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Note:

- Financial statements of subsequent periods need not repeat these disclosures.
 - These disclosures will form part of Notes to Accounts.
- When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:
 - (a) this fact; and
 - (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.
 - In complying with the above requirement, an entity considers disclosing:
 - (a) the title of the new Ind AS;
 - (b) the nature of the impending change or changes in accounting policy;
 - (c) the date by which application of the Ind AS is required;
 - (d) the date as at which it plans to apply the Ind AS initially;
 - (e) either:
 - (i) a discussion of the impact that initial application of the Ind AS is expected to have on the entity's financial statements; or
 - (ii) if that impact is not known or reasonably estimable, a statement to that effect.

Illustration 6

Whether an entity is required to disclose the impact of any new Ind AS which is issued but not yet effective in its financial statements as per Ind AS 8?

Solution

Paragraph 30 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors, states as follows:

“When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

- (a) this fact; and
- (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.”

Accordingly, it may be noted that an entity is required to disclose the impact of Ind AS which has been issued but is not yet effective.



1.6 CHANGE IN ACCOUNTING ESTIMATES

1.6.1 Meaning

- An accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty — that is, the accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, an entity develops an accounting estimate to achieve the objective set out by the accounting policy. Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information. Examples of accounting estimates include:
 - (a) a loss allowance for expected credit losses, applying Ind AS 109, Financial Instruments;
 - (b) the net realisable value of an item of inventory, applying Ind AS 2 Inventories;
 - (c) the fair value of an asset or liability, applying Ind AS 113, Fair Value Measurement;
 - (d) the depreciation expense for an item of property, plant and equipment, applying Ind AS 16; and

- (e) a provision for warranty obligations, applying Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.
- An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques (for example, techniques used to measure a loss allowance for expected credit losses applying Ind AS 109) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying Ind AS 113).
 - The term 'estimate' in Ind AS sometimes refers to an estimate that is not an accounting estimate as defined in this Standard. For example, it sometimes refers to an input used in developing accounting estimates.
 - The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

1.6.2 Can changes in estimates be related to prior periods?

- An entity may need to change an accounting estimate if changes occur in the circumstances on which the accounting estimate was based or as a result of new information, new developments or more experience.
- By its nature, a change in an accounting estimate does not relate to prior periods and is not the correction of an error.
- The effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimates unless they result from the correction of prior period errors.

1.6.3 Change in the basis of measurement – Whether a change in accounting policy or change in estimate?

A change in the measurement basis applied is a change in an accounting policy and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Illustration 7

Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

Solution

As per Ind AS 8, accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. Further,

paragraph 36(a) of Ind AS 2, 'Inventories', specifically requires disclosure of 'cost formula used' as a part of disclosure of accounting policies adopted in measurement of inventories.

Accordingly, a change in cost formula is a change in accounting policy.

1.6.4 Accounting treatment for applying changes in accounting estimates

- The effect of change in an accounting estimate, except to the extent that the change results in change in assets, liabilities or relates to an item of equity, shall be recognised prospectively by including it in profit or loss in:

- (a) the period of the change, if the change affects that period only; or
- (b) the period of the change and future periods, if the change affects both.

A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods.

- To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.
- Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of that change. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in a loss allowance for expected credit losses affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

Relevant extract from Annual Report of Indus Towers Limited for Financial Year 2020-2021 on change in accounting estimates

The Company has revised the useful life of property, plant and equipment and useful life and estimation of ARO and taken the impact prospectively from the date of change.

During the period ended March 31, 2021, the Company has revised the useful life of civil work included in Plant and machinery from 15 years to 20 years with effect from December 1, 2020. Set out below is impact of such change on future period depreciation:

Particulars	Year ended March 31, 2021	Year ended March 31, 2022
Decrease in Depreciation	405	1043

Further, the Company has also reassessed useful life from 15 years to 20 years and estimate of dismantling obligation for Asset retirement obligation w.e.f. December 1, 2020 and has taken the credit of ₹ 184 Mn in the Statement of Profit and Loss.

Examples 11 and 12

11. A change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is to be recognised as income or expense in those future periods.
12. During the financial year ended 31st March, 20X2, Entity ABC introduced a new range of electric motors. It sold the motors with a standard warranty of two years. Warranty provides assurance that a product will function as expected and in accordance with certain specifications and it has been assessed that it is not a separate performance obligation under Ind AS 115.

Based on results of testing of the motors during trials prior to commercial production, Entity ABC made a provision for warranty costs amounting to ₹ 1,00,000 for motors sold during the year ended 31st March, 20X2.

During financial year 20X2-20X3, a defect was discovered in the motors that had not come to light during the trials. The defect resulted in the entity incurring an amount of

₹ 2,00,000 during the financial year 20X2-20X3 on repairs of motors sold during the financial year 20X1-20X2. Besides, the entity expects to incur ₹ 1,50,000 as costs during the year 20X3-20X4 on meeting its warranty obligations in respect of motors sold during the financial year 20X2-20X3.

In preparing its financial statements for the year ended 31st March, 20X3, the entity would carry forward a warranty provision of ₹ 1,50,000 in respect of motors sold during the financial year 20X1-20X2. It would recognise an amount of ₹ 2,50,000 (₹ 2,00,000 plus ₹ 1,50,000 minus ₹ 1,00,000) in respect of motors sold during the financial year 20X1-20X2 as an expense in profit or loss for the financial year 20X2-20X3. The warranty provision included in the comparatives for financial year ended 31st March, 20X2 would not be adjusted.

The provision for warranty costs in respect of motors sold during the financial year 20X2-20X3 would be made by considering the information concerning the defect in motors that came to light during the financial year 20X2-20X3.

1.6.5 Disclosure of changes in estimates

- An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.
- If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

Thus, to summarise the above-mentioned provisions, the entity should disclose:

- i. Effect of change in estimate on the current period
- ii. If applicable and practicable, effect of change in estimate on the future periods
- iii. If applicable but impracticable, the fact that it is impracticable to estimate the effect on future periods.



1.7 ERRORS

1.7.1 Meaning

- Ind AS 8 deals with the treatment of errors that have taken place in past but were not discovered at that time. Subsequently, when they are discovered, it is necessary to correct

such errors in the financial statements and make sure that the financial statements present relevant and reliable information in the period in which they are discovered.

As per the definition given in Ind AS 8, **Prior period errors** are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were approved for issue; and
 - (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
- Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

1.7.2 Common types of errors

- (i) **Mathematical Mistakes:** In accounting terms, generally the errors are called as error of commission. Wrong calculations, carry forward of wrong balances and errors in totals are few examples of mathematical errors.
- (ii) **Mistakes in applying policies:** Specific standards may prescribe method of applying specific policies for particular nature of transaction. For example, as a general rule, assets and liabilities and income and expenses should not be offset, unless otherwise specifically required or permitted in an Ind AS. If a receivable from another entity and payable to that entity are offset without any currently existing legally enforceable right to set off the recognised amounts, then, it will be an error while applying the policies, since it is against the principles of offset prescribed in Ind AS 32, 'Financial Instruments: Presentation'.
- (iii) **Misinterpretations of facts:** Ind AS 10 deals with treatment of the events after the reporting period. Whether the event is an adjusting event or a non-adjusting event depends on whether that event provides evidence of a condition existing at the end of the reporting period. Sometimes, this requires judgement of the management and may result into misinterpretation of facts, if not dealt with properly.
- (iv) **Omissions:** The mistakes that happened due to omission to record a material transaction, perhaps, due to oversight.
- (v) **Frauds:** Major theft undetected in the past.

The abovementioned errors and any other error may happen while recognising the transaction, or while measuring the transaction, or while presenting it in financial statements or it might be possible that proper disclosure is not done.

Example 13

The following errors occurred in preparation of A Ltd.'s financial statements for the immediately preceding financial year –

- (a) Depreciation on plant and machinery understated by an amount equal to 0.30% of sales;
- (b) Warranty provisions understated by an amount equal to 0.15% of sales;
- (c) Allowance for bad debts understated by an amount of 0.25% of sales.

Individually none of these errors may be material but could collectively influence the economic decision of the users of the financial statements. These are material prior period errors.

1.7.3 Treatment of errors

Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

1.7.3.1 Potential errors of current period

Potential current period errors discovered in that period are corrected before the financial statements are approved for issue.

1.7.3.2 Prior period errors discovered subsequently

Material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Following is the snapshot of how the balance sheet and statement of profit and loss is presented after correction of prior period errors:

Consolidated balance sheet

	Notes	31 March 2019	31 March 2018 Restated**	1 April 2017 Restated**
ASSETS				
Non-current assets				
Property, plant and equipment	3	137,048	97,023	88,145
Capital work-in-progress	3	17,450	3,100	-
Investment properties	4	7,419	7,179	7,255
Goodwill	5	8,670	4,530	4,530
Other intangible assets	5	12,033	10,895	11,210
Intangible assets under development*		-	-	-
Biological assets other than bearer plants*		-	-	-
Investments accounted for using the equity method	34(e)	2,776	2,128	1,604
Financial assets				
i. Investments	6(a)	38,165	32,253	32,299
ii. Loans	6(c)	3,084	2,601	2,182
iii. Other financial assets	6(e)	1,187	625	754
Deferred tax assets	7	4,598	2,774	2,054
Other non-current assets	8	21,586	10,565	7,466
Total non-current assets		254,016	173,673	157,499

Consolidated statement of profit and loss

	Notes	Year ended 31 March 2019	Year ended 31 March 2018 Restated**
Continuing operations			
Revenue from operations ³¹	20	221,783	201,107
Other income	21(a)	4,430	3,444
Other gains/(losses) – net ¹	21(b)	1,233	1,203
Total income		227,446	205,754
Expenses			
Cost of materials consumed	22(a)	78,382	76,039
Purchases of stock-in-trade		62,763	45,632
Changes in inventories of work-in-progress, stock-in-trade and finished goods	22(b)	(7,038)	(2,428)
Excise duty ¹		-	3,174
Employee benefit expense	23	20,237	17,786
Depreciation and amortisation expense	24	10,820	9,761
Impairment of goodwill and other non-current assets ¹	3, 5	2,100	-
Net impairment losses on financial and contract assets ³⁰	29	443	454
Other expenses	25	9,591	8,801
Finance costs	26	3,203	2,794
Total expenses		180,501	162,013

Situation 1: Error discovered relates to the comparative prior period presented:

Unless impracticable, an entity shall correct material prior period errors **retrospectively** in the first set of financial statements approved for issue after their discovery by **restating the comparative amounts for the prior period(s)** presented in which the error occurred;

Example 14

While preparing the financial statement for the financial year 20X2-20X3, the prior period presented would be financial year 20X1-20X2, if one year comparative period is presented. If the error occurred in the year 20X1-20X2 but discovered in year 20X2-20X3, then it should be corrected in the financial statements for the year 20X2-20X3 by restating the comparative amounts for the year 20X1-20X2. This will result in consequential restatement of opening balances for the year 20X2-20X3.

Situation 2: Error discovered relates to period before the earliest comparative prior period presented:

If the material error occurred before the earliest prior period presented, an entity shall, unless impracticable, correct the same retrospectively in the first set of financial statements approved

for issue after their discovery by restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Examples 15-17

15. An entity presents one year comparative period in its financial statements. While preparing the financial statements for the financial year 20X4-20X5, if an error has been discovered which occurred in the year 20X1-20X2, i.e., for the period which was earlier than earliest prior period presented (which is 20X3-20X4 in this example), then, the error should be corrected by restating the opening balances of relevant assets and/or liabilities and relevant component of equity for the year 20X3-20X4. This will result in consequential restatement of balances as at 1st April, 20X3 (i.e, the third balance sheet).
16. A material error in depreciation provision of the preceding year ended 31st March, 20X2 was discovered when preparing the financial statements for the year ended 31st March, 20X3. The amount recognised in statement of profit and loss for the year ended 31st March, 20X2 was ₹ 1,00,000 instead of ₹ 50,000. In this case, when presenting the financial statements for the year ended 31st March, 20X3, depreciation for the comparative year 20X1-20X2 will be restated at ₹ 50,000. The carrying amount i.e., net book value of property, plant and equipment for the comparative year ending 31st March, 20X2 will be increased by ₹ 50,000 (due to restatement of accumulated depreciation). This will result in consequential restatement of opening balance of retained earnings and property, plant and equipment for the year 20X2-20X3.
17. Continuing with the aforesaid example, assume that the error relates to year ended 31st March, 20X1 and 20X0-20X1 is not the earliest period for which comparative information is presented. In this case, the error will be corrected by restating the opening balances of retained earnings and carrying amount i.e., net book value, of property, plant and equipment, for the year 20X1-20X2. This will result in restatement of balances as at 1st April, 20X1.

Illustration 8

An entity has presented certain material liabilities as non-current in its financial statements for periods upto 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 20X1). Would this reclassification of liabilities from non-current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Solution

As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not

comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts as at 31st March, 20X1 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1st April, 20X0 in addition to the comparatives for the financial year 20X0-20X1.

1.7.4 Limitations on retrospective restatement

We have already discussed in detail the treatment when there are the limitations on giving retrospective effect to changes in accounting policies. Similar provisions are included in Ind AS 8 to deal with limitations on retrospective restatement of prior period errors.

Step 1: A prior period error shall be corrected by retrospective restatement if it is practicable to determine both the period specific effects and cumulative effect of the error.

The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.

Step 2: If it is not practicable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall first find out the earliest period for which retrospective restatement is practicable and then restate the opening balances of assets, liabilities and equity for that period. Ind AS 8 further states that such period can be the current period also.

For meaning of 'impracticable' for the purposes of Ind AS 8, see section 1.5.5.3.

Step 3: If it is not practicable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.

When it is impracticable to determine the amount of an error (e.g., a mistake in applying an accounting policy) for all prior periods, the entity restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date.

Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need changing as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.



1.8 DISCLOSURE OF PRIOR PERIOD ERRORS

An entity shall disclose the following:

- (a) the nature of the prior period error;
- (b) for each prior period presented, to the extent practicable, the amount of the correction:
 - (i) for each financial statement line item affected; and
 - (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;
- (c) the amount of the correction at the beginning of the earliest prior period presented; and
- (d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.



1.9 IMPRACTICABILITY IN RESPECT OF RETROSPECTIVE APPLICATION AND RETROSPECTIVE RESTATEMENT

In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period.

For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error,

because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

- (a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
- (b) would have been available when the financial statements for that prior period were approved for issue

from other information.

For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with Ind AS 19, 'Employee Benefits', it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were approved for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.



1.10 SIGNIFICANT DIFFERENCES BETWEEN IND AS 8 AND AS 5

S. No.	Particulars	Ind AS 8	AS 5
	Title	Accounting Policies, Changes in Accounting Estimates and Errors	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
1.	<i>Scope</i>	There are some differences in the scope of the two standards. For example, Ind AS 8 deals	Under AS, selection of accounting policies is dealt with in AS 1 'Disclosure of

		with the criteria for selecting and applying accounting policies.	Accounting Policies’.
2.	<i>Extraordinary items</i>	Under Ind AS, presentation of any items of income or expense as extraordinary items is explicitly prohibited by Ind AS 1.	AS 5, on the other hand, requires separate presentation of extraordinary items in the statement of profit and loss. AS 5 defines extraordinary items as income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. As per AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.
3.	<i>Change in accounting policies</i>	Ind AS 8 does not deal with change in accounting policy on the basis of the requirement by the statute.	AS 5 allows change in accounting policy if required by the statute.
4.	<i>Accounting for changes in accounting policies</i>	Ind AS 8 requires that, subject to limited exceptions, changes in accounting policies should be accounted for retrospectively by restatement of comparative information. In	While AS 5 does not clearly specify how changes in accounting policies other than those dealt with by specific transitional provisions of an accounting standard should be

		addition, a third balance sheet as of the beginning of the preceding period is also required to be presented by an entity where it applies an accounting policy retrospectively and the retrospective application has a material effect on the information in the balance sheet at the beginning of the preceding period.	accounted for (i.e., whether retrospectively or prospectively), it requires that the impact of, and the adjustments resulting from, a change in an accounting policy, if material, should be shown in the financial statements of the period in which the change is made.
5.	<i>Prior period items</i>	Ind AS refers to the term 'prior period errors' which is wider in scope as compared to 'prior period items' used in AS 5. Ind AS 8 definition of prior period errors include the effects of misinterpretations of facts and fraud as well.	AS 5 defines prior period items as incomes or expenses which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods.
6.	<i>Correction of material prior period errors</i>	Ind AS 8 requires, subject to limited exception, retrospective correction of material prior period errors, i.e., restatement of comparative information and presentation of a third balance sheet as in case of a retrospective change in an accounting policy where the retrospective correction has a material effect on the information in the balance sheet at the beginning of the preceding period. Thus, under Ind AS 8, material prior period errors are	Unlike Ind AS 8, AS 5 requires the correction of prior period items by including the required adjustments in the determination of net profit or loss for the current period, though the standard also permits an alternative approach under which the adjustments are included in the statement of profit and loss after determination of current net profit or loss.

		corrected by correcting the recognition, measurement and disclosure of amounts of elements of financial statements retrospectively as if the prior period error had never occurred.	
7.	<i>Disclosure requirements</i>	Disclosure requirements of Ind AS 8 are more detailed as compared to those of AS 5. For e.g. in case of a voluntary change in accounting policy, an entity is required to disclose the reasons why applying the new accounting policy provides reliable and more relevant information.	Disclosure requirements of AS 5 are less as compared to those of Ind AS 8.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. A carpet retail outlet sells and fits carpets to the general public. It recognizes revenue when the carpet is fitted, which on an average is six weeks after the purchase of the carpet.

It then decides to sub-contract the fitting of carpets to self-employed fitters. It now recognizes revenue at the point-of-sale of the carpet.

Whether this change in recognising the revenue is a change in accounting policy as per the provision of Ind AS 8?

2. Under what circumstances an entity is required to present a third balance sheet at the beginning of the preceding period?
3. During 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply a component approach completely, whilst at the same time adopting the revaluation model.

In years before 20X2, Delta Ltd.'s asset records were not sufficiently detailed to apply a component approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

Delta Ltd.'s management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller component approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation

model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta Ltd.'s new policy prospectively from the start of 20X2.

Additional information:

- (i) Delta Ltd.'s tax rate is 30%
- (ii) Property, plant and equipment at the end of 20X1:

Cost	₹ 25,000
Depreciation	₹ 14,000
Net book value	₹ 11,000
- (iii) Prospective depreciation expense for 20X2 (old basis) ₹ 1,500
- (iv) Some results of the engineering survey:

Valuation	₹ 17,000
Estimated residual value	₹ 3,000
Average remaining asset life	7 years
Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	₹ 2,000

You are required to prepare the relevant note for disclosure in accordance with Ind AS 8.

4. Is change in the depreciation method for an item of property, plant and equipment a change in accounting policy or a change in accounting estimate?
5. An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X1). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts will be considered as correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?
6. While preparing the annual financial statements for the year ended 31st March, 20X3, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 20X2 and was recognised as an expense in the annual financial statements for

the said year. Would this situation require retrospective restatement of comparatives considering that the amount was material?

7. While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?
8. ABC Ltd has an investment property with an original cost of ₹ 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil.

How should the error be corrected in the financial statements for the year ended 31st March, 20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

9. ABC Ltd. changed its method adopted for inventory valuation in the year 20X2-20X3. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

The effect of the change in the method of valuation of inventory was as follows:

- 31st March, 20X1 - Increase of ₹ 10 million
- 31st March, 20X2 - Increase of ₹ 15 million
- 31st March, 20X3 - Increase of ₹ 20 million

Profit or loss under the FIFO valuation model are as follows:

	20X2-20X3	20X1-20X2
Revenue	324	296
Cost of goods sold	<u>(173)</u>	<u>(164)</u>
Gross profit	151	132
Expenses	<u>(83)</u>	<u>(74)</u>
Profit	<u>68</u>	<u>58</u>

Retained earnings at 31st March, 20X1 were ₹ 423 million

You are required to present the impact of change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.

10. During 20X4-20X5, Cheery Limited discovered that some products that had been sold during 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500.

Cheery Limited's accounting records for 20X4-20X5 show sales of ₹ 104,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

In 20X3-20X4, Cheery Limited reported:

	₹
Sales	73,500
Cost of goods sold	<u>(53,500)</u>
Profit before income taxes	20,000
Income taxes	<u>(6,000)</u>
Profit	<u>14,000</u>
Basic and diluted EPS	2.8

The 20X3-20X4 opening retained earnings was ₹ 20,000 and closing retained earnings was ₹ 34,000. Cheery Limited's income tax rate was 30% for 20X4-20X5 and 20X3-20X4. It had no other income or expenses.

Cheery Limited had ₹ 50,000 (5,000 shares of ₹ 10 each) of share capital throughout, and no other components of equity except for retained earnings.

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

11. In 20X3-20X4, after the entity's 31st March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹ 1,00,000 of unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31st March 20X3. An additional ₹ 20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹ 5,000 of which relates to items of inventory at 31st March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹ 18,000. The accounting estimates made in preparing the 31st March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Analyse the above situation in accordance with relevant Ind AS.

Answers

1. This is not a change in accounting policy as the carpet retailer has changed the way that the carpets are fitted.

Therefore, there would not be any need to retrospectively change the prior period figures for revenue already recognized.

2. As per paragraph 40A of Ind AS 1, Presentation of Financial Statements, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required by paragraph 38A of the standard if:

- it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
- the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

3. **Extract from the notes**

From the start of 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by ₹ 6,000; increase the opening deferred tax provision by ₹ 1,800; create a revaluation surplus at the start of the year of ₹ 4,200; increase depreciation expense by ₹ 500; and reduce tax expense by ₹ 150.

4. As per paragraphs 60 and 61 of Ind AS 16, Property, Plant and Equipment, the depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8.

As per the above, depreciation method for a depreciable asset has to reflect the expected pattern of consumption of future economic benefits embodied in the asset. Determination

of depreciation method involves an accounting estimate and thus depreciation method is not a matter of an accounting policy.

Accordingly, Ind AS 16 requires a change in depreciation method to be accounted for as a change in an accounting estimate, i.e., prospectively.

5. As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts for the year ended 31st March, 20X1 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1st April, 20X0). Therefore, the entity is not required to present a third balance sheet.

6. As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial

statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 20X1 and liabilities as at 31st March, 20X1 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31st March, 20X2, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 20X3, the entity should:

- (a) restate the comparative amounts (i.e., those for the year ended 31st March, 20X2) in the statement of profit and loss; and
 - (b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 20X1) wherein it should recognise the provision for bonus and restate the retained earnings.
7. Paragraph 41 of Ind AS 8, inter alia, states that financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, Interim Financial Statements, states as follows:

“While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding of an entity's financial position and performance during the interim period.”

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

8. The error shall be corrected by retrospectively restating the figures for financial year 20X2-20X3 and also by presenting a third balance sheet as at 1st April, 20X2 which is the beginning of the earliest period presented in the financial statements.

9. Profit or loss under weighted average valuation method is as follows:

	20X2-20X3	20X1-20X2 (Restated)
Revenue	324	296
Cost of goods sold	<u>(168)</u>	<u>(159)</u>
Gross profit	156	137
Expenses	<u>(83)</u>	<u>(74)</u>
Profit	<u>73</u>	<u>63</u>

Statement of changes in Equity (extract)

	Retained earnings	Retained earnings (Original)
At 1 st April, 20X1	423	423
Change in inventory valuation policy	<u>10</u>	<u>-</u>
At 1st April, 20X1 (Restated)	433	-
Profit for the year 20X1-20X2	<u>63</u>	<u>58</u>
At 31st March, 20X2	496	481
Profit for the 20X2-20X3	<u>73</u>	<u>68</u>
At 31st March, 20X3	<u>569</u>	<u>549</u>

10.

Cheery Limited
Extract from the Statement of profit and loss

	20X4-20X5 ₹	(Restated) 20X3-20X4 ₹
Sales	1,04,000	73,500
Cost of goods sold	<u>(80,000)</u>	<u>(60,000)</u>
Profit before income taxes	24,000	13,500
Income taxes	<u>(7,200)</u>	<u>(4,050)</u>
Profit	<u>16,800</u>	<u>9,450</u>
Basic and diluted EPS	3.36	1.89

Cheery Limited
Statement of Changes in Equity

	Share capital	Retained earnings	Total
Balance at 31 st March, 20X3	50,000	20,000	70,000
Profit for the year ended 31 st March, 20X4 as restated	—	<u>9,450</u>	<u>9,450</u>
Balance at 31st March, 20X4	50,000	29,450	79,450
Profit for the year ended 31 st March, 20X5	—	<u>16,800</u>	<u>16,800</u>
Balance at 31st March, 20X5	<u>50,000</u>	<u>46,250</u>	<u>96,250</u>

Extract from the Notes

Some products that had been sold in 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500. The financial statements of 20X3-20X4 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below:

	Effect on 20X3-20X4
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expenses	1,950
(Decrease) in profit	(4,550)
(Decrease) in basic and diluted EPS	(0.91)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

There is no effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3.

11. Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting

estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were approved for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

On the basis of above provisions, the given situation would be dealt as follows:

The defect was neither known nor reasonably possible to detect at 31st March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31st March 20X3 financial statements are not prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31st March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31st March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (i.e. ₹ 15,000) and fair value less costs to complete and sell (i.e. ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

UNIT 2: IND AS 10: EVENTS AFTER THE REPORTING PERIOD

LEARNING OUTCOMES

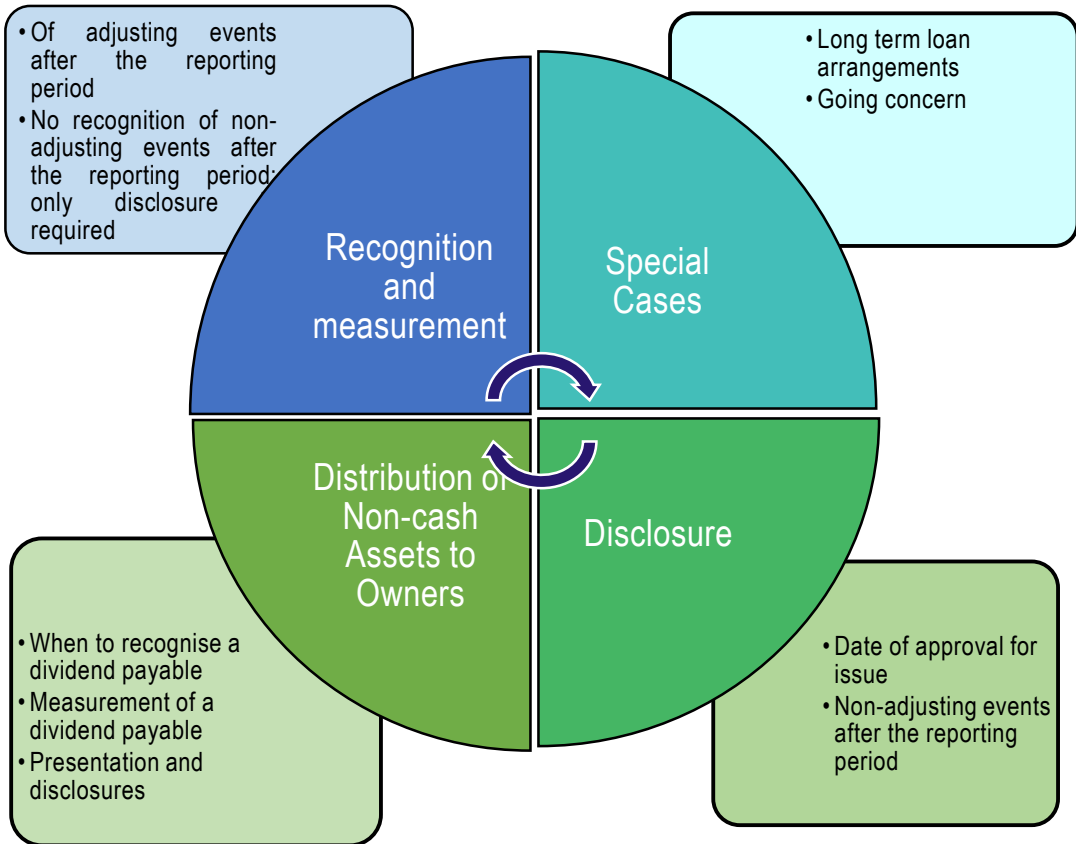
After studying this unit, you will be able to:

- ❑ Define the relevant terms like 'events after the reporting period', 'date of approval', 'adjusting events' and 'non-adjusting events'.
- ❑ Differentiate between adjusting events and non-adjusting events in terms of their treatment and disclosure.
- ❑ Recommend the accounting treatment for special cases like dividend, going concern, long-term loan arrangements.

UNIT OVERVIEW



IND AS 10





2.1 INTRODUCTION

It is impossible for any company to present the information on the same day, as the day of reporting. There would always be a gap between the end of the period for which financial statements are presented and the date on which the same will actually be made available to the public.

During this gap, there is a possibility of occurring of few events which will have far reaching effects on the business / existence of the company. Now the question arises: what view the company should take about such events? Should it leave it without any cognizance as they are taking place after the reporting period, or should it take cognizance of such events as at the time of preparation of the financial statement and making it available to the public? If the company is aware of the facts and is still not disclosing the same, it may mislead the users.

Ind AS 10 deals with such events and provides guidance about its treatment in the financial statements.

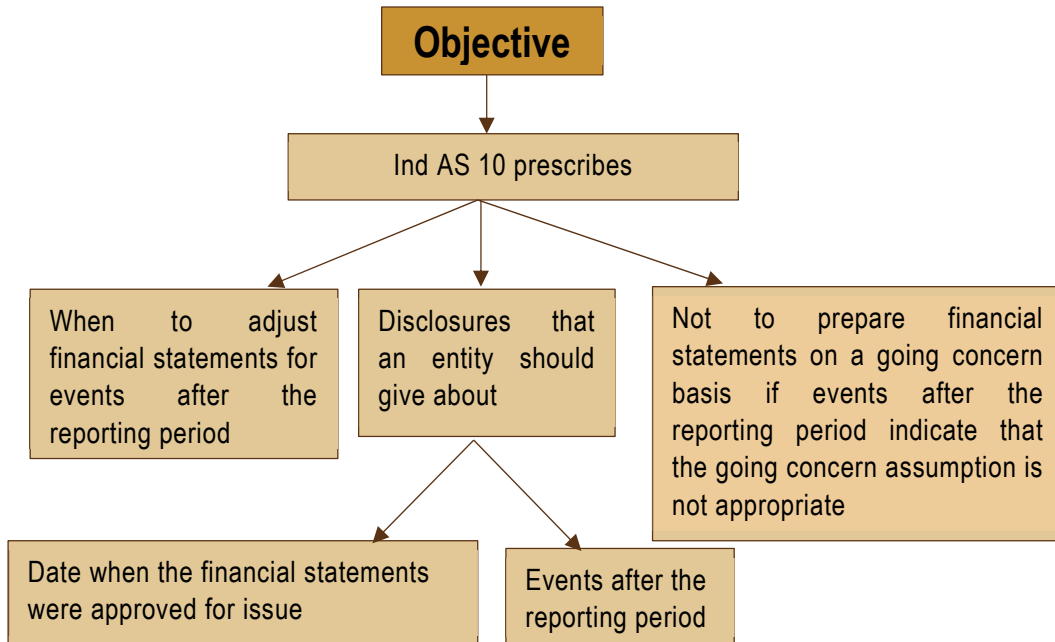


2.2 OBJECTIVE

The objective of this standard is to prescribe.

1. When an entity should adjust its financial statements for the events after the reporting period.
2. **The disclosures** that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period.

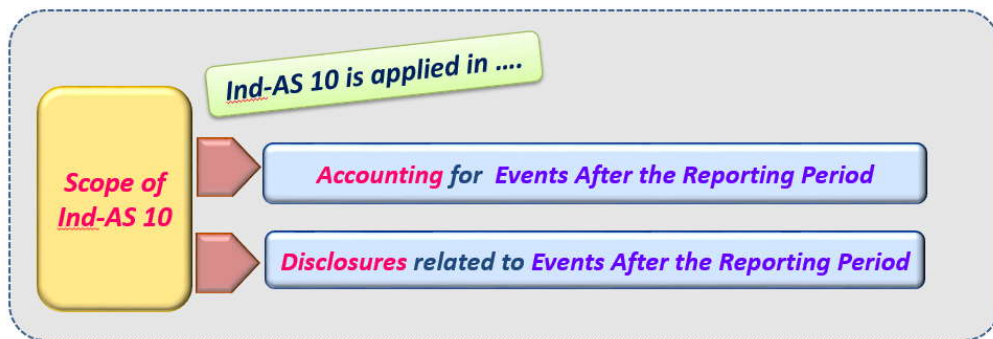
The standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is no longer appropriate.



2.3 SCOPE

The Standard -shall be applied in:

1. **Accounting** for events after reporting period; and
2. **Disclosure** of events after the reporting period.

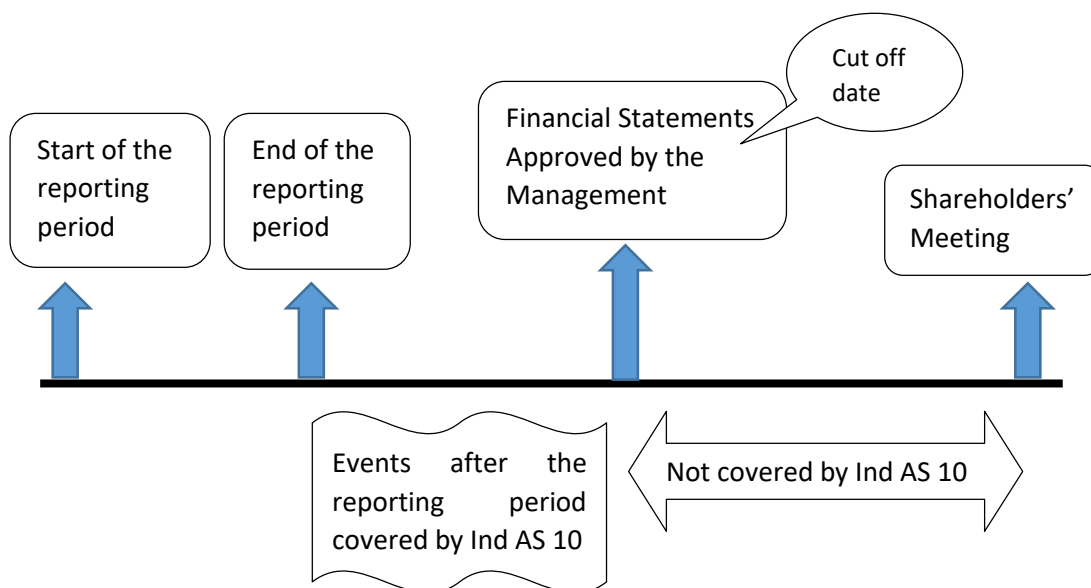


2.4 DEFINITIONS AND EXPLANATIONS

We have seen above that the main focus of the standard is **events after the reporting period**. Therefore, it is necessary to understand the meaning of it.

2.4.1 Events after the Reporting Period

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors (in case of a company) and by the corresponding approving authority (in case of any other entity) for issue. This is depicted in the below chart:



Example 1

The financial year of an entity ends on 31st March, 20X2. If the board of directors approves the financial statements on 15th May, 20X2, 'after the reporting period' will be the period between 31st March, 20X2 and 15th May, 20X2 and the events occurring during this period should be considered as 'events after the reporting period'.

2.4.2 Approval of Financial statements

Now the question arises that what is meant by approval of financial statements? When can one say that the financial statements are approved? Which body needs to be considered as an approving authority? If there is a hierarchy of approvals, at what level one can assume that the financial statements are approved?

What is the date of approval of financial statements?

It is worthwhile to note that the process involved in approving the financial statements for issue will vary depending upon the (a) management structure, (b) statutory requirements and (c) procedures followed in preparing and finalising the financial statements.

This standard prescribes,

- (i) **In case of a company:** The financial statements will be treated as approved when board of directors approves the same;
- (ii) **In the case of any other entity:** The financial statements will be treated as approved when the corresponding approving authority approves the same. The standard does not mention specifically what will constitute the approving authority in case of any other entity. But from the word “**Corresponding**” one can construe that it is the body which is authorised to manage the entity on behalf of all members.

It is pertinent to note that in some cases, an entity is required to submit its financial statements to its shareholders for approval after the financial statements have been approved by the Board for issue. In such cases, as per paragraph 5 of Ind AS 10, even though shareholders' approval is needed, yet, for the purpose of deciding the events after the reporting period, the date of approval of financial statements will be considered as the date of approval by the board of directors only.

Example 2

The Board of Directors of ABC Ltd., in its meeting on 5th May, 20X1, reviews and approves the financial statements for the year ended 31st March, 20X1 and issues them to the shareholders. The financial statements are adopted by the shareholders in the annual general meeting on 23rd June, 20X1. The date of approval of financial statements for the is 5th May, 20X1 in accordance with the standard.

Likewise, in some cases, the management of an entity is required to issue its financial statements to a **supervisory board** (made up solely of non-executives) for approval. In such cases, as per paragraph 6 of Ind AS 10, the financial statements are approved for issue when the management approves them for issue to the supervisory board.

Example 3

On 18th May, 20X2, the management of an entity approves financial statements for issue to its supervisory board. The supervisory board is made up solely of non-executives and may include representatives of employees and other outside interests. The supervisory board approves the financial statements on 26th May, 20X2. The financial statements are made available to shareholders and others on 1st June, 20X2. The shareholders approve the financial statements at their annual meeting on 15th July, 20X2 and the financial statements are then filed with a regulatory body on 17th July, 20X2.

The financial statements are approved for issue on 18th May, 20X2 (date of management approval for issue to the supervisory board).

2.4.3 When date of approval is after the public announcement of some other financial information

'Events after the reporting period' include all events up to the date when the financial statements are approved for issue, even if those events occur after the public announcement of profit or of other selected financial information.

Illustration 1

What is the date of approval for issue of the financial statements prepared for the reporting period from 1st April, 20X1 to 31st March, 20X2, in a situation where following dates are available? Completion of preparation of financial statements 28th May, 20X2 Board reviews and approves it for issue 19th June, 20X2.

Available to shareholders	1 st July, 20X2
Annual General Meeting	15 th September, 20X2
Filed with regulatory authority	16 th October, 20X2

Will your answer differ if the entity is a partnership firm?

Solution

As per Ind AS 10 the date of approval for issue of financial statements is the date on which 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. Accordingly, in the instant case, the date of approval is the date on which the financial statements are approved by the Board of Directors of the company, i.e., 19th June, 20X2.

If the entity is a partnership firm, the date of approval will be the date when the relevant approving authority of such entity approves the financial statements for issue i.e. the date when the partner(s) of the firm approve(s) the financial statements.

Illustration 2

ABC Ltd. prepared interim financial report for the quarter ending 30th June, 20X1. The interim financial report was approved for issue by the Board of Directors on 15th July, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending 30th June, 20X1?

Solution

Paragraph 3 of Ind AS 10, *inter alia*, defines 'Events after the reporting period' as 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.

What is reporting period has not been dealt with in Ind AS 10. Absence of any specific guidance regarding reporting period implies that any term for which reporting is done by preparing financial statements is the reporting period for the purpose of Ind AS 10. Accordingly, financial reporting done for interim period by preparing either complete set of financial statements or by preparing condensed financial statements will be treated as reporting period for the purpose of Ind AS 10.

Paragraph 2 of Ind AS 34, *inter alia*, provides that each financial report, annual or interim, is evaluated on its own for conformity with Ind AS. Further, paragraph 19 of Ind AS 34, provides that an interim financial report shall not be described as complying with Ind AS unless it complies with all of the requirements of Ind AS.

In accordance with the above, an entity describing that its interim financial report is in compliance with Ind AS, has to comply with all the provisions of Ind AS including Ind AS 10.

In order to comply with the requirements of Ind AS 10, each interim financial report should be adjusted for the adjusting events occurring between end of the interim financial report and the date of approval by Board of Directors. Therefore, in the instant case, events occurring between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period should be adjusted in the interim financial report ending 30th June, 20X1.

Illustration 3

The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1-20X2 for issue on 15th June, 20X2. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on 30th June, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case?

Solution

As per paragraph 3 of Ind AS 10, the – date of approval is the date on which 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. In the given case, there are two dates of approval by Board of Directors. The financial statements were reopened for further adjustments subsequent to initial approval. The date of approval should be taken as the date on which financial statements are finally approved by the Board of Directors. Therefore, in the given case, the date of approval for issue as per Ind AS 10 should be considered as 30th June, 20X2.

2.4.4 Should the company report only unfavourable events?

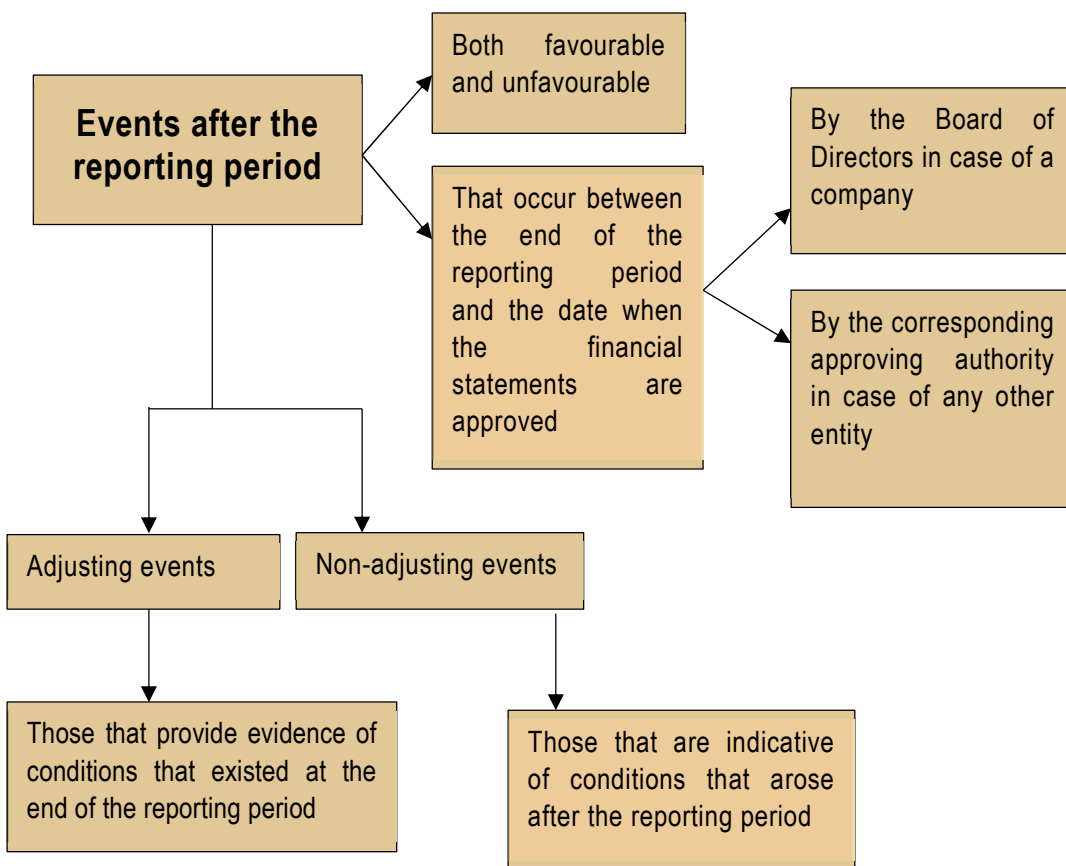
The standard clearly states that events after reporting period can be favourable as well as unfavourable. Accordingly, an entity should report both favourable as well as unfavourable events after the reporting period.



2.5 TYPES OF EVENTS

The 'events after the reporting period' are classified into two categories

- (i) **Adjusting Events:** Adjusting events are those that provide **evidence** of conditions that existed **at the end of the reporting period** (adjusting events after the reporting period); and
- (ii) **Non Adjusting Events:** Non-adjusting events are those that are **indicative** of conditions that arose **after the reporting period** (non-adjusting events after the reporting period).



Ind AS 10 Carve Out: Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an **adjusting event**.



2.6 RECOGNITION AND MEASUREMENT OF ADJUSTING EVENTS

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

Examples of adjusting events after the reporting period

The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

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

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

Illustration 4

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 20X1-20X2. The court issued the order on 15th April, 20X2 and rejected the claim of the company. Accordingly, the company is liable to pay additional tax. The financial statements of the company for the year 20X1-20X2 have been approved on 15th May, 20X2. Should the company account for such tax in the year 20X1-20X2 or should it account for the same in the year 20X2-20X3?

Solution

An event after the reporting period is an adjusting event, if it provides evidence of a condition existing at the end of the reporting period. Here, this condition is satisfied. Court order received after the reporting period (but before the financial statements are approved) provides evidence of the liability existing at the end of the reporting period. Therefore, the event will be considered as an adjusting event and, accordingly, the amounts will be adjusted in financial statements for 20X1-20X2.

- (b) The receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
- (i) The bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period;

Example 4

Loss allowance for expected credit loss in respect of the amount due from a customer was recognised at the end of the reporting period in accordance with Ind AS 109, 'Financial Instruments'. Subsequent liquidation order on the customer issued before the date of approval of financial statements for the reporting period indicates that nothing could be received from the customer. This confirms that the expected credit loss at the end of the reporting period on this particular trade receivable is equal to its

gross carrying amount and, consequently, the entity needs to adjust the loss allowance for the expected credit loss at the end of the reporting period so that net carrying amount of this particular trade receivable at the end of the reporting period is zero.

Illustration 5

While preparing its financial statements for the year ended 31st March, 20X1, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 20X1 a debtor for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 20X1 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 20X1?

Would the answer be different if earthquake had taken place after 31st March, 20X1, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors?

Solution

As per the definition of 'Events after the Reporting Period' and paragraph 8 of Ind AS 10, *Events after the Reporting Period*, financial statements should be adjusted for events occurring after the reporting period that provide evidence of conditions that existed at the end of the reporting period. In the instant case, the earthquake took place in February 20X1 (i.e. before the end of the reporting period). Therefore, the condition exists at the end of the reporting date though the debtor is declared insolvent after the reporting period. Accordingly, full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the bankruptcy of the debtor in the financial statements for the year ended 31st March, 20X1. In this case, assuming that the financial statements are approved by the approving authority after April, 20X1, XYZ Ltd should provide for the remaining amount as a consequence of declaration of this debtor as bankrupt.

In case, the earthquake had taken place after the end of the reporting period, i.e., after 31st March, 20X1, and XYZ Ltd. had not made any specific provision for the debtor who was declared bankrupt later on, since the earthquake occurred after the end of the reporting period no condition existed at the end of the reporting period. The company had made only general provision for bad debts in the ordinary business

course – without taking cognizance of the catastrophic situation of an earthquake. Accordingly, bankruptcy of the debtor in this case is a non-adjusting event.

As per para 21 of Ind AS 10, if non-adjusting events after the reporting period are material, their non-disclosure could influence the economic decisions that users make based on the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

- (a) the nature of the event; and
- (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.”

If the amount of bad debt is considered to be material, the nature of this non-adjusting event, i.e., event of bankruptcy of the debtor should be disclosed along with the estimated financial effect of the same in the financial statements.

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

While making the valuation of closing inventories, Ind AS 2, *Inventories*, prescribes the general principle that the inventories need to be valued at cost or net realisable value, whichever is less. In cases, where inventories are valued at net realisable value (and not ‘at cost’), the estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. However, when the inventories are actually sold during the period after the reporting date (but before approval of financial statements), the selling price of the actual sale transaction provides the evidence of net realisable value *provided* the market conditions remains unchanged. In contrast, if a change in the market conditions occur (say, due to surplus production, additional import, etc.), then the resultant changes to the selling price of inventories do not reflect the conditions that existed on the reporting date (when the inventories were valued).

Example 5

Entity A values its inventories at cost or NRV, whichever is less. Entity A has 10 pieces of item A in its stock at the year end. Each item cost ₹ 500. All these items are sold subsequently but before the date of approval of financial statements for the reporting period at ₹ 450 per piece. The sale of inventories after the reporting period normally provides evidence about their net realisable value at the end of the reporting period.

Illustration 6

The company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of ₹ 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to ₹ 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at ₹ 4,00,000 each or should it value at ₹ 3,00,000 each? Ignore estimated costs necessary to make the sale.

Solution

Events after the reporting period provide the evidence about the net realisable value of the cars at the end of the reporting period and, therefore, the amount of ₹ 3,00,000 should be considered for the valuation of stock.

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

Same principle can be applied for sale of assets as well.

Example 6

The sale of an asset took place in March, 20X2. However, the actual consideration was determined and collected after 31st March, 20X2, i.e., on 10th May, 20X2 (date of approval of financial statements was 15th May, 20X2). In such a situation, sale value recognised in the books as on 31st March, 20X2 should be adjusted.

Illustration 7

ABC Ltd. has purchased a new machinery during the year 20X1-20X2. The asset was finally installed and made ready for use on 15th March, 20X2. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same.

The supplier company sent the bills on 10th April, 20X2, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 20X1-20X2 or in the year 20X2-20X3?

Solution

As per the provisions of the contract, the cost of installation and training of new machine is an integral part of the cost of asset purchased. Therefore, even if the details are available

after reporting period, they provide proof about the circumstances that existed at the end of reporting period. Therefore, the cost of installation and training will be considered for capitalisation in the year 20X1-20X2.

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

The careful reading of the above provision brings forth following two points:

- (i) There is a legal or constructive obligation at the end of reporting period
- (ii) The obligation is based on profit sharing or bonus payments.

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

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

If any error or any fraud related to the reporting period is detected after the reporting period (but before approval of the financial statements), then the entity must adjust the financial statements appropriately by rectifying the same. This is because such fraud and errors provide evidence that the financial statements are *not correct as at the reporting date*. Discovery of such fraud and errors are adjusting events under Ind AS 10

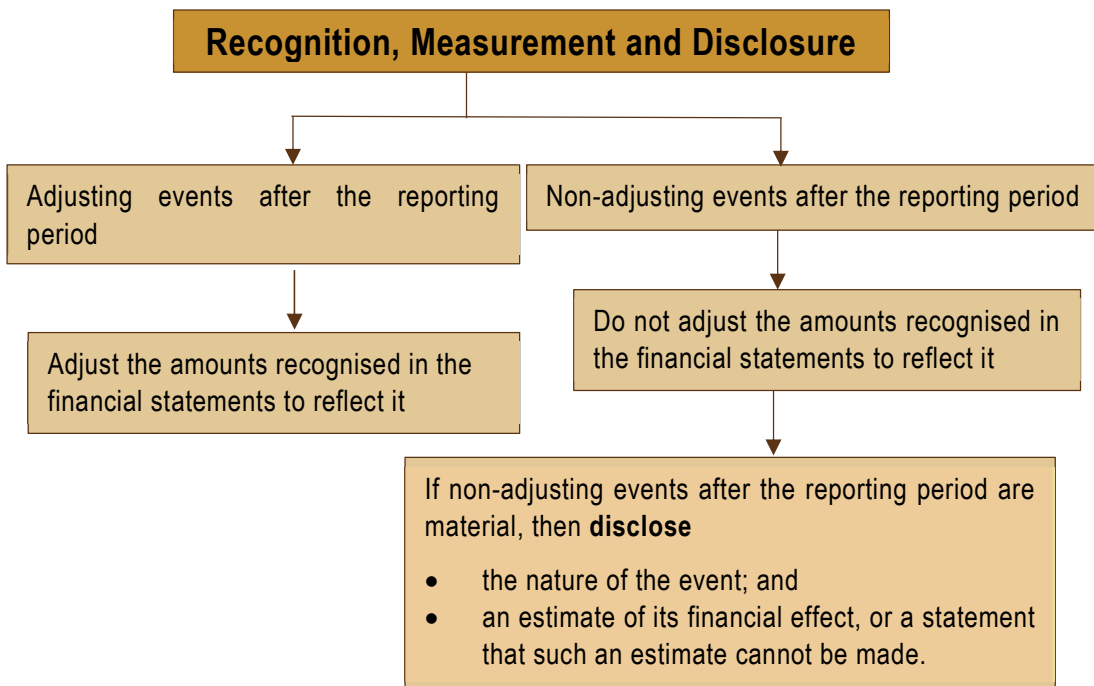


2.7 ACCOUNTING TREATMENT AND DISCLOSURE OF NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD

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

An example of a non-adjusting event after the reporting period is a decline in fair value of investments between the end of the reporting period and the date when the financial statements are approved for issue. The decline in fair value does not normally relate to the condition of the investments at the end of the reporting period but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial

statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure as required under paragraph 21 of Ind AS 10.



2.8 SPECIAL CASES

2.8.1 Long-term Loan Arrangements

Notwithstanding anything contained in the definition of adjusting events and non-adjusting events in paragraph 3 of Ind AS 10, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an adjusting event.

Example 7

ABC Ltd., in order to raise funds, has privately placed debentures of ₹ 1 crore, on 1st January, 20X1, issued to PQR Ltd. As per the original terms of agreement, the debentures are to be redeemed on 31st March, 20X9. One of the conditions of the private placement of the debentures was that debt-equity ratio at the end of any reporting year should not exceed 2:1. If this condition is not fulfilled, then PQR Ltd., has a right to demand immediate redemption of the

debentures. On 31st March, 20X6, debt-equity ratio of ABC Ltd., exceeds 2:1. Therefore, PQR Ltd., decides to return the debentures.

Thus, on 31st March, 20X6, the liability of the ABC Ltd., towards PQR Ltd., (which was originally a long-term liability) becomes a current liability, since it is now a liability on demand. However, ABC Ltd. enters into an agreement with PQR Ltd. on 15th April, 20X6 that PQR Ltd., will not demand the payment immediately. The financial statements are approved by the BOD on 30th April, 20X6.

In this case, the agreement that PQR Ltd., will not demand the money immediately is a subsequent event. Even though it is a subsequent event not affecting the condition existing at the balance sheet date, yet because of the specific provisions of paragraph 3 of Ind AS 10, it has to be given effect in the financial statements for the year 20X5-20X6. Accordingly, though as per original terms the liability would have been otherwise reclassified as a current liability as on 31st March, 20X6, by giving effect to the event after the reporting period due to the specific provisions of paragraph 3 of Ind AS 10, it would continue to be classified as a non-current liability as on 31st March, 20X6. In other words, the re-classification of debentures as current liability as at 31st March, 20X6 will be adjusted and once again classified as a non-current liability as at that date.

2.8.2 Going Concern

- An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.
- Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.
- Ind AS 1 specifies required disclosures if:
 - (a) the financial statements are not prepared on a going concern basis; or
 - (b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the reporting period.

Going concern approach has a lot of importance in the financial statements. Going concern approach can be applied if and only if the entity has intentions to continue its operations. The

carrying amount of assets and carrying amount of liabilities will be much different if the entity has plans to go in for liquidation.

Example 8

A going concern company assumes that the raw material inventory and work in progress will be completed in due course and the inventories of finished goods would be ready for sale. But, if the company has no intention to continue with the business, it may take a decision to sell the raw material and WIP at best available market price, may be at scrap value also.

If a company decides to go into liquidation, then the long-term liabilities of the company will turn into short-term liabilities as the company will have to pay all its debts before it closes down its operations. Thus, the overall approach of accounting will change when there is no going concern approach.

Therefore, Ind AS 10, specifically requires that if after the reporting period but before approval of the financial statements, there are any signs of not continuing the operations, or the decision is taken during that period not to continue with the operations, in spite of the fact that the decision was taken after the reporting period, still the entity should prepare the financial statements with a different approach and, accordingly, inform the stakeholders clearly that the is planning to cease operations.

Illustration 8

Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the financial year 20X4-20X5 have been approved by the Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis?

Solution

With regard to going concern basis to be followed for preparation of financial statements, paras 14 & 15 of Ind AS 10 states that-

An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern

assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

In accordance with the above, an entity needs to change the basis of accounting if the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

In the instant case, since contract is expiring on 31st December 20X5 and it is confirmed on 23rd April, 20X5, (i.e., after the end of the reporting period and before the approval of the financial statements), that no further contact is secured, it implies that the entity's operations are expected to come to an end by 31st December 20X5. Accordingly, if entity's operations are expected to come to an end, the entity needs to make a judgement as to whether it has any realistic possibility to continue or not. In case, the entity determines that it has no realistic alternative of continuing the business, preparation of financial statements for 20X4-20X5 and thereafter going concern basis may not be appropriate.

Illustration 9

In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of ₹ 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of ₹ 27,00,000 is expected.

The financial statements for the year ending 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed?

Solution

In the instant case, since fire took place after the end of the reporting period, it is a non-adjusting event. However, in accordance with paragraph 21 of Ind AS 10, disclosures regarding material non-adjusting event should be made in the financial statements, i.e., the nature of the event and the expected financial effect of the same.

With regard to going concern basis followed for preparation of financial statements, the company needs to determine whether it is appropriate to prepare the financial statements on going concern basis, since there is only one plant which has been damaged due to fire. If the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so, preparation of financial statements for the financial year 20X0-20X1 on going concern assumption may not be appropriate. In that case, the financial statements may have to be prepared on a basis other than going concern.

However, if the going concern assumption is considered to be appropriate even after the fire, no adjustment is required in the financial statements for the year ending 31st March, 20X1.



2.9 DIVIDENDS

- If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, *Financial Instruments: Presentation*) after the reporting period, the entity **shall not** recognise those dividends as a liability at the end of the reporting period.
- If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are **not recognised** as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are **disclosed** in the notes to accounts in Financial Statements.
- The crux of difference between adjusting event and non-adjusting event depends on the fact whether the event provides evidence for existence of a condition at the end of reporting period or not.

Illustration 10

ABC Ltd. declares the dividend on 15th July, 20X2 as the results of year 20X1-20X2 as well as Q1 ending 30th June, 20X2 are better than expected. The financial statements of the company are approved on 20th July, 20X2 for the financial year ending 31st March, 20X2. Will the dividend be accounted for in the financial year 20X2-20X3 or will it be accounted for in the year 20X1-20X2?

Solution

The dividend was declared in the year 20X2-20X3. Therefore, the obligation towards dividend did not exist at the end date of reporting period i.e., on 31st March, 20X2. Therefore, it will be accounted for in the year 20X2-20X3 and not in 20X1-20X2, even if financial statements for 20X1-20X2 were approved after the declaration of dividend. It will, however, be disclosed in the notes in the financial statements for the year 20X1-20X2 in accordance with Ind AS 1.

Illustration 11

What would be the treatment for dividends declared to redeemable preference shareholders after the reporting period but before the financial statements are approved for issue for the year 20X1-20X2. Whether Ind AS 10 prescribes any accounting treatment for such dividends?

Solution

Paragraph 12 of Ind AS 10 prescribes accounting treatment for dividends declared to holders of equity instruments. If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, *Financial Instruments: Presentations*) after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.

However, Ind AS 10 does not prescribe accounting treatment for dividends declared to redeemable preference shareholders. As per the principles of Ind AS 32, *Financial Instruments: Presentation*, a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability. Thus, dividend payments to such preference shares are recognised as expense in the same way as interest on a bond. Since interest will be charged on time basis, the requirements of Ind AS 10 regarding date of declaration of dividend is not relevant for its recognition.



2.10 DISCLOSURE REQUIRED UNDER IND AS 10

2.10.1 Date of approval for issue

- An entity shall disclose the date when the financial statements were approved for issue and who gave that approval. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.
- It is important for users to know when the financial statements were approved for issue, because the financial statements do not reflect events after this date.

Ind AS 10, underlines the importance of date of approval, by requiring a separate disclosure of the date of approval of financial statements. Note that this date is important because it gives a clear idea to the stakeholders about the period, which is covered after the reporting period, for providing information to the stakeholders. In a way, it determines the scope of the financial statements in terms of time.

2.10.2 Updating disclosure about conditions at the end of the reporting period

- If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information.

In case of adjusting events, the entity is supposed to make the necessary adjustments in the financial statements. But just making the changes in the financial statements will not be sufficient as the stakeholders will not be in a position to understand why the adjustments are made. Therefore, in addition to adjustments in the financial statements, it is necessary to make the separate disclosure of the same.

- In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the reporting period, even when the information does not affect the amounts that it recognises in its financial statements. One example of the need to update disclosures is when evidence becomes available after the reporting period about a contingent liability that existed at the end of the reporting period. In addition to considering whether it should recognise or change a provision under Ind AS 37, an entity updates its disclosures about the contingent liability in the light of that evidence.

2.10.3 Disclosure of Non-adjusting events after the reporting period

If non-adjusting events after the reporting period are material, non-disclosure could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements., which provide financial information about a specific reporting entity. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

- (a) the nature of the event; and
- (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

Examples of non-adjusting events after the reporting period generally resulting in disclosure:

- (a) a major business combination after the reporting period (Ind AS 103, *Business Combinations*, requires specific disclosures in such cases) or disposing of a major subsidiary;
- (b) announcing a plan to discontinue an operation;
- (c) major purchases of assets, classification of assets as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*, other disposals of assets, or expropriation of major assets by government;
- (d) the destruction of a major production plant by a fire after the reporting period;
- (e) announcing, or commencing the implementation of, a major restructuring (see Ind AS 37);
- (f) major ordinary share transactions and potential ordinary share transactions after the reporting period (Ind AS 33, *Earnings per Share*, requires an entity to disclose a description

of such transactions, other than when such transactions involve capitalisation or bonus issues, share splits or reverse share splits all of which are required to be adjusted under Ind AS 33);

- (g) abnormally large changes after the reporting period in asset prices or foreign exchange rates;
- (h) changes in tax rates or tax laws enacted or announced after the reporting period that have a significant effect on current and deferred tax assets and liabilities (see Ind AS 12, Income Taxes);
- (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and
- (j) commencing major litigation arising solely out of events that occurred after the reporting period.

Important points to remember

S.No.	Item	Timing	Treatment	Reason
1.	Dividends	Declared after the reporting period but before approval of financial statements	- Do not recognise it as a liability at the end of the reporting period. - Disclosed in the notes to accounts	No obligation exists at that time
2.	Going concern	If management determines after the reporting period either that it intends to liquidate the entity or to cease trading	- Do not prepare the financial statements on a going concern basis; or - Make necessary disclosure of not following going concern basis or events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern	The deterioration in operating results and financial position after the reporting period may be so pervasive that it may require a fundamental change in the basis of accounting

3.	Date of approval of financial statements for issue	Approved after the reporting period	Disclose the date when the financial statements were approved for issue and who gave that approval	Important for users to know when the financial statements were approved for issue because the financial statements do not reflect events after this date
4.	Updating disclosure about conditions at the end of the reporting period	Received information after the reporting period	Update disclosures that relate to new information / conditions	When the information does not affect the amounts that it recognises in its financial statements, disclosures are required

An extract from the annual report of JSW Steel Limited for the year ended 31st March, 2021:

53. Subsequent events

- On 21 May 2021, the board of directors recommended a final dividend of ₹ 6.50 (Rupees six and paise fifty only) per equity share of ₹ 1 each to be paid to the shareholders for the financial year 2020-21, which is subject to approval by the shareholders at the Annual General Meeting to be held on 21 July 2021. If approved, the dividend would result in cash outflow of ₹ 1,571 crores.
- On 13 April 2021, JSW Steel Italy S.r.L, a wholly owned subsidiary of the Company completed the acquisition of remaining 840,840 equity shares, representing 30.73% equity share capital of GSI Luchini S.p.A. for a consideration of EUR 1 million. Consequent to this, GSI Luchini S.p.A. has become a wholly owned subsidiary of the Company.



2.11 DISTRIBUTION OF NON-CASH ASSETS TO OWNERS

Sometimes an entity distributes non-cash assets as dividends to its equity shareholders, acting in their capacity as owners. In those situations, an entity may also give equity shareholders a choice of receiving either non-cash assets or a cash alternative.

It may be recalled that paragraph 107 of Ind AS 1, *inter alia*, requires an entity to present the amount of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements but does not prescribe how to measure it. Appendix A to Ind AS 10, *Distribution of Non-cash Assets to Owners* is relevant in this regard.

2.11.1 Applicability

- Appendix A to Ind AS 10 applies to the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:
 - (a) distributions of non-cash assets (e.g., items of property, plant and equipment, businesses as defined in Ind AS 103, ownership interests in another entity or disposal groups as defined in Ind AS 105); and
 - (b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.
- It applies only to distributions in which all owners of the same class of equity instruments are treated equally.

2.11.2 Non-applicability

- This Appendix does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution.
- This exclusion applies to the separate, individual and consolidated financial statements of an entity that makes the distribution.
- For a distribution to be outside the scope of this Appendix on the basis that the same parties control the asset both before and after the distribution, a group of individual shareholders receiving the distribution must have, as a result of contractual arrangements, such ultimate collective power over the entity making the distribution.
- It does not apply when an entity distributes some of its ownership interests in a subsidiary but retains control of the subsidiary. The entity making a distribution that results in the entity recognising a non-controlling interest in its subsidiary accounts for the distribution in accordance with Ind AS 110, *Consolidated Financial Statements*.
- This Appendix addresses only the accounting by an entity that makes a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

2.11.3 Issues addressed by Appendix A to Ind AS 10

- When an entity declares a distribution (and hence, has an obligation to distribute the assets concerned to its owners), it must recognise a liability for the dividend payable.
- Accordingly, this Appendix addresses the following three questions:
 - **When** should the entity recognise the dividend payable?
 - **How** should an entity measure the dividend payable? and
 - When an entity settles the dividend payable, **how** should it account for any difference between (a) the carrying amount of the assets distributed and (b) the carrying amount of the dividend payable?

These issues have been discussed in the subsequent paragraphs.

2.11.4 Accounting Principles enunciated by Appendix A to Ind AS 10

When an entity declares a distribution and has an obligation to distribute the assets concerned to its owners, it must recognise a liability for the dividend payable.

2.11.4.1 When to recognise a dividend payable

- The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity
- This is the date:
 - (a) when declaration of the dividend (e.g., by management or the board of directors), is approved by the relevant authority (e.g., the shareholders), if the jurisdiction requires such approval, or
 - (b) when the dividend is declared, (e.g., by management or the board of directors), if the jurisdiction does not require further approval.

2.11.4.2 Measurement of a dividend payable

- An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed.
- If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.
- At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with any changes in the carrying

amount of the dividend payable recognised in equity as adjustments to the amount of the distribution.

Accounting for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when an entity settles the dividend payable.

- When an entity settles the dividend payable, it shall recognise the difference, if any, between (a) the carrying amount of the assets distributed and (b) the carrying amount of the dividend payable - in profit or loss.

2.11.4.3 Presentation and disclosures

An entity shall present the difference between carrying amount of the assets distributed and the carrying amount of the dividend payable at the time of settlement of the dividend payable as a separate line item in profit or loss.

An entity shall disclose the following information, if applicable:

- the carrying amount of the dividend payable at the beginning and end of the period; and
- the increase or decrease in the carrying amount recognised in the period as result of a change in the fair value of the assets to be distributed.

If after the end of a reporting period but before the financial statements are approved for issue, an entity declares a dividend to distribute a non-cash asset, it shall disclose:

- the nature of the asset to be distributed;
- the carrying amount of the asset to be distributed as of the end of the reporting period; and
- the fair value of the asset to be distributed as of the end of the reporting period, if it is different from its carrying amount, and the information about the method(s) used to measure that fair value required to be disclosed by Ind AS 113, *Fair Value Measurement*.



2.12 EXTRACTS OF FINANCIAL STATEMENT OF LISTED ENTITIES

An extract from the annual report of JSW Steel Limited for the year ended March 31, 2021:

Subsequent Events

- On 21 May 2021, the board of directors recommended a final dividend of ₹ 6.50 (Rupees six and paise fifty only) per equity share of ₹ 1 each to be paid to the shareholders for the financial year 2020-21, which is subject to approval by the shareholders at the Annual General Meeting to be held on 21 July 2021. If approved, the dividend would result in cash outflow of Rs. 1,571 crores.

- b) On 13 April 2021, JSW Steel Italy S.R.L, a wholly owned subsidiary of the Company completed the acquisition of remaining 840,840 equity shares, representing 30.73% equity share capital of GSI Luchini S.P.A. for a consideration of EUR 1 million. Consequent to this, GSI Luchini S.P.A. has become a wholly owned subsidiary of the Company.

(Source: <https://www.jswsteel.in/>)



2.13 SIGNIFICANT DIFFERENCES BETWEEN IND AS 10 AND AS 4

S. No	Particulars	Ind AS 10	AS 4
	Title	Events after the Reporting Period	Contingencies and Events Occurring After the Balance Sheet Date
1.	Material non adjusting events	The standard requires material non-adjusting events to be disclosed in the financial statements.	AS 4 requires the same to be disclosed in the report of approving authority.
2.	Impact on going concern of the entity	If after the reporting date it is determined that the fundamental accounting assumption of going concern is no longer appropriate, Ind AS 10 requires a fundamental change in the basis of accounting. In this regard, Ind AS 10 refers to Ind AS 1, which requires an entity to make the following disclosures: - disclose the fact that the financial statements are not prepared on a going concern basis together with the basis on which the financial statements are prepared. - state the reason why the entity is not regarded as a going concern.	AS 4 requires assets and liabilities to be adjusted for events occurring after the balance sheet date that indicate that the fundamental accounting assumption of going concern is not appropriate. AS 4 does not require any such disclosure. However, AS 1 requires the disclosure of the fact in case going concern assumption is not followed.

3.	Breach of a material provision of a long-term loan arrangement	Consequent to carve-out made in Ind AS 1, it has been provided in the definition of 'Events after the reporting period' that in case of breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, if the lender, before the approval of the financial statements for issue, agrees to waive the breach, it shall be considered as an adjusting event.	No such guidance is given in AS 4
4.	Distribution of non-cash assets to owners	Ind AS 10 includes an Appendix <i>Distribution of Non-cash Assets to Owners</i> which deals, <i>inter alia</i> , with when to recognise dividends payable to its owners.	No such guidance is given in AS 4



2.14 CARVE OUT IN IND AS 10 FROM IAS 10

Ind AS 10 Carve Out: As a consequence to carve-out made in Ind AS 1, Ind AS 10 provides, in the definition of 'Events after the reporting period' that in case of breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, if the lender, before the approval of the financial statements for issue, agrees to waive the breach, it shall be considered as an adjusting event.

However, under IAS 10 '*Events after the Reporting Period*', an agreement with the lender *after the reporting period but before the approval of the financial statements for issue* not to demand payment (say, arising out of breach of loan covenants) is not considered as an adjusting event.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. The AGM of ABC Ltd for the year ended 31st March, 20X2 was held on 10th July, 20X2 and Board Meeting has been conducted on 15th May, 20X2. Meanwhile, the company had to disclose certain financial information pertaining to the year ended 31st March, 20X2 to SEBI as per SEBI regulations on 20th April, 20X2. Since, certain financial information pertaining to the year ended 31st March, 20X2 is submitted to SEBI before approval of financial statements by the Board, the management is suggesting that 20th April 20X2 shall be considered as 'after the reporting period'. Whether the management view is correct in accordance with the guidance given in Ind AS 10?
2. ABC Ltd. is in a legal suit against the GST department. The company gets a court order in its favour on 15th April, 20X2, which resulted into reducing the tax liability as on 31st March, 20X2. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting. Comment on the company's views in the light of Ind AS 10.
3. ABC Ltd. trades in laptops. On 31st March, 20X2, the company has 50 laptops which were purchased at ₹ 45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops goes down to ₹ 35,000 each. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The company does not want to value the stock at ₹ 35,000

less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 20X2 and the reduced prices were not applicable as on 31st March, 20X2. Comment on the company's views.

4. XY Ltd took a large-sized civil construction contract, for a public sector undertaking, valued at ₹ 200 crores. The execution of the project started during 20X1-20X2 and continued in the next financial year also. During execution of the work on 29th May, 20X2, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra ₹ 50 crores, which would not be recoverable from the contractee as per the terms of the contract. The Company's financial year ended on 31st March, 20X2, and the financial statements were considered and approved by the Board of Directors on 15th June, 20X2. How will you treat the above in the financial statements for the year ended 31st March, 20X2?
5. A Ltd. was required to pay a penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 20X1-20X2, which were approved in May, 20X2. The arbitrator, in April, 20X2, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party. Now, whether A Ltd. is required to remeasure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 20X1-20X2?
6. A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file an application within 15 days of meeting the specified turnover. If the application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on 20th April, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition.

Duty drawback has been credited by the Department on 28th June, 20X2 and financial statements have been approved by the Board of Directors of the company on 26th July, 20X2. Whether duty drawback credit should be treated as an adjusting event?
7. XYZ Ltd. sells goods to its customer with a promise to give a discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd.

sold goods for ₹ 5 lakhs to ABC Ltd. between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.

State whether discount will be adjusted from the sales at the end of the reporting period.

8. Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event?
9. X Ltd. was having investment in the form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2?
10. ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of ₹ 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of ₹ 28,00,000 and the company has expected that the demand would be settled at ₹ 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly.

Answers

1. As per Ind AS 10, even if partial information has already been published, the reporting period will be considered as the period between the end of the reporting period and the date of approval of financial statements. In the above case, the financial statements for the year 20X1-20X2 were approved on 15th May, 20X2. Therefore, for the purposes of Ind AS 10, 'after the reporting period' would be the period between 31st March, 20X2 and 15th May, 20X2.
2. As per Ind AS 10, even favourable events need to be considered. What is important is whether a condition exists as at the end of the reporting period and there is evidence for the same.
3. As per Ind AS 10, the decrease in the net realizable value of the stock after the reporting period should normally be considered as an adjusting event.

4. In the instant case, the execution of work started during the financial year 20X1-20X2 and the rocky surface was there at the end of the reporting period, though the existence of rocky surface is confirmed after the end of the reporting period as a result of which it became evident that the cost may escalate by ₹ 50 crores. In accordance with the definition of 'Events after the Reporting Period', since the rocky surface was there, the condition was existing at the end of the reporting period, therefore, it is an adjusting event. The cost of the project and profit should be accounted for accordingly.
5. In the instant case, A Ltd. approached the arbitrator before the end of the reporting period, who decided the award after the end of the reporting period but before approval of the financial statements for issue. Accordingly, the conditions were existing at the end of the reporting date because A Ltd. had approached the arbitrator before the end of the reporting period whose outcome has been confirmed by the award of the arbitrator. Therefore, it is an adjusting event.

Accordingly, the measurement of the provision is required to be adjusted for the event occurring after the reporting period. As far as the recovery of the cost by A Ltd. from the other party is concerned, this right to recover was a contingent asset as at the end of the reporting period.

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

On the basis of the above, a contingent asset should be recognised in the financial statements of the period in which the realisation of asset and the related income becomes virtually certain. In the instant case, the recovery of cost became certain when the arbitrator decided the award during financial year 20X2-20X3.

Accordingly, the recovery of cost should be recognised in the financial year 20X2-20X3.

6. In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled to the duty draw back but the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback is discretionary in the hands of the Department. Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period, which may be realized if the Department credits the same.

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, asset and the related income are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

In accordance with the above, the duty draw-back credit which was contingent asset for the financial year 20X1-20X2 should be recognized as asset and related income should be recognized in the reporting period in which the change occurs. i.e., in the period in which realization becomes virtually certain, i.e., financial year 20X2-20X3.

7. As per Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

In the instant case, the condition that sales have been made exists at the end of the reporting period and the receipt of payment within 15 days time after the end of the reporting period and before the approval of the financial statements confirms that the discount is to be provided on those sales. Therefore, it is an adjusting event. Accordingly, XYZ Ltd. should adjust the sales made to ABC Ltd. with respect to discount of 5% on the list price of the goods.

8. In the instant case, the fraud is discovered after the end of the reporting period of 20X3-20X4, which related to financial year 20X1-20X2. Since the fraud took place before the end of the reporting period, the condition was existing which has been confirmed by the detection of the same after the end of the reporting period but before the approval of financial statements. Therefore, it is an adjusting event.

Moreover, Ind AS 10 in paragraph 9, specifically provides that the discovery of fraud or error after the end of the reporting period, that shows that financial statements are incorrect, is an adjusting event. Such a discovery of fraud should be accounted for in accordance with Ind AS 8 if it meets the definition of prior period error.

9. Since it has been detected that a fraud has been made by committing an intentional error and as a result of the same financial statements present an incorrect picture, which has been detected after the end of the reporting period but before the approval of the financial statements. The same is an adjusting event. Accordingly, the value of investments in the financial statements should be adjusted for the fraudulent error in computation of value of investments.

10. **Ind AS 10 defines 'Events after the Reporting Period' as follows:**

Events after the reporting period are those events, favourable and unfavourable, that occur

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

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)

In the instant case, the demand notice has been received on 15th June, 20X2, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for an additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, the condition exists on 31st March, 20X2, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 20X1-20X2, at best estimate of the expenditure to be incurred, i.e., ₹ 15,00,000.

UNIT 3: INDIAN ACCOUNTING STANDARD 113: FAIR VALUE MEASUREMENT

LEARNING OUTCOMES

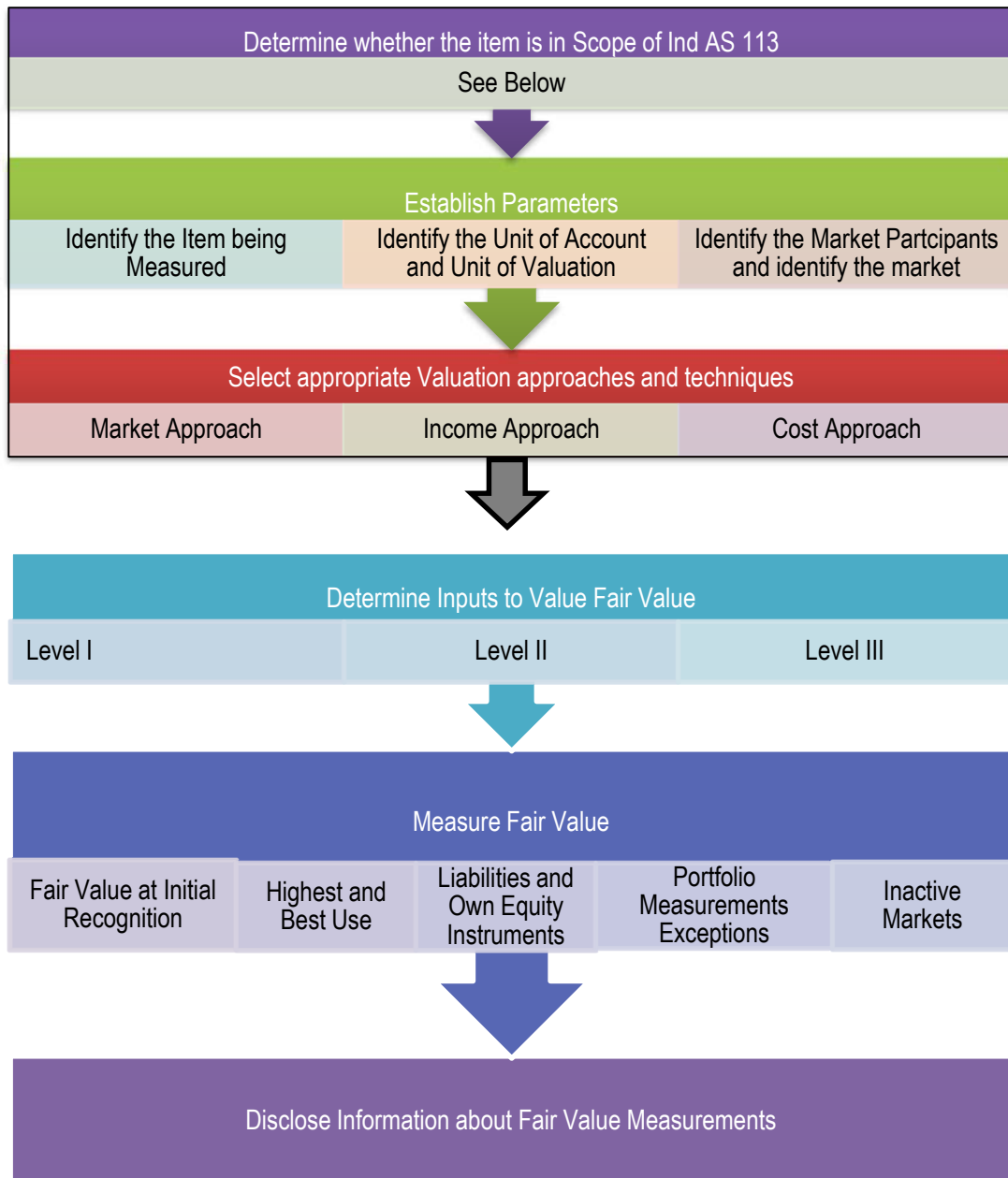
After studying this unit, you will be able to:

- ☐ Understand the need for issuance of Ind AS 113
- ☐ Define fair value
- ☐ Appreciate the scope and objective of this standard
- ☐ Apply the provisions of the standard on 'non-financial assets', 'liabilities' and an entity's 'own equity instruments'
- ☐ Measure fair value at 'initial recognition'
- ☐ Use valuation techniques prescribed in the standard
- ☐ Classify the fair value hierarchy under various level
- ☐ Disclose the information as per the requirements of the standards

UNIT OVERVIEW



Ind AS 113





3.1 WHAT IS FAIR VALUE?

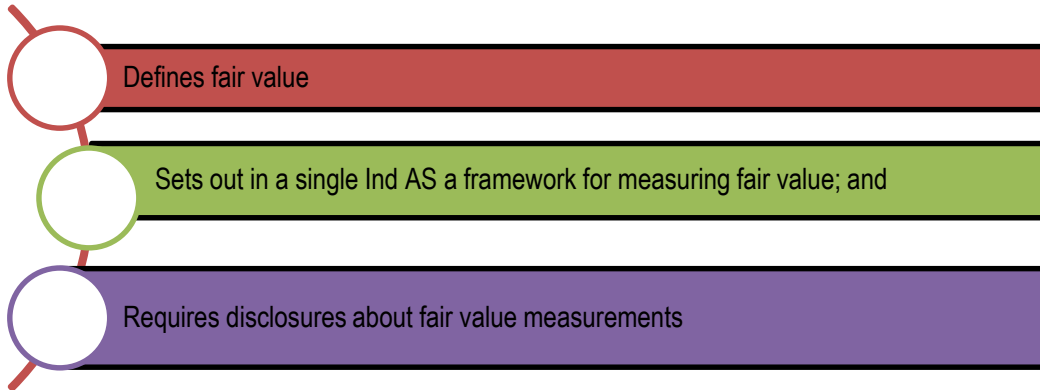


Normally assets and liabilities are being exchanged between parties at their agreed terms and conditions based on the prices which might be related to the entity or event based or in other words which is not at arm's length prices. To define fair value one has to ensure that the values reflect all assumptions/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

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



3.2 OBJECTIVE



Fair value is a market-based measurement, not an entity-specific measurement.

The objective of a fair value measurement is—

- To estimate the price
- At which an orderly transaction to sell the asset or to transfer the liability would take place
- Between market participants
- At the measurement date
- Under current market conditions

(i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that:

- Maximises the use of relevant observable inputs and
- Minimises the use of unobservable inputs.

Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Ind AS shall be applied to an entity's own equity instruments measured at fair value.



3.3 SCOPE



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

Required for →



and /or



Applies to →



and /or



Example of items covered under Ind AS 113

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

3.3.1 What is not covered?

Standard specifically describes the below exceptions which are not covered by this Accounting Standard and hence one has to look at the respective standards to identify the process to calculate fair values of the items of that standard. The scope exclusion will be applied on below:

3.3.1.1 Measurement and Disclosure exclusion

- share-based payment transactions within the scope of Ind AS 102, Share based Payment;
- leasing transactions accounted in accordance with Ind AS 116, Leases; and
- measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2, Inventories, or value in use in Ind AS 36, Impairment of Assets.

3.3.1.2 Disclosure exclusion

- plan assets measured at fair value in accordance with Ind AS 19, Employee Benefits;
- assets for which recoverable amount is fair value less costs of disposal in accordance with Ind AS 36.

**3.4 DEFINITION**

This Ind AS defines fair value as **the price** that would be received to sell an asset or paid to transfer a liability in **an orderly transaction** between **market participants** at the measurement date.

Fair Value			
The price that would be received to sell an asset or paid to transfer a liability	In an orderly transaction	Between market participants	At the measurement date

In order to understand the definition of the fair value, some of the major terms as used in the definition need to be understood which are as follows:

- a. The asset or liability
- b. The transaction
- c. Market participants
- d. The price

Example 1 - Settlement vs Transfer

A bank holds a debt obligation with a face value of ₹ 1,00,000 and a market value of ₹ 95,000. Assume that market interest rates are consistent with the amount in the note; however, there is ₹ 5,000 discount due to market concerns about the risk of non-performance by Counterparty I.

Settlement value

Counterparty I would be required to pay the face value of the note to settle the obligation, because the bank might not be willing to discount the note by the market discount or the credit risk adjustment. Therefore, the settlement value would equal the face value of the note.

Transfer value

In order to calculate the transfer value, Counterparty I must construct a hypothetical transaction in which another counterparty (Counterparty II), with a similar credit profile, is seeking financing on terms that are substantially the same as the note. Counterparty II could choose to enter into a new note agreement with the bank or receive the existing note from Counterparty I in a transfer transaction. In this hypothetical transaction, Counterparty II should be equally willing to obtain financing through a new bank note or assumption of the existing note in return for a payment of ₹ 95,000. Therefore, the transfer value would be ₹ 95,000, and thus the fair value.



3.5 ASSET OR LIABILITY SPECIFIC FAIR VALUE

Ind AS 113 states that a fair value measurement takes into account the characteristics of the asset or liability, e.g. the condition and location of the asset and restrictions, if any, on its sale or use.

The restriction or the condition relating to asset which can affect the future economic benefit from the asset need to be considered in determining the fair value of the asset.

The standard emphasizes that in order to get a fair value of an asset/ liability, the restrictions or conditions that might be related to a particular entity should not be taken into account because a fair value will be based on market participant assumptions rather than an entity specific conditions or restriction which usually will not affect fair valuation of an asset/ liability.

The restrictions could be entity specific or an asset/ liability specific hence all such restrictions which are asset/liability specific & being transfer to the buyer as it is, then these will be considered while calculating fair value. In contrast, if the restrictions are entity specific then it will not be considered.

	To consider in Fair Value
Entity specific restrictions	NO
Asset / liability specific restrictions	YES

Example 2: Entity Specific restrictions

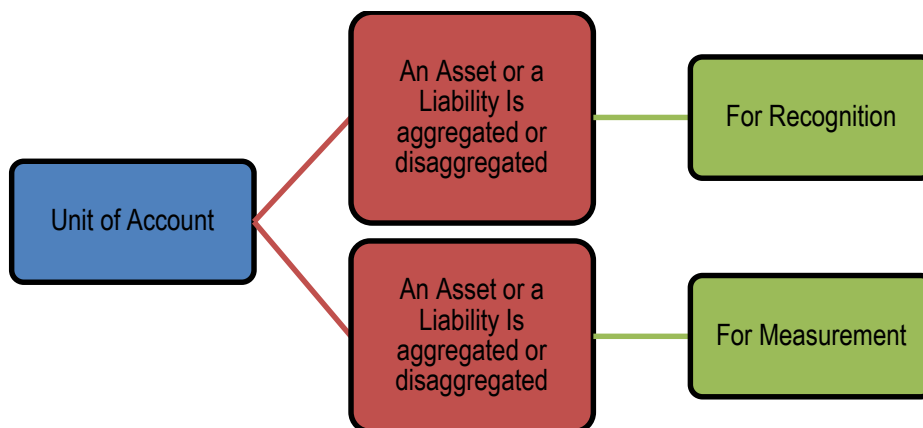
An entity is having a land which has a restriction to develop into a commercial house because of restricted business objective in which currently the entity operates. The entity wants to sell the land and there would not be any restriction for a buyer of the land to develop a commercial house, since this restriction is entity specific. Hence, it will not be considered while calculating fair value of the land.

Example 3: Asset / Liability specific restrictions

A car has been bought for private use and there is a restriction of not to use the car for any commercial purposes. Commercial vehicle is having more fair value than private vehicle. since the restriction to use the vehicle is asset specific and market participant will also consider the asset specific restrictions while calculating fair values for such asset, hence this condition will be considered while evaluating fair value of the car.



3.6 UNIT OF ACCOUNT



Ind AS 113 describes how to measure fair value, not what is being measured at fair value. Other Ind AS specify whether a fair value measurement considers an individual asset or liability or a group of assets or liabilities (i.e. the unit of account).

Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its unit of account.

The unit of account for the asset or liability shall be determined in accordance with the Ind AS that requires or permits the fair value measurement, except as provided in this Ind AS.

This essentially defines the level of aggregation or disaggregation while calculating fair values of the assets/ liabilities.

Examples 5 & 6

5. An entity having certain securities which are quoted at market and these are recognized at fair value in the balance sheet. Quoted prices **at individual level** will be used in order to find fair values of these investments.
6. In order to evaluate fair value of assets to identify impairment as per Ind AS 36, which requires to measure such fair value at CGU (cash generating unit) level, group of assets will be used to find fair values as per the requirement of such standard.



3.7 THE TRANSACTION

A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- (a) in the principal market for the asset or liability; or
- (b) in the absence of a principal market, in the most advantageous market for the asset or liability.

There could be different principal markets for different reporting entities even if they belong to the same group. The principal market / most advantageous market would separately be evaluated for different assets / liabilities under the fair valuation requirements.

3.7.1 Principal market

Market which is normally the place in which the assets / liabilities are being transacted with highest volume and with high level of activities comparing with any other market available for similar transactions.

If there is principal market, the price in the market must be used even if the prices in the other market are more advantageous.

Because the principal market is the most liquid market for the asset or liability, that market will provide the most representative input for a fair value measurement.

Example 7

Shares of a company which is listed at BSE and NYSE have different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

3.7.2 Most advantageous market

- This is the market which either maximizes the amount that would be received when an entity sells an asset or minimize the amount that is to be paid while transferring the liability.
- In the absence of a principal market, this market is used for fair valuation of the assets / liabilities. In many cases Principal Market & Most Advantageous Market will be same.
- The market will be assessed based on net proceeds from the sale after deducting expenses associated with such sale in the most advantageous market.

Example 8

Diamond (a commodity) has got a domestic market where the prices are less compared to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done in the domestic market only i.e. 90% and balance 10% only can be sold via export. The highest level of activities with the highest volume is being done in the domestic market. Hence, the principal market for diamond would be the domestic market. Export prices are more than the prices in the principal market, and it would give the highest return as compared to the domestic market. Therefore, the export market would be considered as the most advantageous market. However, if principal market is available, then its prices would be used for fair valuation of assets/ liabilities.

**3.8 MARKET PARTICIPANTS**

A fair value measurement is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement uses the assumptions that market participants would use when pricing the asset or liability.

An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

3.8.1 What are market participants?

The parties which eventually transact the assets/ liabilities either in principal market or the most advantageous market in their best economic interest i.e.

- They should be independent and not related parties. However, if related parties have done similar transaction on arm's length price, then it can be between related parties as well.
- The parties should not be under any stress or force to enter into these transactions
- All parties should have reasonable and sufficient information about the same.

Example 9

A land has legal restriction to use it for commercial purposes in next 10 years irrespective of its holder. The fair value of the land will include this restriction about its usage because it is an asset related restriction and any buyer will need to take over with similar restriction to use the land for next 10 years. Now to evaluate its fair value, one has to consider the restriction based on the assumptions which normally would be taking into account by its market participants, mentioned as below

- a) Whether the restriction is commonly imposed on each such type of land?
- b) How useful it will be after the end of 10 years?
- c) Whether there is any alternative use which may be considered normally by a participant for similar kind of deals?
- d) How liquid the sale of land will be with such restrictions?
- e) Comparing the price with similar kind of land without restrictions to arrive at its fair values.



3.9 THE PRICE

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

A fair value is being assessed based on principal market and if principal market is not available then based on the most advantageous market.

Illustration 1

A Ltd. has invested in certain bonds. The fair value of these bonds in different markets to which A Ltd. has an access is as follows:

- (i) Principal market ₹ 500*
- (ii) Highest and best use ₹ 600*
- (iii) Net present value of expected cash flows ₹ 550*
- (iv) Asset based valuation approach ₹ 450*

What will be the fair value of bond as per Ind AS 113?

Solution

As per para 24 of Ind AS 113, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

Further, para 72 of the standard inter alia states that the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

According to the above, the value of bond shall be ₹ 500 based on the principal market.

3.9.1 Transaction cost

The transaction costs are not a characteristic of an asset or a liability, but a characteristic of the transaction.

Hence, it would not be appropriate to consider any transaction cost further while assessing fair values from such principal markets.

Note: Transaction costs do not include transport costs.

3.9.2 Transport cost

Transport costs are different from transaction costs. It is the cost that would be incurred to transport the asset from its current location to its principal (or most advantageous) market. Unlike transaction costs, which arise from a transaction and do not change the characteristics of the asset or liability, transport costs arise from an event (transport) that does change a characteristic of an asset (its location).

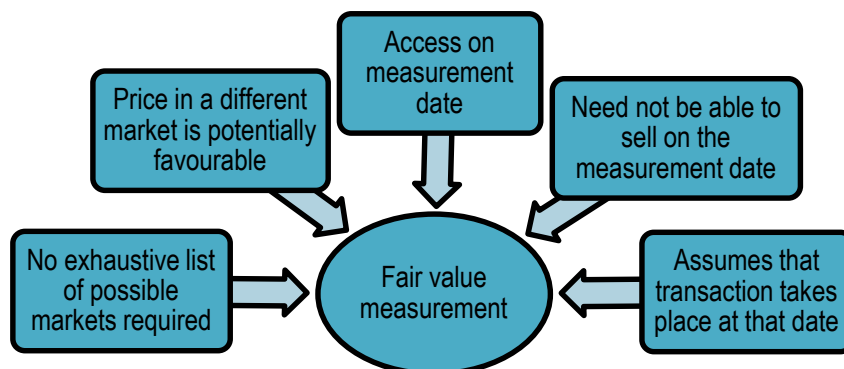
If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

It would be considered, if in case it is an inherent part of the Assets/ Liability so transacted e.g. commodity.

	Principal market	Most advantageous market
Transaction Cost	NO	YES
Transport cost	YES	YES

Example 10

An entity sells certain commodity which are available actively at location A and which is considered to be its principal market (being significant volume of transactions and activities takes place). However, fair value of the commodity is required to be assessed for location B which is far from location A and requires a transport cost of ₹ 100. Since the transport cost is not a transaction cost and it is not specific to any transaction but it is inherent cost which required to be incurred while bringing such commodity from location A to location B, it will be considered while evaluating fair value from the principal market.





3.10 APPLYING FAIR VALUE RULES ON NON-FINANCIAL ASSETS



The financial assets do not have alternative uses because they have specific contractual terms and can have a different use only if the characteristics of the financial assets (ie the contractual terms) are changed.

Fair valuation in case of non-financial assets especially buildings and other property, plant and equipment often require to look for the best and highest use by its market participants and that will be the reference point to evaluate fair value of such non-financial assets.

3.10.1 Highest and best use

The highest and best use is a valuation concept used to value many non-financial assets (eg real estate). The highest and best use of a non-financial asset must be physically possible, legally permissible and financially feasible.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The highest and the best use is determined from market participant perspective. It does not matter whether the entity intends to use the asset differently.

Analysis of Highest and best use for non-financial asset

- The highest and best use would determine an indicative price for a non-financial asset which usually do not have any frequently traded market unlike for other financial products.
- The concept emphasizes that in order to find a fair value of such non-financial products, one has to define its best possible use which makes the non-financial asset separate from any specific entity who would like to use such asset in their own specific purposes which may or may not be its best use.

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

Examples 11, 12 & 13

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

12. Current use as Highest and Best Use

A Ltd acquires a machine in a business combination by acquiring controlling stake in B Ltd. The machine will be held and used in A's operations. The machine was originally purchased by B Ltd from an outside vendor and, before the business combination, was customized by B Ltd for use in its operations. However, the customization of the machine was not extensive.

A Ltd determines that the asset would provide maximum value to market participants through its use in combination with other assets or with other assets and liabilities (as installed or otherwise configured for use). There is no evidence to suggest that the current use of the machine is not its highest and best use. Therefore, the highest and best use of the machine is its current use in combination with other assets or with other assets and liabilities.

13. Potential use as Highest and Best Use

A Ltd owns a property, which comprises land with an old warehouse on it. It has been determined that the land could be redeveloped into a leisure park. The land's market value would be higher if redeveloped than the market value under its current use. A Ltd is unclear about whether the investment property's fair value should be based on the market value of the property (land and warehouse) under its current use, or the land's potential market value if the leisure park redevelopment occurred.

The property's fair value should be based on the land's market value for its potential use. The 'highest and best use' is the most appropriate model for fair value. Under this approach, the property's existing-use value is not the only basis considered. Fair value is the highest value, determined from market evidence, by considering any other use that is **physically possible, legally permissible and financially feasible**.

The highest and best use valuation assumes the site's redevelopment. This will involve demolishing the current warehouse and constructing a leisure park in its place. Therefore, none of the market value obtained for the land should be allocated to the building. So, the market value of the current building on the property's highest and best use (as a warehouse), is Nil. As a result, the building's current carrying amount should be written down to zero.

3.10.2 Valuation premise

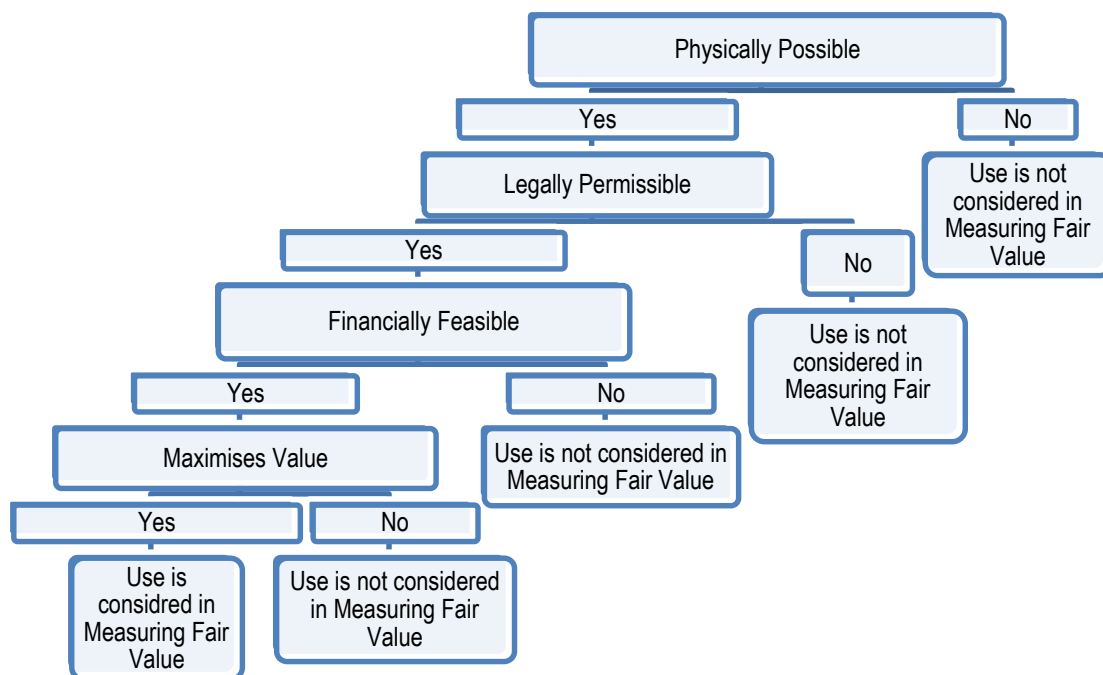
Fair value measurement of non-financial assets would be based on either

- 1) In combination with other assets, or
- 2) At standalone basis,

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

Example 14

To find the fair value of customer relations where a right to receive all future technological updates/ researches is being provided as complementary (which is in a way another intangible asset) i.e. other than customer relations. The customer relations would be valued together with the right to receive all the future technological updates / researches, as it is likely to have less or no value for the customer relations without considering such right to receive all future technological updates/ researches which is being provided free to them.



3.11 APPLYING FAIR VALUE RULES TO LIABILITIES AND AN ENTITY'S OWN EQUITY INSTRUMENTS

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

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

The standard specifies an assumption that liabilities and /or equity instruments so transferred will remain outstanding on the date of measurement. Standard prescribes to use all observable inputs (if direct quoted prices are not available) and should minimize any un-observable inputs. The transaction considered to find fair value should be evaluated in line with an orderly transaction (not an entity specific).

The standard specifically provides guidance on the respective scenarios while evaluating fair values of the liabilities and own equity instruments in case direct quoted prices are not available.

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

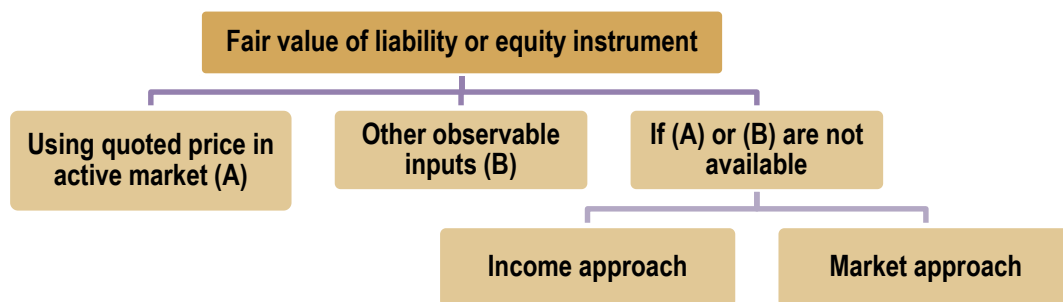
Unobservable Inputs : Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

3.11.1 When liability and equity instruments are held by other parties as assets

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

3.11.2 When liability and equity instruments are not held by other parties as assets

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



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

Assets and liabilities that are being managed by an entity would be affected by its market risk i.e. interest rate risk, currency risk etc. and credit risk relating to its respective counterparties.

There are many situations where a group of assets and liabilities are being managed on net basis rather than individual basis by an entity.

For example, certain contracts of derivatives which are being netted with all existing open positions from same counterparty etc.

If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this Ind AS for measuring fair value.

That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

Analysis of applying offsetting position in market or credit risk

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

All open position for derivatives are being normally evaluated on net exposure basis from each counterparty.

- Once the exception to fair value certain assets/ liabilities on net basis is being used, then unit of account to measure fair value would be considered as net.
- Market risk should be same while combining any asset/ liability.

An interest rate risk can not be netted with a commodity price risk.

- Duration of a market risk should be identical to use the exception for valuing assets/ liabilities on net basis.

1. An interest rate swap of longer period will only be allowed to value at net basis upto the duration of financial instrument of the same duration.
2. Certain Interest rate risk from counterparty Z is being managed on net basis considering the changes in interest rate amount receivable and amounts payable to counterparty Z from normal sale/ purchase basis. Hence such net exposure would be used to evaluate fair values as required by this standard. The netting should normally be followed by other market participants as well and should not be an entity specific.



3.13 FAIR VALUE AT INITIAL RECOGNITION



When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price).

In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them.

Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

In many cases the transaction price will equal the fair value (eg that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).

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

- (a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
- (c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another Ind AS, or the transaction price includes transaction costs.
- (d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

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



3.14 VALUATION TECHNIQUES

When measuring fair value, the objective of using a valuation technique is to estimate the price at which an orderly transaction would take place between market participants at the measurement date under current market conditions.

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

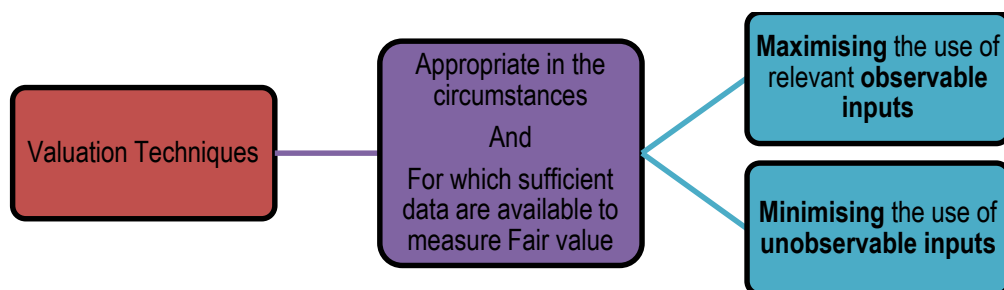
It is pertinent to note that the overall objective to use any valuation approach or technique is in accordance with all relevant data available related to the Asset/ liability which could utilize all directly observable inputs.

Note: It is worth to be noted that in case of availability of **quoted prices** which are being used in an active market, there is no need to consider any valuation approach further.

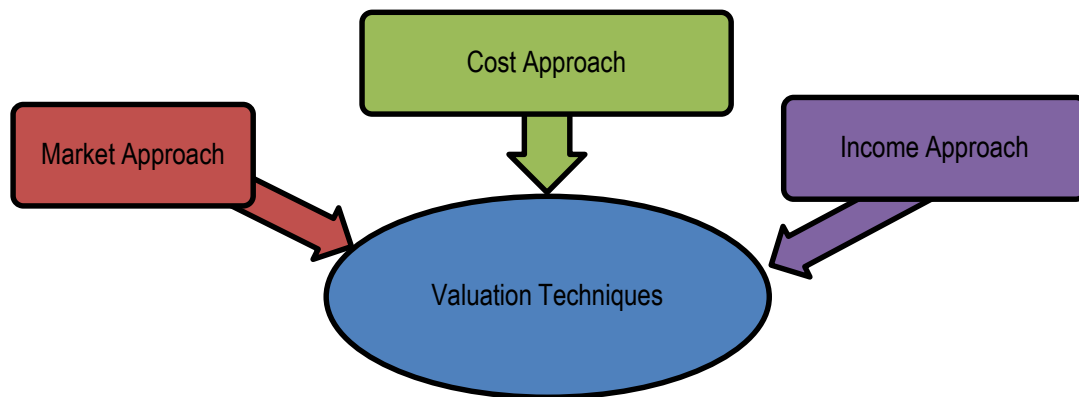
The standard requires and allows using one or combination of more than one approach to measure any fair value which corroborates all inputs available related to such asset/ liability. Selecting an appropriate approach is matter of judgment and based on the available inputs related to the asset / liability.

Example 15

An unquoted investment can be fair valued either by taking similar entity's quoted prices with appropriate adjustments or a valuation of business using DCF or some other technique. This would purely be dependent upon the available inputs and approach relevant for the asset/ liability.



Ind AS 113 specifies following three approaches to measure fair values:



1. MARKET APPROACH : The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.

For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

Quoted prices are indicative values of any business if it exchanges in an active market. However, in the absence of such quoted prices, it is relevant to value the business based on market values and do some adjustment relevant to the assets/ liabilities. Standard specifies a valuation technique called “Matrix pricing” which is normally used to value debt securities. This technique relates the securities with some similar benchmarked securities including coupons, credit ratings etc. to derive at fair value of the debt.

An entity does not have any security which is quoted in an active market, however, its price to earnings ratio is being used to corroborate its enterprise value with certain adjustments relevant to the business e.g. there are some specific restrictions to use certain assets for some specific period being in a specialized industry.

2. INCOME APPROACH: The income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

It is a present value of all future earnings from an entity whose fair values are being evaluated or in other words all future cash flows to be discounted at current date to get fair value of the asset / liability.

Assumption to the future cash flows and an appropriate discount rate would be based on the other market participant’s views. Related risks and uncertainty would require to be considered and would be taken into either in cash flow or discount rate.

Illustration 2**Discount Rate assessment to measure present value:**

Investment 1 is a contractual right to receive ₹ 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

- a. *Investment 2 is a contractual right to receive ₹ 1,200 in 1 year and has a market price of ₹ 1,083.*
- b. *Investment 3 is a contractual right to receive ₹ 700 in 2 years and has a market price of ₹ 566.*

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information.

Solution

On the basis of the timing of the contractual payments to be received for Investment 1 relative to the timing for Investment 2 and Investment 3 (that is, one year for Investment 2 versus two years for Investment 3), Investment 2 is deemed more comparable to Investment 1. Using the contractual payment to be received for Investment 1 (₹ 800) and the 1-year market rate derived from Investment 2, the fair value of Investment 1 is calculated as under:

Investment 2 Fair Value	₹ 1,083
Contractual Cash flows in 1 year	₹ 1,200
IRR	= ₹ 1,083 × (1 + r) = ₹ 1,200
	= (1 + r) = (₹ 1,200 / ₹ 1,083) = 1.108
	r = 1.108 – 1 = 0.108 or 10.8%
Value of Investment 1	= ₹ 800 / 1.108 = ₹ 722

Alternatively, in the absence of available market information for Investment 2, the one-year market rate could be derived from Investment 3 using the build-up approach. In that case, the 2-year market rate indicated by Investment 3 would be adjusted to a 1-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

Standard defines the below techniques which may be considered while using Income approach

- a) Present value techniques

- b) Option pricing modals e.g. Black-Scholes Merton modal or Binomial modal
- c) The multi period excess earning method.

Example 16

An entity has estimated its next year's earnings (cash flows) based on certain probability as mentioned below:

Possible cash flows (₹)	Probability	Probability weighted cash flows
700	20%	140
800	40%	320
900	40%	<u>360</u>
	Total expected cash flow	820
	Risk free rate	6%
	Present value of cash flow (1 year)	$820 / (1.06) = ₹ 773.58$

3. COST APPROACH: This method describes how much cost is required to replace existing asset/ liability in order to make it in a working condition. All related costs will be its fair value. It actually considers replacement cost of the asset/ liability for which we need to find fair value.



3.15 INPUTS TO VALUATION TECHNIQUES

Valuation techniques used to measure fair value shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

It has widely been mentioned that observable inputs should be used to evaluate fair value of an asset/ liability and we should minimize using any unobservable inputs.

Standard describes the below instances where observable inputs are being used in case of certain Financial Instruments:

Markets (by nature)	Prices (observable)	Rationale	Ind AS 113 compliant
Exchange Markets	Closing prices	Readily available	Yes
Dealer Market	Bid & Ask prices	Readily available than closing prices	Yes

Brokered Market	Buy & Sell order matching, commercial and residential markets	Broker knows better prices from both buy & Sell side	Yes
Principal to principal Markets	Negotiated prices with no intermediary	Little information available in market	Yes

The inputs refer broadly to the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In order to establish comparability and consistency in fair value measurement, Ind AS 113 has made some hierarchy to define the level of inputs for fair value. The hierarchy is purely based on the level of inputs available for the specific Asset / liability for which the fair value is to be measured.

Some significant notes about the fair value hierarchy

- The hierarchy has been categorized in 3 levels which are based on the level of inputs that are being used to find out such fair values. There could be a situation where more than one level of fair value is being used, hence standard provides a guidance which states that in case of using more than one level of input, the entire class of asset / liability will be defined by its level which has significance on overall basis.

Note: Significance has not been defined anywhere and could be a matter of judgement.

- Standard defines the valuation techniques that could be used to evaluate fair values of Assets/ liabilities and its level of hierarchy will be depending upon the level of inputs that have been used while using such valuation techniques.
- If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorized within Level 3 of the fair value hierarchy.

Example 17

If a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a Level 2 input and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorised within Level 3 of the fair value hierarchy.

3.15.1 Level 1 Inputs

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available.

A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (e.g. on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability

Whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date

Example 18

An entity is holding investment which is quoted in BSE, India and NYSE, USA. However, significant activities are being done at BSE only. The fair value of the investment would be referenced to the quoted price at BSE India (which is Level 1 fair value- Direct quoted price with no adjustments).

3.15.1.1 Adjustment to Quoted Price when it does not reflect the fair price

In certain situations, a quoted price in an active market might not faithfully represent the fair value of an asset or liability, such as when significant events occur on the measurement date but after the close of trading. In these situations, companies should adjust the quoted price to incorporate this new information into the fair value measurement. However, if the quoted price is adjusted, the resulting fair value measurement would no longer be considered a Level 1 measurement. A company's valuation policies and procedures should address how these "after-hour" events will be identified and assessed. Controls should be put in place to ensure that any adjustments made to quoted prices are appropriate and are applied in a consistent manner.

Example 19

A Ltd., a large biotech company with shares traded publicly, has developed a new drug that is in the final phase of clinical trials. B Ltd. has an equity investment in A Ltd.'s shares. B Ltd. determines that the shares have a readily determinable fair value and accounts for the investment at fair value through profit and loss. B Ltd. assesses the fair value as of the measurement date of 31st March 20X3. Consider the following:

- (i) On 31st March 20X3, the Drug Approval authority notifies A Ltd.'s management that the drug was not approved. A Ltd.'s shares closed at ₹ 36.00 on 31st March 20X3.
- (ii) A Ltd. issued a press release after markets closed on 31st March 20X3 announcing the failed clinical trial.

(iii) A Ltd.'s shares opened on next working day at ₹ 22.50.

The drug failure is a condition (or a characteristic of the asset being measured) that existed as of the measurement date. B Ltd. concludes the ₹ 36.00 closing price on the measurement date does not represent fair value of the A Ltd.'s shares at 31st March 20X3 because the price does not reflect the effect of the Authority's non-approval.

The subsequent transactions that take place when the market opens are relevant to the fair value measurement recorded as of the measurement date. The opening price of ₹ 22.50 indicates how market participants have incorporated the effect of the non-approval on A Ltd.'s stock price.

B Ltd. adjusts the 31st March 20X3 quoted price for the new information, records the shares at ₹ 22.50 per share at 31st March 20X3 and discloses the investment as a Level 2 measurement.

3.15.2 Level 2 Inputs

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- (a) quoted prices for similar assets or liabilities in active markets.
- (b) quoted prices for identical or similar assets or liabilities in markets that are not active.
- (c) inputs other than quoted prices that are observable for the asset or liability, for example:
 - (i) interest rates and yield curves observable at commonly quoted intervals;
 - (ii) implied volatilities; and
 - (iii) credit spreads.
 - (iv) market-corroborated inputs.

Examples 20-22

20. Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency. It requires rate of swap which is of 11 years. However, normally the rates are available only for the maximum period of 10 years. The rate for 11 years can be established using extrapolation or some other techniques which is based on 10 years' available rates of swap. The fair value of 11 years so derived would be level 2 fair value.
21. An entity has an investment in another entity which has no active market. However, some similar investment is being traded in an active market. Now, the fair valuation can be done based on either the prices based on the market which is not active or similar traded investment in an active market. This would be considered as level 2 inputs.
22. X and Y each enter into a contractual obligation to pay ₹ 500 in cash to D in five years. X has an AA credit rating and can borrow at 6%. Y has a BBB credit rating and can borrow at 12%.

X will receive about ₹ 374 in exchange for its promise (the present value of ₹ 500 in five years at 6%). Y will receive about ₹ 284 in exchange for its promise (the present value of ₹ 500 in five years at 12%).

The fair value of the liability to each entity (that is, the proceeds) incorporates that entity's credit standing.

3.15.3 Level 3 Inputs

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability.

For example - It might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g. when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value).

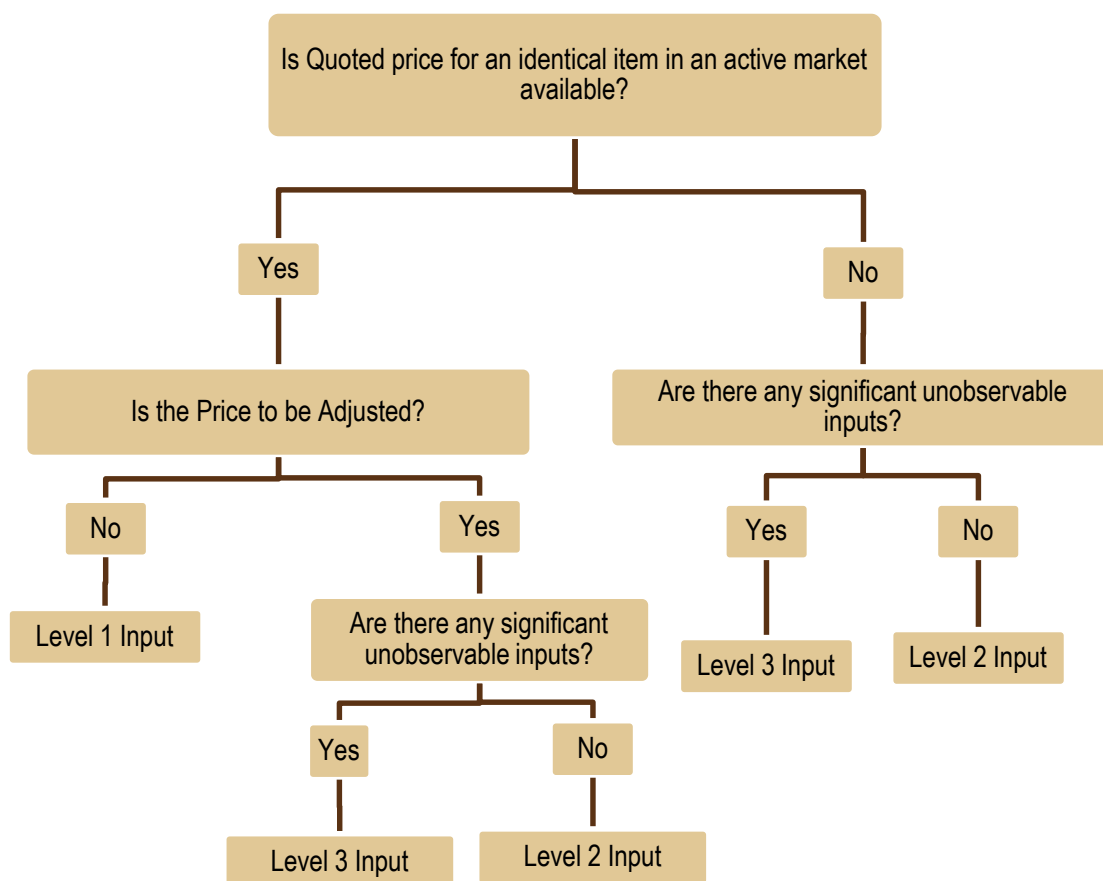
Examples 23 and 24

23. Interest rate swap

An adjustment to a mid-market consensus (non-binding) price for the swap is being developed using data that are not directly observable and cannot otherwise be corroborated by observable market data. This would be level 3 input for measurement of fair value.

24. Cash-generating unit

A Level 3 input would be a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data, if there is no reasonably available information that indicates usage of different assumptions by market participants.



3.16 DISCLOSURES

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

- for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.
- for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

The disclosure requirements can be summarized as per the below table –

	Fair Value Measurement						Disclosure		
	Recurring			Non-recurring					
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Fair value at each reporting date	✓	✓	✓	✓	✓	✓			
Reasons for measurement				✓	✓	✓			
Level of hierarchy	✓	✓	✓	✓	✓	✓	✓	✓	✓
Transfers	✓	✓	✓						
Valuation techniques		✓	✓		✓	✓		✓	✓
If change in valuation techniques		✓	✓		✓	✓		✓	✓
Quantitative info about significant unobservable inputs			✓			✓			
Reconciliation of opening & closing			✓						
Unrealized gains/ losses from remeasurement			✓						
Valuation process & policies			✓			✓			
Sensitivity to changes in unobservable inputs			✓						
If highest & best use differs from actual	✓	✓	✓	✓	✓	✓	✓	✓	✓



3.17 EXTRACTS OF FINANCIAL STATEMENTS OF LISTED ENTITIES

Following is the extract from the financial statements of the listed entity 'Titan Company Limited' for the financial year 2021-2022 with respect to 'Fair Value Measurement' and accounting policy adopted by the company with respect to measurement technique.

34.2 (i) Fair value hierarchy

This note explains about basis for determination of fair values of various financial assets and liabilities:

₹ in crore

Particulars	As at 31 st March 2022			
	Level 1	Level 2	Level 3	Total
a) Financial assets and liabilities measured at fair value				
Financial assets				
- Quoted investments at FVTPL	1	-	-	1
- Other unquoted investments	-	-	18	18
- Derivative instruments other than in designated hedge accounting relationships	-	1	-	1
Total financial assets	1	1	18	20
Financial liabilities				
- Gold on loan	5,161	-	-	5,161
Total financial liabilities	5,161	-	-	5,161

₹ in crore

Particulars	As at 31 st March 2021			
	Level 1	Level 2	Level 3	Total
b) Financial assets and liabilities measured at fair value				
Financial assets				
- Quoted investments at FVTPL	-	2,753	-	2,753
- Other unquoted investments	-	-	10	10
- Derivative instruments other than in designated hedge accounting relationships	-	1	-	1
Total financial assets	-	2,754	10	2,764
Financial liabilities				
- Gold on loan	4,094	-	-	4,094
Total financial liabilities	4,094	-	-	4,094

Notes to the Standalone Financial Statements

for the year ended 31st March 2022

(ii) Valuation technique used to determine fair value

Specific value techniques used to value financial instruments include:

- the use of quoted market prices for listed instruments.
- the fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date.
- the fair value of foreign currency option contracts is determined using option prices obtained from banks.
- the fair value of remaining financial instruments is determined using market comparables, discounted cash flow analysis.

(iii) Fair value of financial assets and liabilities that are not measured at fair value but fair value disclosures are required

The carrying values of financial assets and liabilities approximate the fair values.

(Source: Annual Report 2021-2022 - 'Titan Company Limited')

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. An asset is sold in 2 different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The price that would be received is ₹ 26, transaction costs in that market are ₹ 3 and the costs to transport the asset to that market are ₹ 2.

In Market B:

The price that would be received is ₹ 25, transaction costs in that market are ₹ 1 and the costs to transport the asset to that market are ₹ 2.

You are required to calculate:

- (i) The fair value of the asset, if market A is the principal market, and
 - (ii) The fair value of the asset, if none of the markets is principal market.
2. Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market

participants would take into account the potential to develop the site for residential use when pricing the land.

Determine the highest and best use of the land.

3. ABC Ltd. acquired 5% equity shares of XYZ Ltd. for ₹ 10 crores in the year 20X1-20X2. The company is in process of preparing the financial statements for the year 20X2-20X3 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for ₹ 60 crores. The price of such transaction was determined on the basis of Comparable Companies Method (CCM)-Enterprise Value (EV) / EBITDA which was 8. For the current year, the EBITDA of XYZ Ltd. is ₹ 40 crores. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.'s investment in XYZ Ltd. as on the balance sheet date?
4. UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flows of PT Ltd. for the next 5 years are as follows:

(₹ in crores)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965

The weightage average cost of capital of PT Ltd. is 11%. The total debt as on measurement date is ₹ 1,465 crores and the surplus cash & cash equivalent is ₹ 106.14 crores.

The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd. as per Income Approach.

5. You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

Particulars	₹ in crore
Valuation as per Market Approach	5268.2
Valuation as per Income Approach	3235.2
Debt obligation as on Measurement date	1465.9

Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	8,52,84,223 shares

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.

6. Comment on the following by quoting references from appropriate Ind AS.

- (i) DS Limited holds some vacant land for which the use is not yet determined. The land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

On what basis will the land be fair valued under Ind AS?

- (ii) DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market.

Under which level of fair value hierarchy will the above inputs be classified?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares?

7. On 1st January, 20X1, A Ltd assumes a decommissioning liability in a business combination. The reporting entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. The following information is relevant:

If A Ltd was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use all of the following inputs, probability weighted as appropriate, when estimating the price it would expect to receive:

- a. Labour costs

Labour costs are developed based on current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability to a range of cash flow estimates as follows:

Cash Flow Estimates:	100 Cr	125 Cr	175 Cr
Probability:	25%	50%	25%

- b. Allocation of overhead costs:

Assigned at 80% of labour cost

- c. The compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset. Such compensation includes both of the following:

- i. Profit on labour and overhead costs:

A profit mark-up of 20% is consistent with the rate that a market participant would require as compensation for undertaking the activity

- ii. The risk that the actual cash outflows might differ from those expected, excluding inflation:

A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

- d. Effect of inflation on estimated costs and profits

A Ltd. assumes a rate of inflation of 4 percent over the 10-year period based on available market data.

- e. Time value of money, represented by the risk-free rate: 5%

- f. Non-performance risk relating to the risk that Entity A will not fulfill the obligation, including A Ltd.'s own credit risk: 3.5%

A Ltd, concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability.

You are required to calculate the fair value of the asset retirement obligation.

8. (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ₹ 10. Entity XYZ's after-tax maintainable profits are estimated at ₹ 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

- (ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is ₹ 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

Answers

1. (i) If Market A is the principal market

If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs.

Fair Value will be

	₹
Price receivable	26
Less: Transportation cost	(2)
Fair value of the asset	<u>24</u>

(ii) If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

	₹	₹
	Market A	Market B
Price receivable	26	25
Less: Transaction cost	(3)	(1)
Less: Transportation cost	(2)	(2)
Fair value of the asset	<u>21</u>	<u>22</u>

Since the entity would maximise the net amount that would be received for the asset in Market B i.e. ₹ 22, the fair value of the asset would be measured using the price in Market B.

Fair value

	₹
Price receivable	25
Less: Transportation cost	<u>(2)</u>
Fair value of the asset	<u>23</u>

2. The highest and best use of the land is determined by comparing the following:

- The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and
- The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory's operating cash flows) and its assets and liabilities (e.g., the factory's working capital).

3. Determination of Enterprise Value of XYZ Ltd.

Particulars	₹ in crore
EBITDA as on the measurement date	40
EV/EBITDA multiple as on the date of valuation	8
Enterprise value of XYZ Ltd.	320

Determination of subsequent measurement of XYZ Ltd.

Particulars	₹ in crore
Enterprise Value of XYZ Ltd.	<u>320</u>
ABC Ltd.'s share based on percentage of holding (5% of 320)	16
Less: Liquidity discount & Non-controlling stake discount (5%+5%=10%)	<u>(1.6)</u>
Fair value of ABC Ltd.'s investment in XYZ Ltd.	<u>14.4</u>

4. Determination of equity value of PT Ltd.

(₹ in crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965
Discount rate factor	0.9009	0.8116	0.7312	0.6587	0.5935
Free Cash Flow available to the firm	168.56	152.26	89.06	177.19	2,518.69
Total of all years					3,105.76
Less: Debt					(1,465)
Add: Cash & Cash equivalent					<u>106.14</u>
Equity Value of PT Ltd.					<u>1,746.90</u>
No. of Shares					85,284,223.0
Per Share Value					204.83

5. Equity Valuation of KK Ltd.

Particulars	Weights	(₹ in crore)
As per Market Approach	50	5268.2
As per Income Approach	50	3235.2
Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%)		4,251.7
Less: Debt obligation as on measurement date		(1465.9)
Add: Surplus cash & cash equivalent		106.14
Add: Fair value of surplus assets and liabilities		<u>312.40</u>
Enterprise value of KK Ltd.		<u>3204.33</u>
No. of shares		85,284,223
Value per share		375.72

6. (i) As per Ind AS 113, a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

- (a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).
- (b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).
- (c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the land is to develop a commercial complex. Although developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as Ind AS 113 does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

- (ii) As per Ind AS 113, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, DS Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Level 2 inputs include the following:

- (a) quoted prices for similar assets or liabilities in active markets.
- (b) quoted prices for identical or similar assets or liabilities in markets that are not active.
- (c) inputs other than quoted prices that are observable for the asset or liability.

If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

7.

		Amount (In Crore)
Expected Labour Cost (Refer W.N.)		131.25
Allocated Overheads	$(80\% \times 131.25 \text{ Cr})$	105.00
Profit markup on Cost	$(131.25 + 105) \times 20\%$	<u>47.25</u>
Total Expected Cash Flows before inflation		<u>283.50</u>
Inflation factor for next 10 years (4%)	$(1.04)^{10} = 1.4802$	
Expected cash flows adjusted for inflation	283.50×1.4802	419.65
Risk adjustment - uncertainty relating to cash flows	$(5\% \times 419.64)$	<u>20.98</u>
Total Expected Cash Flows	$(419.65 + 20.98)$	<u>440.63</u>
Discount rate to be considered = risk-free rate + entity's non-performance risk	$5\% + 3.5\%$	8.5%
Expected present value at 8.5% for 10 years	$(440.63 / (1.085^{10}))$	194.97

Working Note:

Expected labour cost:

Cash Flows Estimates	Probability	Expected Cash Flows
100 Cr	25%	25 Cr
125 Cr	50%	62.50 Cr
175 Cr	25%	<u>43.75 Cr</u>
Total		<u>131.25 Cr</u>

8. (i) An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

Particulars	Unit
Entity XYZ's after-tax maintainable profits (A)	₹ 70,000
Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of Company XYZ (A) x (B) x (C)	₹ 8,40,000

Value of a share of XYZ = ₹ 8,40,000 ÷ 5,000 shares = ₹ 168

The fair value of Entity A's investment in XYZ's shares is estimated at ₹ 42,000 (that is, 250 shares x ₹ 168 per share).

- (ii) Share price = ₹ 8,50,000 ÷ 5,000 shares = ₹ 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be ₹ 42,500 (250 shares x ₹ 170 per share).

[illegible]

IND AS 115 REVENUE FROM CONTRACTS WITH CUSTOMERS

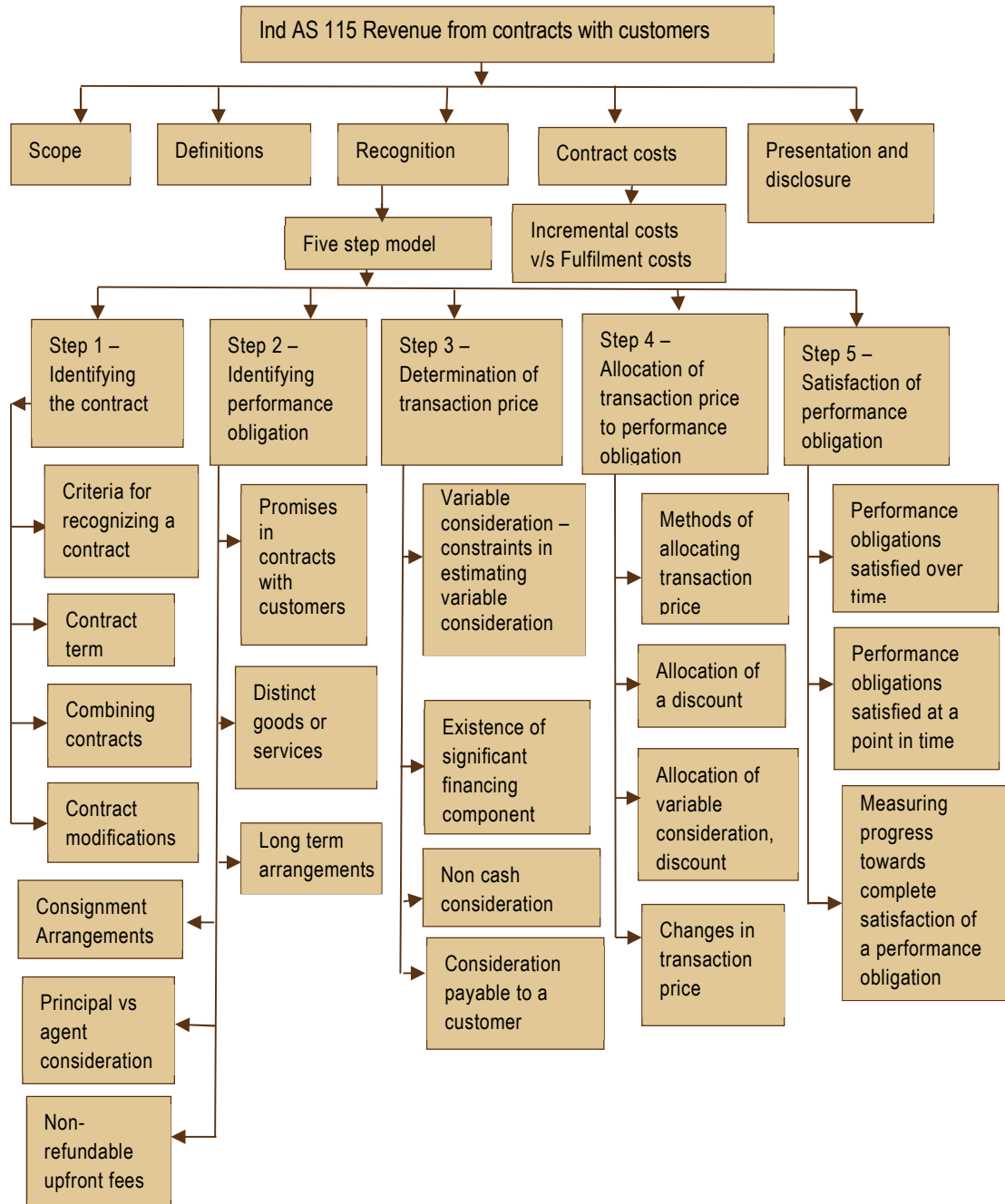


LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ Appreciate the scope and definition of the standard.
- ☐ Identify the contract.
- ☐ Comprehend the criteria for revenue recognition.
- ☐ Gain knowledge on accounting treatment of various aspects like combination of contracts, contract modifications etc.
- ☐ Identify performance obligations and when the performance obligation is satisfied.
- ☐ Determine the transaction price and allocate the performance obligation to transaction price.
- ☐ Allocate discount to various performance obligations in determining their transaction price.
- ☐ Account for the changes in the transaction price.
- ☐ Account for variable considerations while determining the transaction price.
- ☐ Deal with contract costs.
- ☐ Comply with the Presentation and disclosure requirements of the standard.

CHAPTER OVERVIEW



This standard establishes principles to report useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

The core principle is that an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The standard specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects of applying the Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio.



1. SCOPE

Ind AS 115 applies to all contracts with customers to provide goods or services that are outputs of the entity's ordinary course of business in exchange for consideration, unless specifically excluded from the scope of the new guidance, as described below.

An entity shall apply this Standard to all contracts with customers, except the following:

- (a) lease contracts within the scope of Ind AS 116, Leases;
- (b) insurance contracts within the scope of Ind AS 104, Insurance Contracts
- (c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Financial Instruments, Ind AS 110, Consolidated Financial Statements, Ind AS 111, Joint Arrangements, Ind AS 27, Separate Financial Statements and Ind AS 28, Investments in Associates and Joint Ventures; and
- (d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

This standard is applicable only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for a consideration.

A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as

developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.

A contract with a customer may be partially within the scope of Ind AS 115 and partially within the scope of other Ind AS. In such cases, the following steps should be followed to identify how it should be split between Ind AS 115 and other Ind AS:

- (i) If the other Ind AS specifies how to separate and/or measure a portion of the contract, then that guidance should be applied first. The amounts measured under other Ind AS should be excluded from the transaction price that is allocated to performance obligations under Ind AS 115.
- (ii) If the other Ind AS does not stipulate how to separate and/or measure a portion of the contract, then Ind AS 115 would be used to separate and/or measure that portion of the contract (refer discussion relating to Step 4 - Allocation of transaction price to performance obligation).

Ind AS 115 also specifies the accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfil a contract with a customer if those costs are not within the scope of another Standard (see section related to Contract Costs). An entity shall apply those paragraphs only to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of this Standard.



2. DEFINITIONS

Contract	An agreement between two or more parties that creates enforceable rights and obligations.
Contract asset	An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
Contract liability	An entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.
Customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for a consideration.
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in

	an increase in equity, other than those relating to contributions from equity participants.
Performance obligation	A promise in a contract with a customer to transfer to the customer either: (a) a goods or service (or a bundle of goods or services) that is distinct; or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
Revenue	Income arising in the course of an entity's ordinary activities.
Stand-alone selling price (of goods or service)	The price at which an entity would sell a promised goods or service separately to a customer .
Transaction price (for a contract with a customer)	The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer , excluding amounts collected on behalf of third parties.



3. OVERVIEW

After more than a decade of work, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) had published their largely converged standards on revenue recognition in May, 2014. The IASB issued IFRS 15 Revenue from Contracts with Customers and FASB issued ASU 2014-09 with the same name.

In convergence with IFRS, the Ministry of Corporate Affairs (MCA) issued Ind AS 115, Revenue from Contracts with Customers vide its notification dated 28th March, 2018.

Ind AS 115 supersedes and replaces Ind AS 11 and Ind AS 18.

Ind AS 115 is based on a core principle that requires an entity to recognize revenue:

- (a) In a manner that depicts the transfer of goods or services to customers
- (b) At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

To achieve the core principle, an entity should apply the following five-step model:

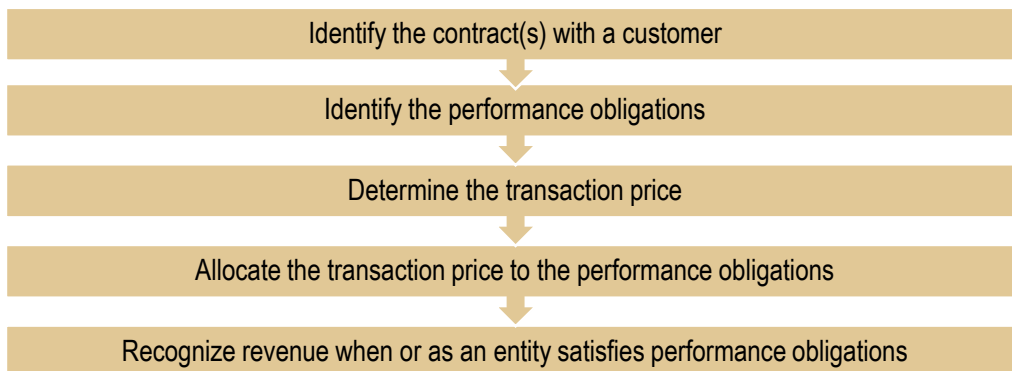
Step 1: Identify the contract with the customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies its performance obligations.



Each of these steps, and some other related guidance, is discussed in details below.

Entities will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. Entities will also have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances.



4. TRANSITION

Ind AS 115 is effective for annual reporting periods beginning on or after 1st April, 2018.

Entities are required to apply the new revenue standard using either of the following two approaches:

- (a) Full retrospective approach: apply retrospectively to each prior period presented in accordance with Ind AS 8, subject to some practical expedients mentioned in the standard or
- (b) Modified retrospective approach: apply retrospectively with the cumulative effect of initial application recognized at the date of initial application

When applying the full retrospective method, an entity shall restate all prior periods presented in accordance with Ind AS 8. This results in comparative statements in which all periods are presented as if Ind AS 115 had been in effect since the beginning of the earliest period presented.

When applying modified retrospective approach, an entity does not restate prior periods presented and the cumulative effect of initial application is recognized in the opening retained earnings of the first year of application of Ind AS 115.



5. STEP 1: IDENTIFYING THE CONTRACT

As the guidance in Ind AS 115 applies only to contracts with customers, the first step in the model is to identify such contracts.

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations. For example, if an entity has an established practice of starting performance based on oral agreements with its customers, it may determine that such oral agreements meet the definition of a contract. As a result, an entity may need to account for a contract as soon as performance begins, rather than delay revenue recognition until the arrangement is documented in a signed contract.

The guidance in Ind AS makes it clear that the rights and obligations in a contract must be “enforceable” in order for an entity to apply the five-step revenue model. Enforceability is a matter of law, so an entity needs to consider the local relevant legal environment to make that determination. That said, while the contract must be legally enforceable, oral or implied promises may give rise to performance obligations in the contract.

5.1 Criteria for recognizing a contract

Step 1 serves as a ‘gateway’ through which an entity must pass before proceeding to the later steps of the model. In other words, if at the inception of an arrangement, an entity concludes that the criteria below are not met, it should not apply Step 2 to 5 of the model until it determines that the Step 1 criteria are subsequently met. When a contract meets the five criteria and ‘passes’ Step 1, the entity will not reassess the Step 1 criteria unless there is an indication of a significant change in facts and circumstances.

Ind AS 115 requires an entity to account for a contract with a customer that is within the scope of the model in this standard only when **all** the following criteria are met:

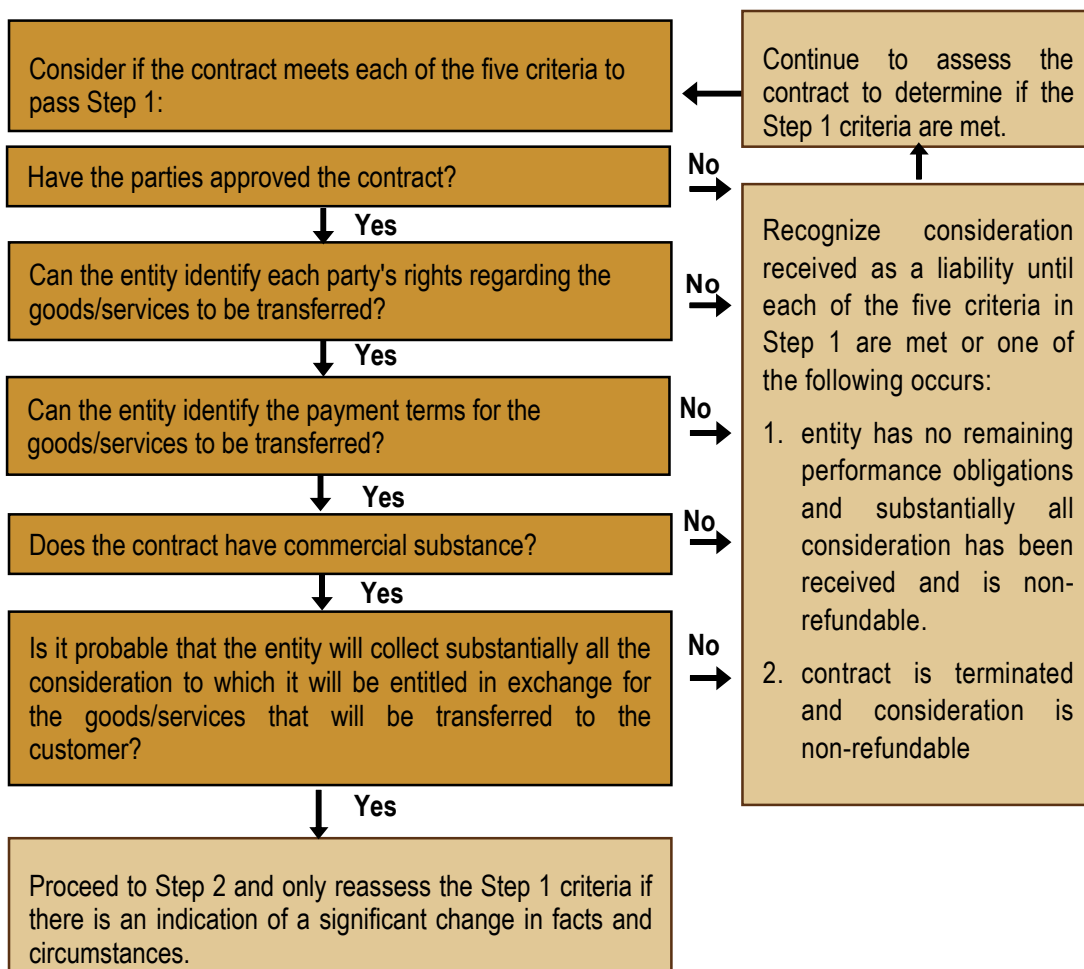
- (a) The parties have approved (in writing, orally or in accordance with other customary business practices) the contract and are committed to perform their contractual obligations
- (b) The entity can identify each party's rights regarding the goods or services to be transferred
- (c) The entity can identify the payment terms for the goods or services to be transferred

- (d) The contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract), and
- (e) It is probable that the entity will collect substantially all of the consideration to which it expects to be entitled in exchange for the goods or services that will be transferred to the customer.

If the arrangement does not meet the five criteria at inception, an accounting contract, for purposes of applying Ind AS 115, does not exist, and the entity should continue to reassess whether the five criteria are subsequently met. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which it will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

A contract may not pass Step 1, but the entity may still transfer goods or services to the customer and receive non-refundable consideration in exchange for those goods or services. In that circumstance, the entity cannot recognize revenue for the non-refundable consideration received until either the Step 1 criteria are subsequently met, or one of the events outlined below has occurred:

- (a) The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable, or
- (b) The contract has been terminated, and the consideration received from the customer is non-refundable.



Each of the criteria mentioned above are discussed in more detail below:

5.1.1 Criteria 1: The parties have approved the contract and are committed to perform

To pass Step 1, the parties must approve the contract. This approval may be written, oral, or implied, as long as the parties intend to be bound by the terms and conditions of the contract. The form of the contract (i.e. oral, written or implied) is not determinative, in assessing whether the parties have approved the contract. Instead, an entity must consider all relevant facts and circumstances when assessing whether the parties intend to be bound by the terms and conditions of the contract. In some cases, the parties to an oral or implied contract may have the intent to fulfil their respective obligations. However, in other cases, a written contract may be required before an entity can conclude that the parties have approved the arrangement.

In addition to approving the contract, the entity must also be able to conclude that both parties

are committed to performing their respective obligations under the contract. This does not mean that the parties need to be committed to fulfil all of their respective rights and obligations in order for this criterion to be met. For example, an entity may include a requirement in a contract for the customer to purchase a minimum quantity of goods each month, but the entity may have a history of not enforcing the requirement. In this example, the contract approval criterion can still be satisfied if evidence supports that the customer and the entity are both substantially committed to the contract. Termination clauses are also an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract exists. See 5.3.1 below for further discussion of termination clauses and how they affect contract duration.

5.1.2 Criteria 2: The entity can identify each party's rights

An entity must be able to identify its rights, as well as the rights of all other parties to the contract. An entity cannot assess the transfer of goods or services if it cannot identify each party's rights regarding those goods or services.

5.1.3 Criteria 3: The entity can identify the payment terms for the goods or services

An entity must also be able to identify the payment terms for the promised goods or services within the contract. Identifying the payment terms does not require that the transaction price be fixed or stated in the contract with the customer. As long as there is an enforceable right to payment (i.e. enforceability as a matter of law) and the contract contains sufficient information to enable the entity to estimate the transaction price, the contract would meet this criterion. The entity cannot determine how much it will receive in exchange for the promised goods or services (the "transaction price" in Step 3 of the model) if it cannot identify the contractual payment terms.

5.1.4 Criteria 4: The contract has commercial substance

A contract has commercial substance if the risk, timing, or amount of the entity's cash flows is expected to change as a result of the contract. In other words, the contract must have economic consequences. This criterion was added to prevent entities from transferring goods or services back and forth to each other for little or no consideration to artificially inflate their revenue. This criterion is applicable for both monetary and non-monetary transactions, because without commercial substance, it is questionable whether an entity has entered into a transaction that has economic consequences. Determining whether a contract has commercial substance for the purposes of Ind AS 115 may require significant judgement. In all situations, the entity must be able to demonstrate that a substantive business purpose exists, considering the nature and structure of its transactions.

5.1.5. Criteria 5: It is probable the entity will collect substantially all of the consideration

To pass Step 1, an entity must determine that it is probable that it will collect substantially all of the consideration to which it will be entitled under the contract in exchange for goods or services that it will transfer to the customer. This criterion is also referred to as the 'collectability assessment'. In determining whether collection is probable, the entity considers the customer's ability and intention to pay considering all relevant facts and circumstances, including past experiences with that customer or customer class. In making the determination of customer's ability to pay, the credit risk was an important thing to determine if the contract is valid. However, customer's credit risk should not affect the measurement or presentation of revenue. The standard requires an entity to evaluate at contract inception (and when significant facts and circumstances change) whether it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to a customer. For purposes of this analysis, the meaning of the term 'probable' means 'more likely than not'. If it is not probable that the entity will collect amounts to which it is entitled, the model in Ind AS 115 is not applied to the contract until the concerns about collectability have been resolved.

Illustration 1

New Way Ltd. decides to enter a new market that is currently experiencing economic difficulty and expects that in future the economy will improve. New Way Ltd. enters into an arrangement with a customer in the new region for networking products for promised consideration of ₹ 1,250,000. At contract inception, New Way Ltd. expects that it may not be able to collect the full amount from the customer.

Determine how New Way Ltd. will recognize this transaction?

Solution

Assuming the contract meets the other criteria covered within the scope of the model in Ind AS 115, New Way Ltd. need to assess whether collection is probable.

In making this assessment, New Way Ltd. considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price.

5.2 Contracts that do not pass Step 1: Reassessing the Step 1 criteria

When an entity determines that a contract passes Step 1, it should not reassess contract existence unless there is an indication of a significant change in facts and circumstances.

For example, if the customer's ability to pay significantly deteriorates, an entity would have to reassess whether it is probable that the entity will collect the consideration to which it is entitled in exchange for transferring the remaining goods and services under the contract. The updated assessment is prospective in nature and would not change the conclusions associated with goods and services already transferred. That is, an entity would not reverse any receivables, revenue or contract assets already recognized under the contract.

However, the revenue related to the remaining goods or services yet to be transferred is impacted.

5.3 Contract term

An entity applies Ind AS 115 to the contractual period over which the parties to the contract have present enforceable rights and obligations.

Some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply this Standard to the duration of the contract (ie the contractual period) in which the parties to the contract have present enforceable rights and obligations.

5.3.1 Termination provisions

Some contracts can be terminated by either party at any time while others may only be terminated by one party. The contract does not exist if each party to a contract has the unilateral enforceable right to terminate a wholly unperformed contract without paying a termination penalty. A 'wholly unperformed' contract means that the entity has not yet performed and is not entitled to any consideration.

In some situations, only the customer has the ability to terminate the contract without penalty. In those situations, the contract term for accounting purposes may be shorter than that stated in the contract.

However, a substantive termination penalty payable by a customer to the entity is evidence of enforceable rights and obligations of both parties throughout the period covered by the termination penalty. For example, consider a four-year service contract in which the customer has the right to cancel without cause at the end of each year, but for which the customer would incur a termination penalty that decreases each year and is determined to be substantive. Then, this arrangement would be treated as a four-year contract only and contract term should not be assessed less than four years unless the entity has past experience of having such contracts terminated by this customer or class of customer which may demand assessment of the contract term based on previous trend or experience.

Illustration 2

A gymnasium enters into a contract with a new member to provide access to its gym for a 12-month period at ₹ 4,500 per month. The member can cancel his or her membership without penalty after three months. Specify the contract term.

Solution

The enforceable rights and obligations of this contract are for three months, and therefore the contract term is three months.

Illustration 3

Contractor P enters into a manufacturing contract to produce 100 specialised CCTV cameras for Customer Q for a fixed price of ₹ 1,000 per sensor. Customer Q can cancel the contract without a penalty after receiving 10 CCTV cameras. Specify the contract units.

Solution

P determines that because there is no substantive compensation amount payable by Q on termination of the contract – i.e. no termination penalty in the contract – it is akin to a contract to produce 10 CCTV cameras that gives Customer Q an option to purchase additional 90 CCTV cameras. Hence, contract is for 10 units.

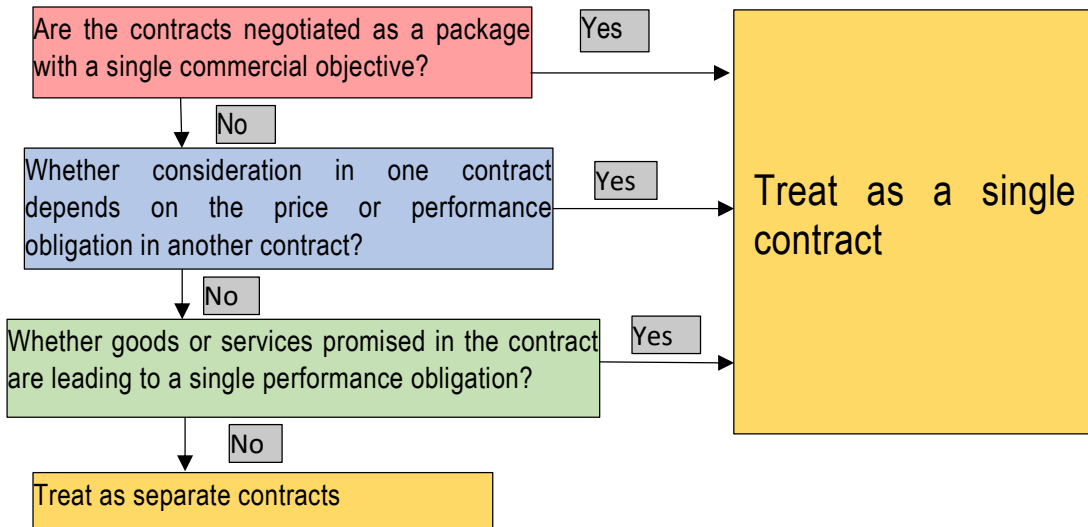
5.4 Combining contracts

An entity should combine two or more contracts and account for them as a single contract in certain circumstances because the substance of the individual contracts cannot be understood without considering the entire arrangement. This evaluation takes place at contract inception.

Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with the same customer (or with related parties of the customer), and if one of the following conditions exists:

- (a) The contracts are negotiated as a package with a single commercial objective;
- (b) The amount of consideration paid in one contract depends on the price or performance in the other contract; or
- (c) The goods or services promised in the contract are a single performance obligation.

Note: Entities will need to apply judgement to determine whether contracts are entered into at or near the same time because the standard does not provide a bright line for making this assessment.

**Illustration 4**

Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases.

Would these contracts be combined?

Solution

Contracts were negotiated at the same time, but they appear to have separate commercial objectives. Manufacturing and supply contracts are not dependent on one another, and the planes and the parts are not a single performance obligation. Therefore, contracts for supply of fighter planes and supply of parts shall not be combined and instead, they shall be accounted separately.

Illustration 5

Software Company S enters into a contract to license its customer relationship management software to Customer B. Three days later, in a separate contract, S agrees to provide consulting services to significantly customise the licensed software to function in B's IT environment. B is unable to use the software until the customisation services are complete.

Would these contracts be combined?

Solution

S determines that the two contracts should be combined because they were entered into at nearly the same time with the same customer, and the goods or services in the contracts are a single performance obligation.

Illustration 6

Manufacturer M enters into a contract to manufacture and sell a cyber security system to Government-related Entity P. One week later, in a separate contract, M enters into a contract to sell the same system to Government-related Entity Q. Both entities are controlled by the same government. During the negotiations, M agrees to sell the systems at a deep discount if both P and Q purchases the security system.

Should these contracts be combined or separately accounted?

Solution

M concludes that the said two contracts should be combined because, among other things, P is a related party of Q, the contracts were entered into at nearly the same time and the contracts were negotiated as a single commercial package, which is clearly evident from the fact that discount is being offered if both the parties purchase the security system, thereby also making the consideration in one contract dependent on the other contract.

5.5 Contract Modifications

Modifications that change the terms of a contract are common in many industries, including manufacturing, telecommunications, defence, and construction. Depending upon the industry or jurisdiction, the modification may be better known as a change order, a variation, or an amendment.

The modification guidance under Ind AS 115 requires an entity to

- (a) Identify if a contract has been modified.
- (b) Determine if the modification results in a separate contract, a termination of the existing contract and the creation of a new contract, or a continuation of the existing contract.
- (c) Account for the contract modification accordingly.

5.5.1 Identifying a modification

A contract modification exists if three conditions are met:

- (a) There is a change in the scope, price, or both in a contract.
- (b) That change is approved by both the entity and the customer.
- (c) The change is enforceable.

Similar to the criterion discussed above, the approval of a contract modification may be written, oral, or implied by customary business practice.

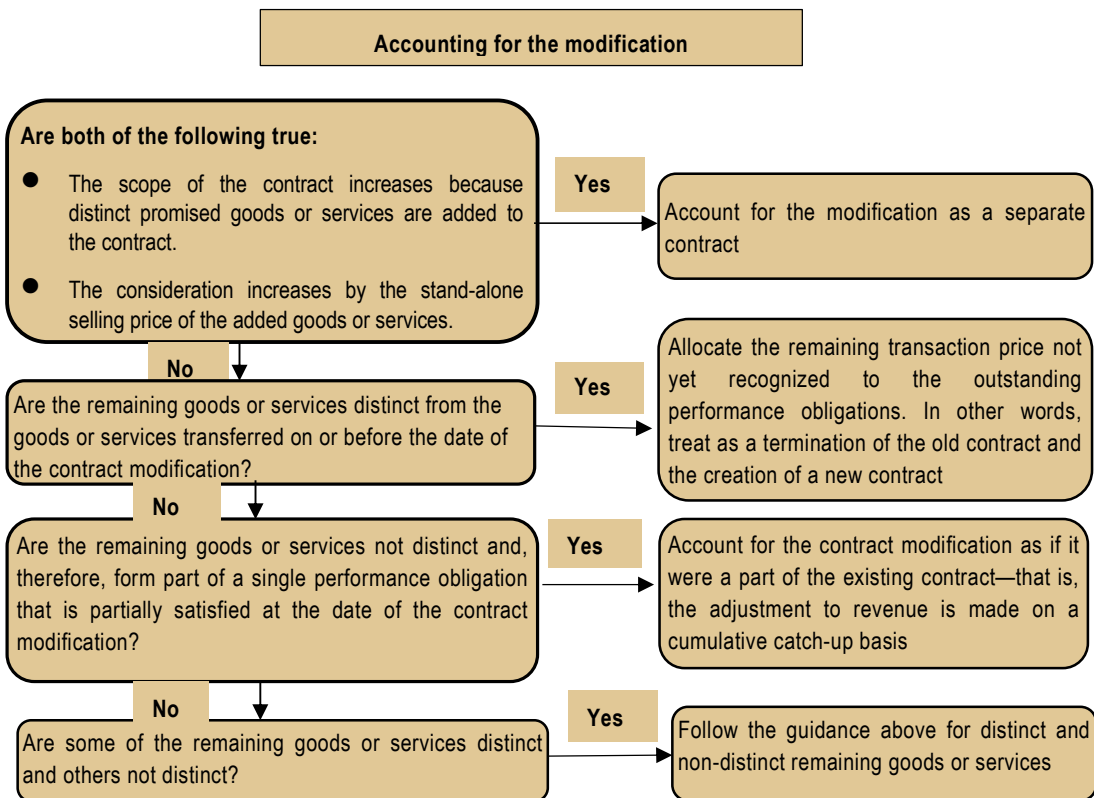
Contract modifications may take many forms and the following list includes some common examples:

- (a) Partially terminating the contract
- (b) Extending the contract term with or without a corresponding increase in price
- (c) Adding new goods and/or services to the contract, with or without a corresponding change in price
- (d) Reducing the contract price without a change in goods or services promised

5.5.2 Accounting for the modification

Once an entity determines that a contract with a customer has been modified, it needs to determine whether the modification should be accounted for as a separate contract as discussed above. If the modification is not accounted for as a separate contract, it will be accounted for in one of the following three ways:

- (a) As a termination of the old contract and the creation of a new contract
- (b) By making a cumulative catch-up adjustment to the original contract
- (c) A combination of the two



5.5.2.1 Modifications that constitute separate contracts

An entity accounts for a contract modification as a separate contract if the modification both

- (1) increases the scope of the work promised under the original contract by adding new promised goods or services that are considered distinct, and
- (2) the increase in the contract price reflects the stand-alone selling price of the additional goods or services. An entity determines if the additional promised goods or services are distinct using the guidance in Section 6.1.

The logic behind this guidance is that there is no economic difference between the entity entering into a separate contract or modifying an existing contract for the additional goods or services.

When assessing whether the transaction price increases by an amount of consideration that reflects the stand-alone selling prices of the additional goods or services, an entity is allowed to adjust the stand-alone selling price for costs that it does not incur because it is contracting with a repeat customer. Therefore, if the stand-alone selling price in the original contract is ₹ 10 per unit, a modification that adds units for ₹ 9.50 per unit might reflect a stand-alone selling price of the additional units. For example, the selling effort and administration costs might be much lower when incremental units are added, in contrast to the effort and cost of the original quantity. The entity needs to exercise judgment to make that determination.

If a modification adds a distinct goods or service to a series of distinct goods or services that is accounted for as a single performance obligation, the modification is accounted for as a separate contract as long as the transaction price increases by the stand-alone selling price for those added goods or services.

Illustration 7

An entity promises to sell 120 products to a customer for ₹ 120,000 (₹ 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of ₹ 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.

It is assumed that additional products are contracted for a price that reflects the stand-alone selling price.

Determine the accounting for the modified contract?

Solution

When the contract is modified, the price of the contract modification for the additional 30 products is an additional ₹ 28,500 or ₹ 950 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification and the additional products are distinct from the original products.

Accordingly, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract and ₹ 950 per product for the 30 products in the new contract.

5.5.2.2 Modifications that do not constitute separate contracts

If a contract modification is not accounted for as a separate contract, the guidance provides the following three methods to account for the modification:

- (a) First, account for the modification prospectively as long as the goods or services to be provided after the modification are distinct from the goods or services that were already provided to the customer. The logic behind this guidance is that accounting for these types of modifications on a cumulative catch-up basis could be complex and may not faithfully depict the economics of the modification since the modification is negotiated based on facts and circumstances that exist after the original contract's inception.

Illustration 8

On 1st April, 20X1, KLC Ltd. enters into a contract with Mr. K to provide

- *A machine for ₹ 2.5 million*
- *One year of maintenance services for ₹ 55,000 per month*

On 1st October, 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from ₹ 55,000 per month to ₹ 45,000 per month.

Determine the effect of change in the contract?

Solution

The next six months of services are distinct from the services provided in the first six months before modification in contract,

Therefore, KLC Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is ₹ 270,000, which is the sum of

- The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and had not yet been recognized as revenue. This amount is zero.
- The consideration promised as part of the contract modification i.e. ₹ 270,000.

- (b) Second, when the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied, the entity recognizes the effect of the modification on a cumulative catch-up basis. This is the case in many construction contracts where a modification does not result in the transfer of additional distinct goods or services.

Illustration 9

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal.

Based on its experience, Growth Ltd determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ₹ 150 per hour.

After incurring 100 hours of time, Growth Ltd and the customer agree to change an aspect of the project and increase the estimate of labour hours by 50 hours at the rate of ₹ 100 per hour.

Determine how contract modification will be accounted for as per Ind AS 115?

Solution

Considering that the remaining goods or services are not distinct, the modification will be accounted for on a cumulative catch up basis, as given below:

Particulars	Hours	Rate (₹)	Amount (₹)
Initial contract amount	200	150	30,000
Modification in contract	50	100	5,000
Contract amount after modification	250	140*	35,000
Revenue to be recognized	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

$$*35,000 / 250 = 140$$

- (c) Third, there may be cases where the remaining goods or services provided after a modification are a combination of both distinct and non-distinct goods or services. In this case, the entity accounts for those remaining goods or services that are distinct on a prospective basis and for those goods and services that are not distinct on a cumulative catch-up basis.



6. STEP 2: IDENTIFYING PERFORMANCE OBLIGATIONS

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

The concept of performance obligations is a cornerstone of the Ind AS 115 revenue recognition model. The timing of revenue recognition is based on satisfaction of performance obligations rather than the contract as a whole. This area is sometimes referred to as 'multiple element arrangements'.

6.1 Criteria for identifying performance obligation

At contract inception, an entity shall assess

- (a) the goods or services promised in a contract with a customer and
- (b) shall identify performance obligation under each promise to be transferred to the customer.

A contract with a customer generally states explicitly, the goods or services that an entity promises to transfer to the customer. However, the performance obligations identified in a contract with the customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises to create a valid expectation of the customer that the entity will transfer goods or service to the customer. Therefore, performance obligations under a contract with the customer are not always explicit or clearly mentioned in the contract, but there can be implied promises or performance obligation under the contract as well.

Promises under the contract can be explicit or implicit if the same creates a valid expectation by the customer that the entity will provide those goods or service based on the customary business practices, published policies, or specific statements. Some of the examples of promised goods or services include:

Promise	Example
• Sale of manufactured goods	• A manufacturing entity sells inventory
• Resale of goods purchased	• A retail entity sells purchased merchandise
• Resale of rights to goods or services purchased by an entity	• A hospitality entity that purchased a concert ticket resells the ticket, acting as principal
• Performing tasks	• A professional services entity provides consulting services
• Providing goods or services to customers on stand-by basis i.e. as and when required	• A manufacturing entity provides maintenance services on machines sold to a customer when the customer decides it wants the services performed
• Construction of an asset for the customers	• A contractor builds a hospital
• Use or access to intellectual property rights of the entity	• An entity grants a license to use its trade name
• Right to purchase additional goods or services to the customer in the future	• A retailer grants a customer an option to buy three items and to receive 60 percent off of a fourth item at a later date

An entity, a manufacturer, sells a product to a distributor (i.e. its customer) who will then resell it to an end customer.

I Explicit promise of service

- The entity promises to the distributor to provide maintenance services for no additional consideration or free of cost to any party that purchases the product from the distributor. The entity in turn appoints the distributor and pays the distributor to provide the maintenance services on company's behalf to the customer for an agreed payment. In case no one avails those services, the company is not required to pay anything to the distributor.
- Under this contract promise to provide maintenance services in the future will be considered as a performance obligation. The entity has promised to provide

maintenance services regardless of whether the entity, the distributor, or a third party provides the service.

II Implicit promise of service

- The entity has historically provided maintenance services for no additional consideration (i.e. 'free') to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor and the final contract between the entity and the distributor does not specify terms or conditions for those services.
- However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers (i.e. the distributor and end customers).

Performance obligations has been defined as a promise in a contract with a customer to transfer to the customer either:

- (a) goods or service (or a bundle of goods or services) that is distinct; or
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer the goods or service to a customer. For example, a service provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

A. Distinct performance obligations

A goods or service that is promised to a customer is distinct if both of the following criteria are met:

Two-step model to identify which goods or services are distinct

Step 1 - Focus on whether the good or service is **capable of being distinct**

Customer can benefit from the individual good or service on its own

Or;

Customer can use good or service with other readily available resources

Step 2 - Focus on whether the good or service is **distinct in the context of the contract**

The good or service is not integrated with, highly dependent on, highly interrelated with, or significantly modifying or customising other promised goods or services in the contract

Each of the criteria mentioned above are discussed in more detail below:

6.1.1 Customer can benefit either on a stand-alone basis or with other readily available resources

The customer can benefit from the goods or service either on its own or with other resources readily available to them. A readily available resource is a goods or service that is sold separately (by the entity or by another entity) or that the customer has already obtained from the entity or from other transactions or events.

A customer can benefit from a goods or service if the goods or service could be used, consumed, sold for an amount that is greater than its scrap value or otherwise held in a way that generates economic benefits.

Sometimes, a customer can benefit from a goods or service only with other readily available resources. A readily available resource is a goods or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a goods or service either on its own or in conjunction with other readily available resources.

For e.g, the fact that the entity regularly sells a goods or service on its own is an indicator that the goods or service is capable of being distinct.

6.1.2 Separately identifiable from other promises in the contract

Factors that indicate that an entity's promise to transfer a goods or service to a customer is separately identifiable include, but are not limited to, the following:

6.1.2.1 Significant integration service

It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the entity provides significant integration services. Stated differently, the entity is using the goods or services as inputs to produce the combined output promised in the contract. When an entity provides a significant service of integrating a goods or service with other goods or services in a contract, the bundle of integrated goods or services represents a combined output or outputs. In other words, when an entity provides a significant integration service, the risk of transferring individual goods or services is inseparable from the bundle of integrated goods or services because a substantial part of an entity's promise to the customer is to make sure the individual goods or services are incorporated into the combined output or outputs.

For example, construction contracts in which a contractor provides an integration (or contract management) service to manage and coordinate the various construction tasks and to assume the risks associated with the integration of those tasks. An integration service provided by the contractor often includes coordinating the activities performed by any subcontractors and making sure the quality of the work performed is in compliance with the contract specifications and that the individual goods or services are appropriately integrated into the combined item that the customer has contracted to receive.

6.1.2.2 Significant modification or customization

It indicates that one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

In some industries, such as the software industry, the notion of inseparable risks is more clearly illustrated by assessing whether one goods or service significantly modifies or customizes another goods or service in the contract. In this case, the goods or services are used as inputs and are being assembled together to create a combined output — a customized product.

Example 1

An entity promises to provide a customer with software that it will significantly customise to make the software function with the customer's existing infrastructure. Based on its facts and circumstances, the entity determines that it is providing the customer with a fully integrated system and that the customisation service requires it to significantly modify the software in such a way that the risks of providing it and the customisation service are inseparable (i.e. the software and customisation service are not separately identifiable).

6.1.2.3 Highly interdependent or highly interrelated

It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the goods or services are highly interdependent or highly interrelated.

Sometimes it may be unclear whether the entity provides an integration service or whether the goods or services are significantly modified or customized; yet the individual goods or services are not separately identifiable from other goods or services because they are highly dependent on, or highly interrelated with, other promised goods or services in the contract.

The principle in evaluating whether promises are “distinct within the context of the contract” is to consider the level of integration, interrelation, or interdependence among promises to transfer goods or services. As a result, the entity must evaluate whether two or more promised goods or services significantly affect the other and are therefore highly interdependent or highly interrelated with other promised goods or services in the contract. An entity does not simply evaluate whether one item depends on another. There must be a two-way dependency. In other words, instead of concluding that an undelivered item would never be obtained by a customer absent the delivered item in the contract, the entity would consider whether the undelivered item and the delivered item each significantly affect the other and therefore are highly interdependent or highly interrelated.

Illustration 10

A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all aspects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components.

Determine whether the company has a single or multiple performance obligations under the contract?

Solution

Determining whether a goods or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition. In order to determine how many performance obligations are present in the contract, the company applies the guidance above. While the customer may be able to benefit from each promised goods or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation.

This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

Illustration 11

An entity provides broadband services to its customers along with voice call service.

Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.

Are the performance obligations under the contract distinct?

Solution

Entity promises to customer to provide

- ❖ Broadband Service
- ❖ Voice Call services
- ❖ Modem

Entity's promise to provide goods and services is distinct if

- ❖ customer can benefit from the goods or service either on its own or together with other resources that are readily available to the customer, and
- ❖ entity's promise to transfer the goods or service to the customer is separately identifiable from other promises in the contract

For broadband and voice call services -

- ❖ Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependant or interrelated. Also the customer can benefit on its own from the services received.

For sale of modem -

- ❖ Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.

Based on the evaluation we can say that there are three separate performance obligation: -

- ❖ Broadband Service
- ❖ Voice Call services
- ❖ Modem

Illustration 12

An entity enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be provided like engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

Determine how many performance obligations does the entity have?

Solution

Based on the discussion above it needs to be determined that the promised goods and services are capable of being distinct as per the principles of Ind AS 115. That is, whether the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the goods and services are not distinct within the context of the contract. That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of putting together the various inputs or goods and services into the power plant or the output for which the customer has contracted.

Since both the criteria have not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

B. Promise to transfer a series of distinct goods or services that are substantially the same and have the same pattern of transfer:

There might be cases, where distinct goods or services are provided continuously over a period of time. For e.g. security services, or bookkeeping services. This will be considered as single performance obligation if the consumption of those services by the customers is symmetrical.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- (a) each distinct goods or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation satisfied over time; and
- (b) the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct goods or service in the series to the customer.

If a series of distinct goods or services meets the criteria in paragraph 22(b) and paragraph 23 of Ind AS 115 (the series requirement), an entity is required to treat that series as a single performance obligation (i.e. it is not optional). Cleaning services, transaction processing services and delivering electricity to customers are some examples that meet the series requirement.

It is important to note that, even if, the underlying activities an entity performs to satisfy a promise vary significantly throughout the day and from day to day, that fact, by itself, does not mean the distinct goods or services are not substantially the same.

Example 2

A vendor enters into a 5-year contract with a customer to provide continuous access to its system and to process all transactions on behalf of the customer. The customer is obligated to use the vendor's system, but the ultimate quantity of transactions is unknown. The vendor concludes that the customer simultaneously receives and consumes the benefits as it performs.

If the vendor concludes that the nature of its promise is to provide continuous access to its system, rather than process a particular quantity of transactions, it might conclude that there is a single performance obligation to stand ready to process as many transactions as the customer requires. If that is the case, it would be reasonable to conclude that there are multiple distinct time increments of the service. Each day of access to the service provided to the customer could be considered substantially the same since the customer is deriving a consistent benefit from the access each day, even if a different number of transactions are processed each day.

If the vendor concludes that the nature of the promise is the processing of each transaction, then each transaction processed could be considered substantially the same even if there are multiple types of transactions that generate different payments. Furthermore, each transaction processed could be a distinct service because the customer could benefit from each transaction on its own and each transaction could be separately identifiable. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series' requirement.

Illustration 13

Could the series requirement apply to hotel management services where day to day activities vary, involve employee management, procurement, accounting, etc?

Solution

The series guidance requires each distinct goods or service to be "substantially the same." Management should evaluate this requirement based on the nature of its promise to customer. For example, a promise to provide hotel management services for a specified contract term may meet the series criteria. This is because the entity is providing the same service of "hotel

management” each period, even though some on underlying activities may vary each day. The underlying activities for e.g. reservation services, property maintenance services are activities to fulfil the hotel management service rather than separate promises. The distinct service within the series is each time increment of performing the service.

6.2 Multiple Element Arrangements/ Goods and services that are not distinct

Once an entity determines whether the goods and services would be distinct based on their individual characteristics, the entity then has to consider if the manner in which the goods and services have been bundled in an arrangement would require the entity to account for two or more goods or services as one performance obligation. This determination would be required regardless of whether or not those goods and services were determined to be distinct on their own.

If the goods or services are not considered as distinct, those goods or services are combined with other goods or services under the contract till the time the entity identifies a bundle of distinct goods or services.

This combination would result in accounting of multiple goods or services in the contract as a single performance obligation. This could also result in an entity combining a goods or service that is not considered distinct with another goods or service that, on its own, would have met the criteria to be considered distinct. An entity may end up accounting for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods and services is the only distinct performance obligation identified.

It is important to note that the assessment of whether a goods or service is distinct must consider the specific contract with a customer. That is, an entity cannot assume that a particular goods or service is distinct (or not distinct) in all instances. The manner in which promised goods and services are bundled within a contract can affect the conclusion of whether a goods or service is distinct. Entities may treat the same goods and services differently, depending on how those goods and services are bundled within a contract.

Illustration 14

Entity A, a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping centre with a customer car parking facility located in sub-levels underneath the shopping centre. Entity B solicited bids from multiple firms on both phases of the project — design and construction.

The design and construction of the shopping centre and parking facility involves multiple goods and services from architectural consultation and engineering through procurement and

installation of all the materials. Several of these goods and services could be considered separate performance obligations because Entity A frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. Entity A may require to continually alter the design of the shopping centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the entity A have?

Solution

Entity A analyses that it will be required to continually alter the design of the shopping centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project. Therefore, the design and construction phases are highly dependent on one another (i.e., the two phases are highly interrelated). Entity A also determines that significant customisation and modification of the design and construction services is required in order to fulfil the performance obligation under the contract. As such, Entity A concludes that the design and construction services will be bundled and accounted for as one performance obligation.

Illustration 15

An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

Determine how many performance obligations does the entity have?

Solution

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available.

The entity also considers the factors of Ind AS 115 and determines that the promise to transfer each goods and service to the customer is separately identifiable from each of the other promises. In particular, the entity observes that the installation service does not significantly modify or customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- The software license
- An installation service
- Software updates
- Technical support

Illustration 16 : Significant customisation

The promised goods and services are the same as in the above Illustration, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

Determine how many performance obligations does the entity have?

Solution

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the license and the customised installation service as inputs to produce the combined output (i.e. a functional and integrated software system) specified in the contract. In addition, the software is significantly modified and customised by the service. Although the customised installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the license is not separately identifiable from the customised installation service and, therefore, the criterion on the basis of the factors is not met. Thus, the software license and the customised installation service are not distinct.

The entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

- a) customised installation service (that includes the software license);
- b) software updates; and
- c) technical support.

Illustration 17

Telco T Ltd. enters into a two-year contract for internet services with Customer C. C also buys a modem and a router from T Ltd. and obtains title to the equipment. T Ltd. does not require customers to purchase its modems and routers and will provide internet services to customers using other equipment that is compatible with T Ltd.'s network. There is a secondary market in which modems and routers can be bought or sold for amounts greater than scrap value.

Determine how many performance obligations does the entity T Ltd. have?

Solution

T Ltd. concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation:

Criterion 1: Capable of being distinct

- C can benefit from the modem and router on their own because they can be resold for more than scrap value.
- C can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set-up, they could be bought from alternative retail vendors or the internet service could be used with different equipment.

Criterion 2: Distinct within the context of the contract

- T Ltd. does not provide a significant integration service.
- The modem, router and internet services do not modify or customise one another.

- C could benefit from the internet services using routers and modems that are not sold by T Ltd. Therefore, the modem, router and internet services are not highly dependent on or highly inter-related with each other.

Illustration 18

V Ltd. grants Customer C a three-year licence for anti-virus software. Under the contract, V Ltd. promises to provide C with when-and-if-available updates to that software during the licence period. The updates are critical to the continued use of the anti-virus software.

Determine how many performance obligations does the entity have?

Solution

V Ltd. concludes that the licence and the updates are capable of being distinct because the anti-virus software can still deliver its original functionality during the licence period without the updates. C can also benefit from the updates together with the licence transferred when the contract is signed.

However, V Ltd. concludes that the licence and the updates are not separately identifiable because the software and the service are inputs into a combined item in the contract – i.e. the nature of V Ltd.'s promise is to provide continuous anti-virus protection for the term of the contract. Therefore, V Ltd. accounts for the licence and the updates as a single performance obligation.

Illustration 19

Media Company P Ltd. offers magazine subscriptions to customers. When customers subscribe, they receive a printed copy of the magazine each month and access to the magazine's online content.

Determine how many performance obligations does the entity have?

Solution

P evaluates whether the promises to provide printed copies and online access are separate performance obligations. P determines that the arrangement includes two performance obligations for the following reasons:

- The printed copies and online access are both capable of being distinct because the customer could use them on their own.

- The printed copies and online access are distinct within the context of the contract because they are different formats, so they do not significantly customise or modify each other, nor is there any transformative relationship into a single output.

Illustration 20-Implied promise to reseller's customers

Software Company K Ltd. enters into a contract with reseller D, which then sells software products to end users. K Ltd. has a customary business practice of providing free telephone support to end users without involving the reseller, and both reseller and the customer expect K Ltd. to continue to provide this support.

Determine how many performance obligations does the entity K Ltd. have?

Solution

In evaluating whether the telephone support is a separate performance obligation, K Ltd. notes that the promise to provide telephone support free of charge to end users is considered a service that meets the definition of a performance obligation when control of the software product transfers to D. As a result, K Ltd. accounts for the telephone support as a separate performance obligation in the transaction with D.

Illustration 21-Implied performance obligation

Carmaker N Ltd. has a historical practice of offering free maintenance services – e.g. oil changes and tyre rotation – for two years to the end customers of dealers who buy its vehicles. However, the two years' free maintenance is not explicitly stated in the contract with its dealers, but it is typically stated in N's advertisements for the vehicles.

Determine how many performance obligations does the entity have?

Solution

The maintenance is treated as a separate performance obligation in the sale of the vehicle to the dealer. Revenue from the sale of the vehicle is recognized when control of the vehicle is transferred to the dealer. Revenue from the maintenance services is recognized separately as and when the maintenance services are provided to the retail customer.

6.3 Customer options for additional goods or services

Retail and consumer products entities frequently give certain customers the option to purchase additional goods or services. These options come in many forms, including sales incentives

(e.g., coupons with a limited distribution, competitor price matching programs aimed at only some customers, gift cards issued by a retailer as a promotion) and customer award credits (e.g., loyalty or reward programs).

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer. The right is material if it results in a discount that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

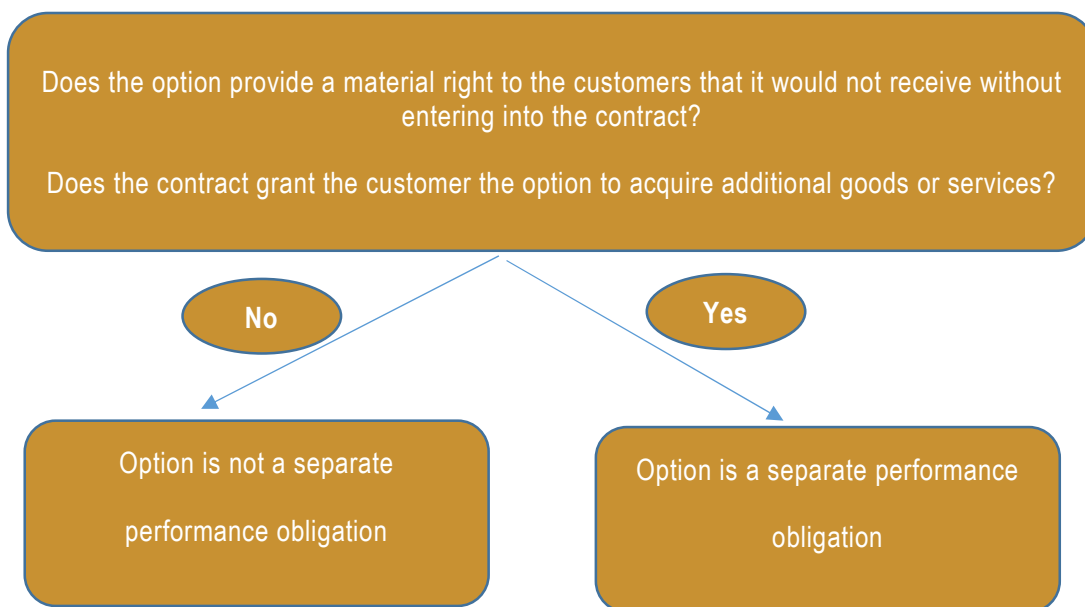
If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right.

In such cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

This standard requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

- (a) any discount that the customer could receive without exercising the option; and
- (b) the likelihood that the option will be exercised.

**Illustration 22**

Entity sells gym memberships for ₹ 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at ₹ 6,000 per year. Entity estimates an annual attrition rate of 50% each year.

Determine the amount of revenue to be recognized in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

Solution

Allocated price per unit (year) is calculated as follows:

Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175

Total consideration is ₹ 12,00,000 {(100 x 7,500) + (50 x 6,000) + (25 x 6,000)}

Allocated price per membership is ₹ 6,857 approx. (12,00,000 / 175)

Based on above, it is to be noted that although entity has collected ₹ 7,500 but revenue can be recognized at ₹ 6,857 approx. per membership and remaining ₹ 643 should be recorded as contract liability against option given to customer for renewing their membership at discount.

Illustration 23

An entity enters into a contract for the sale of Product A for ₹ 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to ₹ 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as

part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes there is 80% likelihood that a customer will redeem the voucher and, on an average, a customer will purchase ₹ 500 of additional products.

Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price?

Solution

Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 80% likelihood that a customer will redeem the voucher and, on an average, a customer will purchase ₹ 500 worth of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is ₹ 120 (₹ 500 average purchase price of additional products x 30% incremental discount x 80% likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the ₹ 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	₹ 1000
Discount voucher	₹ 120
Total	₹ 1120

Performance obligations		Allocated transaction price (to nearest ₹10)
Product A	$(₹ 1000 \div ₹ 1120 \times ₹ 1000)$	₹ 890
Discount voucher	$(₹ 120 \div ₹ 1120 \times ₹ 1000)$	₹ 110
Total		₹ 1000

The entity allocates ₹ 890 to Product A and recognizes revenue for Product A when control transfers. The entity allocates ₹ 110 to the discount voucher and recognizes revenue for the voucher when the customer redeems it for goods or services or when it expires.

6.4 Long term arrangements

Entities frequently enter into arrangements to provide services on a long-term basis, such as maintenance services to be provided over a long period of time.

For example, should a three-year maintenance agreement be considered a single performance obligation representing the entire contractual period, or should it be broken into smaller periods (daily, monthly or yearly)? It may be appropriate to treat a three-year services contract as three separate one-year performance obligations, if the contract can be renewed or cancelled by either party at discrete points in time (that is, at the end of each service year).

The entity would separately account for its rights and obligations for each period in which the contract cannot be cancelled by either party.

In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

Illustration 24

A cable company provides television services for a fixed rate fee of ₹ 800 per month for a period of 3 years. Cable services is satisfied overtime because customer consumes and receives benefit from services as it is provided i.e. customer generally benefits each day that they have access to cable service.

Determine how many performance obligations does the cable company have?

Solution

Cable company determines that each increment of its services e.g. day or month, is a distinct performance obligation because customer benefits from that period of services on its own. Additionally, each increment of service is separately identifiable from those preceding and following it i.e. one service period does not significantly affect, modify or customise another. Therefore, it can be concluded that its contract with customer is a single performance obligation to provide three years of cable service because each of the distinct increments of service is satisfied over time. Also, cable company uses the same measure of progress to recognize revenue on its cable television service regardless of the contract's time period.

6.5 Consignment Arrangements

Entities frequently deliver inventory on a consignment basis to other parties (e.g. distributor, dealer). By shipping on a consignment basis, consignors are able to achieve better sales by moving them closer to the end-customer. However, they do so without selling the goods to the

intermediary (consignee). A consignment agreement is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods. The consignee may take goods from the consignment stock for use or resale subject to payment to the consignor agreeably to the terms bargained in the consignment agreement. Entities frequently deliver inventory on a consignment basis to other parties (e.g., distributor, dealer).

The following indicators have been provided to evaluate whether the arrangement is a consignment arrangement:

- (a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
- (b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
- (c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Entities entering into a consignment arrangement must determine the nature of the performance obligation (i.e., whether the obligation is to transfer the inventory to the consignee or to transfer the inventory to the end customer). This determination is based on whether control of the inventory has passed to the consignee upon delivery. In case of consignment arrangement, a consignor will not relinquish control of consignment inventory until the inventory is sold to the consumer or on the expiry of an agreed period. Consignees does not have an obligation to pay, until the goods are sold to the ultimate or end consumer. As a result, revenue generally would not be recognized for consignment arrangements when the goods are delivered to the consignee because control has been not yet transferred. Revenue is recognized when the entity has transferred control of the goods to the consignor or the end consumer. A consignment sale differs from a sale with a right of return. The customer has control of the goods in a sale with right of return and can decide whether to put the goods back to the seller. In case of consignment sales, the consignee does not have the control over the goods.

Illustration 25

Manufacturer M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's stores. Retailer A is obligated to pay Manufacturer M ₹ 20 per dress when the dress is sold to an end customer.

During the consignment period, Manufacturer M has the contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacturer M is also required to accept the return of the inventory. State when the control is transferred.

Solution

Manufacturer M determines that control has not been transferred to Retailer A on delivery, for the following reasons:

- (a) Retailer A does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;
- (b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and
- (c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when Retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses.

Manufacturer M recognizes revenue as the dresses are sold to the end customer.

6.6 Principal vs agent consideration

Some contracts result in an entity's customer receiving goods or services from another entity that is not a direct party to the contract with the customer. The standard states that when other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the goods or service itself (i.e., the entity is a principal) or to arrange for another party to provide the goods or service (i.e., the entity is an agent). The determination of whether the entity is acting as a principal, or an agent affects the amount of revenue the entity recognizes. That is,

- when the entity is the principal in the arrangement, the revenue recognized is the gross amount to which the entity expects to be entitled.
- when the entity is acting as an agent, the revenue recognized is the net amount i.e. the amount, entity is entitled to retain in return for its services under the contract. The entity's fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

A principal's performance obligations in an arrangement differ from an agent's performance obligations. For example, if an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation may be to provide the goods or services itself. Hence, the entity likely is acting as a principal

and would recognize revenue in the gross amount to which it is entitled. An entity that obtains legal title of a product only momentarily before legal title is transferred to the customer is not necessarily acting as a principal. In contrast, an agent facilitates the sale of goods or services to the customer in exchange for a fee or commission and generally does not control the goods or services for any length of time. Therefore, the agent's performance obligation is to arrange for another party to provide the goods or services to the customer. Since the identification of the principal in a contract is not always clear, Ind AS 115 provides indicators that a performance obligation involves an agency relationship.

Indicators that an entity is a principal (and therefore controls the goods or service before it is provided to a customer) include the following:

- (a) the entity is primarily responsible for fulfilling the contract. This typically includes responsibility for the acceptability of the specified goods or service;
- (b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return).
- (c) the entity has discretion in establishing prices for the goods or services.

After an entity identifies its promise and determines whether it is the principal or the agent, the entity recognizes revenue when it satisfies that performance obligation. In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal.

For example, an entity might satisfy its promise to provide customers with loyalty points when those points are transferred to the customer if:

- (a) The entity's promise is to provide loyalty points to customers when the customer purchases goods or services from the entity
- (b) The points entitle the customers to future discounted purchases with another party (i.e., the points represent a material right to a future discount)
- (c) The entity determines that it is an agent (i.e., its promise is to arrange for the customers to be provided with points) and the entity does not control those points before they are transferred to the customer.

In contrast, if the points entitle the customers to future goods or services to be provided by the entity, the entity may conclude it is not an agent. This is because the entity's promise is to provide those future goods or services.

Therefore, the entity controls both the points and the future goods or services before they are transferred to the customer. In these cases, the entity's performance obligation may only be satisfied when the future goods or services are provided.

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. In this situation, the nature of the entity's performance obligation may not be known until the customer makes its choice. That is, until the customer has chosen the goods or services to be provided (and, therefore, whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Therefore, the entity may not satisfy its performance obligation until it either delivers the goods or services or is no longer obliged to stand ready. If the customer subsequently chooses the goods or services from another party, the entity would need to consider whether it was acting as an agent. If so, it would recognize revenue, but only for the fee or commission that the entity receives in return for providing the services to the customer and the third party.

Following illustrations explain the application of the principal versus agent application guidance:

Illustration 26

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are sold; therefore, there is no credit risk.

The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent.

Solution

To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:

- (a) the entity is primarily responsible for fulfilling the contract, which provides the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.
- (b) the entity has inventory risk for the tickets because they are purchased before, they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.
- (c) the entity has discretion in setting the sales prices for tickets to its customers.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

Illustration 27

Company D Ltd. provides advertising services to customers. D Ltd. enters into a sub-contract with a multinational online video sharing company, F Ltd. Under the sub-contract, F Ltd. places all of D Ltd.'s customers' adverts.

D Ltd. notes the following:

- *D Ltd. works directly with customers to understand their advertising needs before placing adverts.*
- *D Ltd. is responsible for ensuring that the advert meets the customer's needs after the advert is placed.*
- *D Ltd. directs F Ltd. over which advert to place and when to place it.*
- *D Ltd. does not bear inventory risk because there is no minimum purchase requirement with F Ltd.*
- *D Ltd. does not have discretion in setting the price because fees are charged based on F Ltd.'s scheduled rates.*

D is Principal or an agent?

Solution

D Ltd. is primarily responsible for fulfilling the promise to provide advertising services. Although F Ltd. delivers the placement service, D Ltd. works directly with customers to ensure that the services are performed to their requirements. Even though D Ltd. does not bear inventory risk

and does not have discretion in setting the price, it controls the advertising services before they are provided to the customer. Therefore, D Ltd. is the principal in this case.

6.7 Non-refundable upfront fees

In some contracts, an entity charges the customer a non-refundable upfront fee. Examples include joining fees in health club membership, activation fees for telecom services, setup fees in certain service contracts and initial fees or joining fees in some supply contracts with the distributors or customers.

To identify performance obligations in such contracts, an entity shall assess whether the fee relates to an activity that the entity is required to undertake at the inception of the contract, or that activity does not result in the transfer of a promised goods or service to the customer.

In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised goods or service to the customer. Instead, the upfront fee is an advance payment for future goods and services and, therefore, would be recognized as revenue when those future goods and services are provided.

If the non-refundable upfront fee relates to a goods or service, the entity shall evaluate whether to account for the goods or services as a separate performance obligation. An entity may charge a non-refundable fee as a part of compensation of costs incurred in setting up a contract (or other administrative tasks). If those setup activities do not satisfy performance obligation, the entity shall disregard those activities (and related costs) when measuring progress. That is because the costs of setup activities do not depict transfer of services to customer.

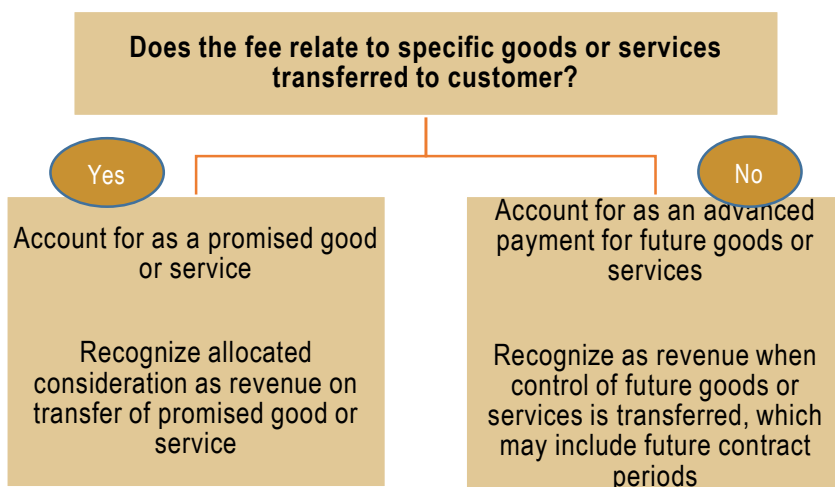


Illustration 28

A customer buy a new data connection from the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection. The customer will be charged based on the usage of the data services of the connection on monthly basis.

Are the performance obligations under the contract distinct?

Solution

By selling a new connection, the entity promises to supply data services to customer. Customer will not be able to benefit from just buying a data card and data services from third party. The activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation.

Entity's obligation is to provide data service and hence activation is not a separate performance obligation.



7. STEP 3: DETERMINING THE TRANSACTION PRICE

Measurement

“When (or as) a performance obligation is satisfied, an entity shall recognize as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56 – 58) that is allocated to that performance obligation.”

After identifying the contract in Step 1 and the performance obligations in Step 2, an entity next applies Step 3 to **determine the transaction price** of the contract. The objective of Step 3 is to predict the total amount of consideration to which the entity will be entitled from the contract.

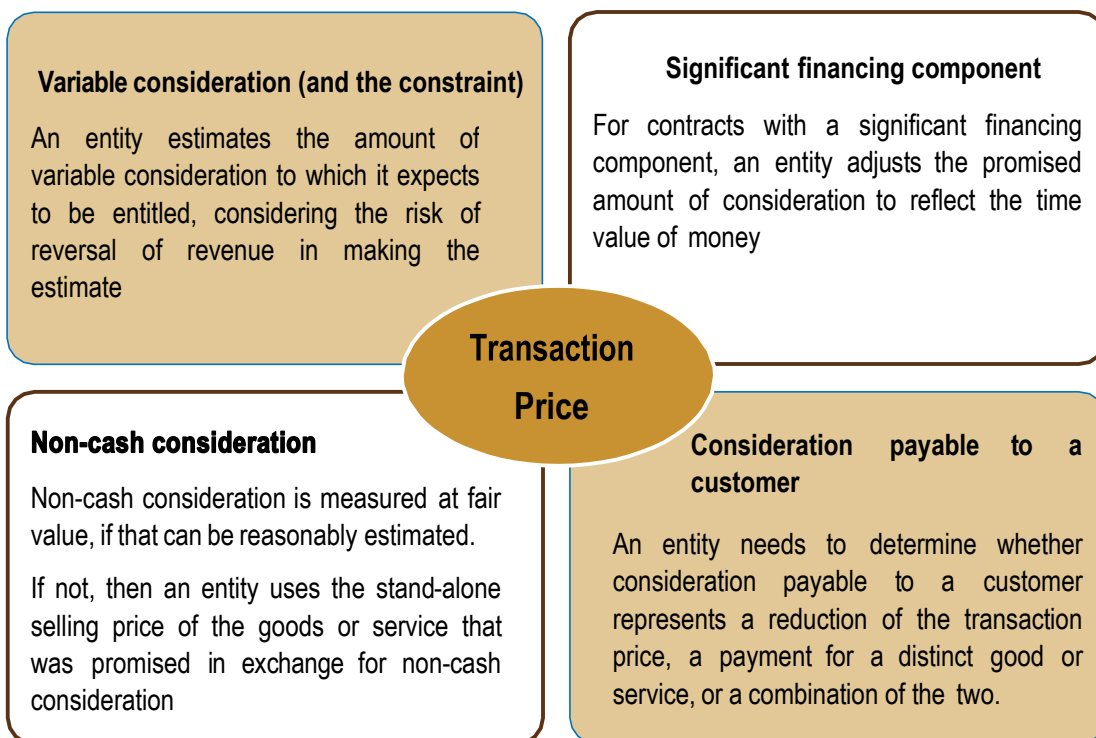
What is the transaction price?

“The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).”

The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. Further, an entity shall consider the terms of the contract and its customary business practices to determine the transaction price.

For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:



Comparison with AS 7 and AS 9

Neither AS 7 nor AS 9 has any specific mention about significant financing component in a transaction price.

7.1 Variable consideration

What is variable consideration?

“If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.”

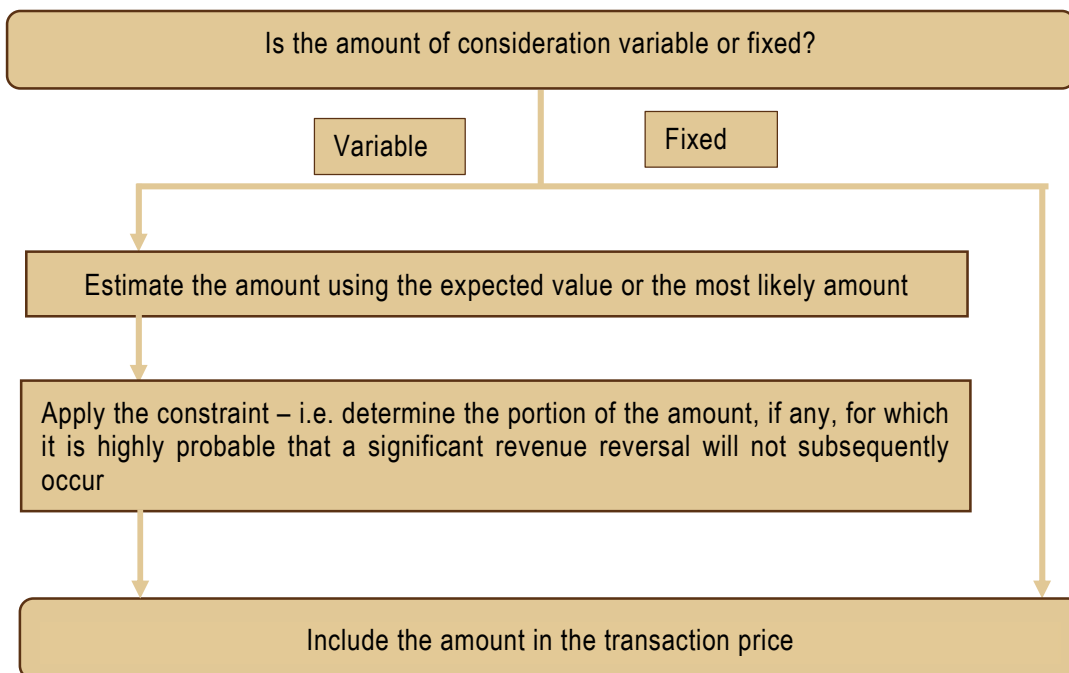
Examples of variable consideration

“An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity’s entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return, or a fixed amount is promised as a performance bonus on achievement of a specified milestone.”

Variable consideration may be fixed in amount, but the entity’s right to receive that consideration is contingent on a future outcome. For example, the amount of a performance bonus might be fixed, but because the entity is not entitled to that bonus until a performance target is met, the outcome is uncertain and therefore the amount is considered variable. Items such as discounts, rebates, refunds, rights of return, early settlement discounts, credits, price concessions, incentives, performance bonuses, penalties or similar items may result in variable consideration.

The variability relating to the consideration promised by a customer **may be explicitly stated** in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

- (a) the customer has a **valid expectation arising from an entity’s customary business practices**, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.
- (b) other facts and circumstances indicate that the **entity’s intention**, when entering into the contract with the customer, is to offer a price concession to the customer.



7.1.1 Penalties

Penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration.

Example 3

Where an entity agrees to transfer control of a goods or service in a contract with customer at the end of 30 days for ₹ 100,000 and if it exceeds 30 days, the entity is entitled to receive only ₹ 95,000, the reduction of ₹ 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed at ₹ 95,000.

7.1.2 Estimating the amount of variable consideration

As per Ind AS 115.53, an entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- The expected value** - the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
- The most likely amount** - the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract).

The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

An entity is required to choose between the expected value method and the most likely amount method. The choice is based on the method which better predicts the amount of consideration to be entitled. **That is, the method selected is not meant to be a 'free choice'.** Rather, an entity selects the method that is best suited, based on the specific facts and circumstances of the contract.

An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. An entity shall consider all the information that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts.

A contract may contain different types of variable consideration. It may be appropriate for an entity to use different methods (i.e. expected value or most likely amount) for estimating different types of variable consideration within a single contract.

Illustration 29 : Estimating variable consideration

XYZ Limited enters into a contract with a customer to build sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ₹ 2.5 crore, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31st March, 20X1 that the asset is incomplete, the promised consideration is reduced by ₹ 1 lakh. For each day before 31st March, 20X1 that the asset is complete, the promised consideration increases by ₹ 1 lakh.

In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of ₹ 15 lakh.

Determine the transaction price.

Solution

In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in paragraph 53 of Ind AS 115:

- a) the entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (i.e. ₹ 2.5 crore, plus or minus ₹ 1 lakh per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

- b) the entity decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only two possible outcomes (₹ 15 lakh or Nil) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

The entity considers the requirements in paragraphs 56–58 of Ind AS 115 (discussed below) on constraining estimates of variable consideration to determine whether the XYZ Limited should include some or all of its estimate of variable consideration in the transaction price.

Illustration 30 : Estimating variable consideration

AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.

Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of ₹ 25 crore.

The entity has the opportunity to earn a performance bonus for early completion as follows:

- *15 percent bonus of the contract price if completed by the 30th month (25% likelihood)*
- *10 percent bonus if completed by the 32nd month (40% likelihood)*
- *5 percent bonus if completed by the 34th month (15% likelihood)*

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of ₹ 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.

Determine the transaction price.

Solution

In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus.

AST Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes, and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. AST's best estimate of the early completion bonus is ₹ 2.13 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability-weighted amount (₹ in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			<u>2.125</u>

AST Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (₹ 2 crore or Nil) and this method would best predict the amount of consideration associated with the quality bonus. AST Limited believes the most likely amount of the quality bonus is ₹ 2 crore.

As per para 54 of Ind AS 115, an entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

7.1.3 Refund liabilities

An entity shall recognize a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price). The refund liability (and corresponding change in the transaction price and, therefore, the *contract liability*) shall be updated at the end of each reporting period for changes in circumstances.

While the most common form of refund liabilities may be related to sales with a right of return, the refund liability requirements also apply when an entity expects that it will need to refund consideration received due to poor customer satisfaction with a service provided (i.e. there was no goods delivered or returned) and/or if an entity expects to have to provide retrospective price reductions to a customer (e.g. if a customer reaches a certain threshold of purchases, the unit price will be retrospectively adjusted).

7.1.4 Constraining estimates of variable consideration

An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised goods or service.
- (b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- (c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) the contract has a large number and broad range of possible consideration amounts.

7.1.5 Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with paragraphs 87 – 90 of Ind AS 115.

Comparison with AS 7 and AS 9

AS 7 and AS 9 both are silent on a situation where revenue should be reversed as specified in Ind AS 115.

Illustration 31 : Volume discount incentive

HT Limited enters into a contract with a customer on 1st April, 20X1 to sell Product X for ₹ 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the

contract specifies that the price per unit is retrospectively reduced to ₹ 900 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 30th June, 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognized (i.e. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).

Further, in May, 20X1, the customer acquires another company and in the second quarter ended 30th September, 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100-unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to ₹ 900.

Determine the amount of revenue to be recognize by HT Ltd. for the quarter ended 30th June, 20X1 and 30th September, 20X1.

Solution

The entity recognizes revenue of ₹ 10,000 (10 units × ₹ 1,000 per unit) for the quarter ended 30th June, 20X1.

HT Limited recognizes revenue of ₹ 44,000 for the quarter ended 30th September, 20X1. That amount is calculated from ₹ 45,000 for the sale of 50 units (50 units × ₹ 900 per unit) less the change in transaction price of ₹ 1,000 (10 units × ₹ 100 price reduction) for the reduction of revenue relating to units sold for the quarter ended 30th June, 20X1.

Illustration 32 : Measurement of variable consideration

An entity has a fixed fee contract for ₹ 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ₹ 9,50,000. The entity will transfer control of the product over five years, and the entity uses the cost-to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	—

701–950	10%	₹ 100,000
700 or less	25%	₹ 250,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10 percent incentive and two that will achieve the 25 percent incentive. In this case, the entity determined that it has 95 percent confidence that it will achieve the 10 percent incentive and 20 percent confidence that it will achieve the 25 percent incentive.

Based on this analysis, the entity believes 10 percent to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10 percent award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 95 percent confidence in achieving the 10 percent award.

The entity reassesses its production status quarterly to determine whether it is on the track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25 percent incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price.

Evaluate the impact of changes in variable consideration when cost incurred is as follows:

Year	₹
1	50,000
2	1,75,000
3	4,00,000
4	2,75,000
5	50,000

Solution

Note: For simplification purposes, the table calculates revenue for the year independently based on costs incurred during the year divided by total expected costs, with the assumption that total expected costs do not change.

Fixed consideration	A	1,000,000				
Estimated costs to complete*	B	950,000				
		<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Total estimated variable amount	C	100,000	100,000	100,000	250,000	250,000
Fixed revenue	$D=A \times H/B$	52,632	184,211	421,053	289,474	52,632
Variable revenue	$E=C \times H/B$	5,263	18,421	42,105	72,368	13,158
Cumulative revenue adjustment	F (see below)	—	—	—	99,370	—
Total revenue	$G=D+E+F$	57,895	202,632	463,158	461,212	65,790
Costs	H	50,000	175,000	400,000	275,000	50,000
Operating profit	$I=G-H$	7,895	27,632	63,158	186,212	15,790
Margin (rounded off)	$J=I/G$	14%	14%	14%	40%	24%

* For simplicity, it is assumed there is no change to the estimated costs to complete throughout the contract period.

* In practice, under the cost-to-cost measure of progress, total revenue for each period is determined by multiplying the total transaction price (fixed and variable) by the ratio of cumulative cost incurred to total estimated costs to complete, less revenue recognized to date.

Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	$M=N/O$		95%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,157
Cumulative catch-up adjustment	$F=L \times M-P$		99,343

Illustration 33 : Management fees subject to the constraint

On 1st April, 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31st March, 20X2, the client's assets under management are ₹ 100 crore. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable considerations.

Analyse the revenue to be recognized on 31st March, 20X2.

Solution

The entity accounts for the services as a single performance obligation because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception — the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the incentive fee in the transaction price.

At 31st March, 20X2, the client's assets under management are ₹ 100 crore. Therefore, the resulting quarterly management fee and the transaction price is ₹ 2 crore.

At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter. This is because the fee relates specifically to the entity's

efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters.

Consequently, the entity recognizes ₹ 2 crore as revenue for the quarter ended 31st March, 20X2.

7.1.6 Sale with a right of return

In some contracts, an entity transfers control of a product to a customer (refer Step 5) and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:

- (a) a full or partial refund of any consideration paid;
- (b) a credit that can be applied against amounts owed, or that will be owed, to the entity; and
- (c) another product in exchange.

In some contracts, an entity transfers control of a product to a customer with an unconditional right of return. In such cases, the recognition of revenue shall be as per the substance of the arrangement. Where the substance is that of a consignment sale, the entity shall account for such a contract as per the provisions of Ind AS 115's application guidance related to consignment sales (refer paragraph B77 and B78 of Application Guidance to Ind AS 115). In other cases, the accounting for contracts with customers shall be as per provisions laid out below.

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognize all of the following:

- (a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognized for the products expected to be returned);
- (b) a refund liability; and
- (c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a performance obligation in addition to the obligation to provide a refund.

An entity shall apply the requirements in paragraphs 47 – 72 (including the requirements for constraining estimates of variable consideration in paragraphs 56 – 58) to determine the amount of consideration to which the entity expects to be entitled (i.e. excluding the products expected

to be returned). For any amounts received (or receivable) for which an entity does not expect to be entitled, the entity shall not recognize revenue when it transfers products to customers but shall recognize those amounts received (or receivable) as a refund liability. Subsequently, at the end of each reporting period, the entity shall update its assessment of amounts for which it expects to be entitled in exchange for the transferred products and make a corresponding change to the transaction price and, therefore, in the amount of revenue recognized.

An entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity shall recognize corresponding adjustments as revenue (or reductions of revenue).

An asset recognized for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity shall update the measurement of the asset arising from changes in expectations about products to be returned. An entity shall present the asset separately from the refund liability.

Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

Accounting for restocking fees for goods that are expected to be returned

Entities sometimes charge customers a 'restocking fee' when a product is returned. This fee may be levied by entities to compensate them for the costs of repackaging, shipping and/or reselling the item at a lower price to another customer.

Restocking fees for goods that are expected to be returned would be included in the estimate of the transaction price at contract inception and recorded as revenue when (or as) control of the goods transfers.

Example 4

An entity enters into a contract with a customer to sell 10 units of a product for ₹ 100 per unit. The customer has the right to return the product, but if it does so, it will be charged a 3% restocking fee (or ₹ 3 per returned unit). The entity estimates that 10% of the sold units will be returned. Upon transfer of control of the 10 units, the entity will recognize revenue of ₹ 903 [(9 units not expected to be returned x ₹ 100 selling price) + (1 unit expected to be returned x ₹ 3 restocking fee per unit)]. A refund liability of ₹ 97 will also be recorded [1 unit expected to be returned x (₹ 100 selling price – ₹ 3 restocking fee)].

Contracts in which a customer may return a defective product in exchange for a functioning product shall be evaluated in accordance with the guidance on warranties given below.

Illustration 34 : Right of return

An entity enters into contracts with 1,000 customers. Each contract includes the sale of one product for ₹ 50 (1,000 total products × ₹ 50 = ₹ 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is ₹ 30.

The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Determine the amount of revenue, refund liability and the asset to be recognized by the entity for the said contracts.

Solution

The entity considers the requirements in paragraphs 56 – 58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of ₹ 48,500 (₹ 50 × 970 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognized (i.e. ₹ 48,500) will not occur as the uncertainty is resolved (i.e. over the return period).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

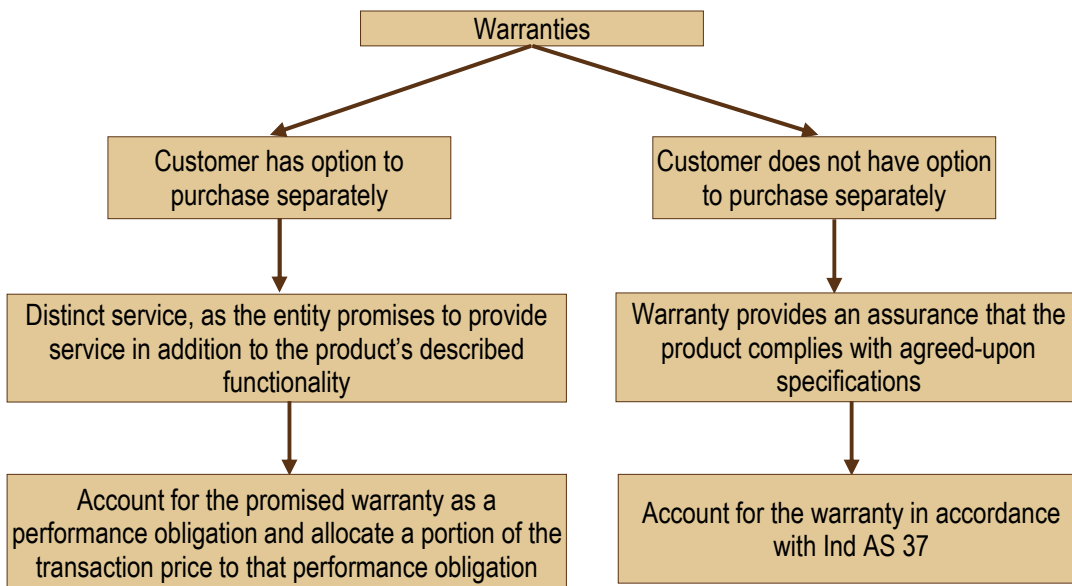
Upon transfer of control of the 1,000 products, the entity does not recognize revenue for the 30 products that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of Ind AS 115, the entity recognizes the following:

- (a) revenue of ₹ 48,500 ($₹ 50 \times 970$ products not expected to be returned)
- (b) a refund liability of ₹ 1,500 ($₹ 50 \text{ refund} \times 30$ products expected to be returned), and
- (c) an asset of ₹ 900 ($₹ 30 \times 30$ products for its right to recover products from customers on settling the refund liability).

7.1.7 Warranties

It is common for an entity to provide (in accordance with the contract, the law or the entity's customary business practices) a warranty in connection with the sale of a product (whether a goods or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with **assurance** that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a **service** in addition to the assurance that the product complies with agreed-upon specifications.

The flowchart below summarises the accounting treatment for the two broad types of warranties:



In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:

- (a) Whether the warranty is required by law — if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.
- (b) The length of the warranty coverage period — the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.
- (c) The nature of the tasks that the entity promises to perform — if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

Comparison with AS 7 and AS 9

Ind AS 115 deals with warranties in two specific ways as discussed above. However, as per AS 9 only a general provision for warranties is sufficient without revenue reversal or recognition of a contractual liability.

Illustration 35 : Warranty

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e. a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is ₹ 36,000. The entity determines that the stand-alone selling prices of the computer and the

extended warranty are ₹ 32,000 and ₹ 4,000, respectively. The inventory value of the computer is ₹ 14,400. Furthermore, the entity estimates that, based on its experience, it will incur ₹ 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

Solution

The entity will record the following journal entries:

		₹	₹
Cash / Trade receivables	Dr.	36,000	
Warranty expense	Dr.	2,000	
To Accrued warranty costs (assurance-type warranty)			2,000
To Contract liability (service-type warranty)			4,000
To Revenue			32,000
(To record revenue and contract liabilities related to warranties)			
Cost of goods sold	Dr.	14,400	
To Inventory			14,400
(To derecognize inventory and recognize cost of goods sold)			

The entity derecognizes the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognizes the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognizes the costs associated with providing the service-type warranty as they are incurred. The entity had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognized as an expense as incurred.

In the above illustration, the net effect of the accounting treatment can be seen as follows:

Accounting point	Treatment under Ind AS 115	Treatment as per AS 9
How warranty is accounted	Expense and liability effect created at the inception of contract with customer	Provision is made on past experience based on a certain percentage of total revenue to give effect to subsequent warranty costs, say 5% of revenue.

Accounting treatment	Total cash inflow	₹ 36,000	Total cash inflow	₹ 36,000
	Warranty expense	₹ 2000	Provision for warranty (at 5% of transaction price)	₹ 1800
	Accrued warranty cost	₹ 2,000	Contract liability –	None
	Contract liability (for future service cost)	₹ 4000	Actual revenue	₹ 34,200
	Actual revenue	₹ 32,000		

Illustration 36 : Warranty

Entity sells 100 ultra-life batteries for ₹ 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that from the years 2 to 5 represent a separate performance obligation. The entity determines that ₹ 1,70,000 of the ₹ 2,00,000 transaction price should be allocated to the batteries and ₹ 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is ₹ 100 per battery.

Pass required journal entries.

Solution

The entity will record the following journal entries:

Upon delivery of the batteries, the entity records the following entry:

Cash/Receivables	Dr.	2,00,000	
To Revenue			1,70,000
To Contract liability (service warranty)			30,000
Warranty expense	Dr.	10,000	
To Accrued warranty costs (assurance warranty)			10,000

The contract liability is recognized as revenue over the service warranty period (years 2 - 5). The costs of providing the service warranty are recognized as incurred. The assurance warranty obligation is used / derecognized as defective units are replaced / repaired during the initial year of the warranty. Upon expiration of the assurance warranty period, any remaining assurance warranty obligation is reversed.

7.1.8 Sales-based or usage-based royalties

As per Ind AS 115.B63, notwithstanding the requirements of Ind AS 115 related to constraining estimate of variable consideration (discussed above), an entity shall recognize revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- (a) the subsequent sale or usage occurs; and
- (b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

As per Ind AS 115.B63A, the accounting requirements for a sales-based or usage-based royalty discussed above apply when the royalty relates only to a licence of intellectual property or when a licence of intellectual property is the predominant item to which the royalty relates (for example, the licence of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates).

As per Ind AS 115.B63B, when the requirement in paragraph B63A is met, revenue from a sales-based or usage-based royalty shall be recognized wholly in accordance with paragraph B63. When the requirement in paragraph B63A is not met, the requirements on variable consideration discussed earlier apply to the sales-based or usage-based royalty.

7.2 Significant financing component

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. Either party may benefit from financing — that is, the customer may pay before the entity performs its obligation (a customer loan to the entity) or the customer may pay after the entity performs its obligation (a loan by the entity to the customer). In those circumstances, the contract contains a significant financing component.

A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an amount that reflects the price that a

customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price).

An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including **both** of the following:

- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and
- (b) the combined effect of both of the following:
 - (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
 - (ii) the prevailing interest rates in the relevant market.

To meet the objective stated above, when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract.

An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

An entity considers the significance of a financing component only at a contract level and not whether the financing is material at a portfolio level. In other words, if the combined effects for a portfolio of similar contracts were material to the entity as a whole, but if the effects of the financing component were not material to the individual contract, such financing component shall not be considered significant and shall not be separately accounted for.

As mentioned above, when a significant financing component exists in a contract, the transaction price is adjusted so that the amount recognized as revenue is the 'cash selling price' of the underlying goods or services at the time of transfer. Essentially, a contract with a customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms). Consequently, the accounting for accounts receivable

arising from a contract that has a significant financing component should be comparable to the accounting for a loan with the same features.

The amount allocated to the significant financing component would have to be presented separately from revenue recognized from contracts with customers. The financing component is recognized as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense is recognized over the financing period using the effective interest method described in Ind AS 109. The standard notes that interest is only recognized to the extent that a contract asset, contract liability or receivable is recognized in accordance with Ind AS 115. An entity may present interest income as revenue only when interest income represents income from an entity's ordinary activities.

Illustration 37 : Financing component: significant or insignificant?

A commercial airplane component supplier enters into a contract with a customer for a promised consideration of ₹ 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 1,40,000 represented an insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.

State whether company needs to make any adjustment in determining the transaction price.

What if the advance payment was larger and received further in advance, such that the entity concluded that ₹ 14,00,000 represented the financing component based on an analysis of the facts and circumstances.

Solution

The entity may conclude that ₹ 1,40,000, or 2 percent of the contract price, is not significant, and the entity may not need to adjust the consideration promised in determining the transaction price.

However, when the advance payment was larger and received further in advance, such that the entity may conclude that ₹ 14,00,000 represents the financing component based on an analysis of the facts and circumstances. In such a case, the entity may conclude that ₹ 14,00,000, or 20 percent of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

Note: In this illustration, the entity's conclusion that 2 percent of the transaction price was not significant and 20 percent was significant is a judgment based on the entity's facts and circumstances. An entity may reach a different conclusion based on its facts and circumstances.

Illustration 38 : Accounting for significant financing component

NKT Limited sells a product to a customer for ₹ 1,21,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new, and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is ₹ 1,00,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is ₹ 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). Analyse the above transaction with respect to its financing component.

Solution

The contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of ₹ 1,21,000 and the cash selling price of ₹ 1,00,000 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

Until the entity receives the cash payment from the customer, interest revenue would be recognized in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity would consider the remaining contractual term.

Comparison with AS 7 and AS 9

Point of accounting	Treatment under Ind AS 115	Treatment under AS 9
Cash selling price ₹ 1,00,000 Promised selling price of ₹ 1,21,000	Transaction price will be bifurcated as ₹ 1,00,000 and ₹ 21,000 ₹ 1,00,000 will be recognised as revenue and ₹ 21,000 shall be treated as interest income being a price difference due to financing arrangement involved in the transaction	Transaction price of ₹ 1,21,000 shall be treated as revenue once the risk and rewards are transferred to the customer. Here, there is no requirement to dissect the transaction price to look for multiple element arrangement like financing component.

Revenue recognized	₹ 1,00,000	₹ 1,21,000
Other income (interest)	₹ 21,000 over 2 years as per Ind AS 109	No interest income is recognized.

Illustration 39 : Determining the discount rate

VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is ₹ 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of ₹ 2,12,470.

Determine the discounting rate and the transaction price when -

Case A — Contractual discount rate reflects the rate in a separate financing transaction.

Case B — Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.

Solution**Case A — Contractual discount rate reflects the rate in a separate financing transaction**

In evaluating the discount rate in the contract that contains a significant financing component, VT Limited observes that the 10% contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is ₹ 1 crore. This amount is recognized as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

Case B — Contractual discount rate does not reflect the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than ₹ 1 crore.

VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is

₹ 9,131,346 (60 monthly payments of ₹ 212,470 discounted at 14%). The entity recognizes revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

Illustration 40 : Advance payment and assessment of discount rate

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

- 1) Payment of ₹ 5,000 in two years when the customer obtains control of the asset or
- 2) Payment of ₹ 4,000 when the contract is signed. The customer elects to pay ₹ 4,000 when the contract is signed.

ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.

Pass journal entries showing how the entity would account for the significant financing component.

Solution

Journal Entries showing accounting for the significant financing component:

- (a) Recognize a contract liability for the ₹ 4,000 payment received at contract inception:

Cash	Dr.	₹ 4,000	
To Contract liability			₹ 4,000

- (b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration and accretes the contract liability by recognizing interest on ₹ 4,000 at 6% for two years:

Interest expense	Dr.	₹ 494*	
To Contract liability			₹ 494
* ₹ 494 = ₹ 4,000 contract liability × (6% interest per year for two years).			

- (c) Recognize revenue for the transfer of the asset:

Contract liability	Dr.	₹ 4,494	
To Revenue			₹ 4,494

Ind AS 115.62 contains an overriding provision, which specifies that, a contract with a customer would not have a significant financing component if any of the following factors exist:

- the **customer paid for the goods or services in advance** and the timing of the transfer of those goods or services is at the discretion of the customer. For example, consider a prepaid card for mobile phone services, wherein the customer has the discretion to avail mobile services within a certain band of time.
- a **substantial amount of the consideration promised by the customer is variable** and the amount or **timing** of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is **not substantially within the control of the customer or the entity** (for example, if the consideration is a sales-based royalty).
- the difference between the promised consideration and the cash selling price of the goods or service arises for **reasons other than the provision of finance to either the customer or the entity**, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

Illustration 41 : Withheld payments on a long-term contract

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid to the entity only when the building is complete.

Analyse whether the contract contains any financing component.

Solution

ABC Limited concludes that the contract does not include a significant financing component since the milestone payments coincide with its performance and the contract requires amounts to be retained for reasons other than the provision of finance. The withholding of a specified

percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under the contract.

Illustration 42 : Advance payment

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional ₹ 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available).

Analyse whether there is any significant financing component in the contract or not.

Solution

To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximise profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (i.e. customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

In assessing whether or not the contract contains a significant financing component, XYZ Limited determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. XYZ Limited charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks it assumes to provide the service and may make it uneconomical to provide the service. As a result of its analysis, XYZ Limited concludes that there is not a significant financing component.

Illustration 43 : Advance payment

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay

for the entire arrangement in advance of the provision of service. Other customers pay overtime.

Analyse whether there is any significant financing component in the contract or not.

Solution

Due to this customer's credit rating, the customer pays in advance for the three-year term. Because there is no difference between the amount of promised consideration and the cash selling price (that is, the customer does not receive a discount for paying in advance), the vendor requires payment in advance only to protect against customer non-payment, and no other factors exist to suggest the arrangement contains a financing, the vendor concludes this contract does not provide the customer or the entity with a significant benefit of financing.

Illustration 44 : Sales based royalty

A software vendor enters into a contract with a customer to provide a license solely in exchange for a sales-based royalty.

Analyse whether there is any significant financing component in the contract or not.

Solution

Although the payment will be made in arrears, because the total consideration varies based on the occurrence or non-occurrence of a future event that is not within the control of the customer or the entity, the software vendor concludes the contract does not provide the customer or the entity with a significant benefit of financing.

Illustration 45 : Payment in arrears

An EPC contractor enters into a two-year contract to develop customized machine for a customer. The contractor concludes that the goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component.

Analyse whether there is any significant financing component in the contract or not.

Solution

There is no difference between the amount of promised consideration and the cash selling price (that is, the customer did not pay a premium for paying a portion of the consideration in arrears). The payment terms included a holdback payment only to ensure successful completion of the project, and no other factors exist to suggest the arrangement contains a financing. Hence, the contractor concludes this contract does not provide the customer or the contractor with a significant benefit of financing.

Illustration 46 : Payment in arrears

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms.

As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to ₹ 100 crore. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the ₹ 100 crore award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed.

The contract specifies Company Z will earn up to ₹ 100 crore based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy.

Partial award fees may be awarded based on a pre-determined scale based on their success.

Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of ₹ 80 crore in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize revenue over time for a single performance obligation using a cost-to-cost input method.

Analyse whether there is any significant financing component in the contract or not.

Solution

Company Z will transfer control over time beginning shortly after the contract is executed but will not receive the cash consideration related to the award fee component from Company X for more than one year in the future. Hence, Company Z should assess whether the award fee represents a significant financing component.

The intention of the parties in negotiating the award fee due upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to produce high functioning missiles that achieved successful scoring from Company X. Therefore, it was determined the contract does not contain a significant financing component, and Company Z should not adjust the transaction price.

As per Ind AS 115.63, as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between:

- (a) when the entity transfers a promised goods or service to a customer and
- (b) when the customer pays for that goods or service

will be one year or less.

Illustration 47 : Applying practical expedient

Company H enters into a two-year contract to develop customized software for Company C. Company H concludes that the goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, Company H determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to Company C.

Company C agrees to provide Company H monthly progress payments. Based on the expectation of the timing of costs to be incurred, Company H concludes that progress payments are being made such that the timing between the transfer of control and payment is never expected to exceed one year.

Analyse whether there is any significant financing component in the contract or not.

Solution

Company H concludes it will not need to further assess whether a significant financing component is present and does not adjust the promised consideration in determining the transaction price, as they are applying the practical expedient under Ind AS 115.

As per Ind AS 115.65, an entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognized only to the extent that a contract asset (or receivable) or a contract liability is recognized in accounting for a contract with a customer.

7.3 Non-cash consideration

Sometimes a customer promises to pay for a goods or service in a form other than cash, such as shares of common stock or other equity instruments, advertising, or equipment.

To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall:

- In the first instance, measure the non-cash consideration (or promise of non-cash consideration) at fair value.
- And, if it cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or a class of customers) in exchange for the consideration.

The fair value of non-cash consideration may change both because of the form of consideration (e.g. a change in the price of a share an entity is entitled to receive from a customer) and for reasons other than the form of consideration (e.g. a change in the exercise price of a share option because of the entity's performance).

7.3.1 Subsequent measurement of non-cash consideration

- If the fair value of the non-cash consideration varies after contract inception because of its form (for example, a change in the price of a share to which an entity is entitled to receive from a customer), the entity does not adjust the transaction price for any changes in the fair value of the consideration.

Illustration 48 : Entitlement to non-cash consideration

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April, 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

How should the entity decide the transaction price?

Solution

The entity measures its progress towards complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognized), the entity has to measure the fair value of 100 shares that are received upon completion of each weekly service. The entity shall not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

- If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), the entity is required to apply the guidance on variable consideration and the constraint when determining the transaction price.

Illustration 49 : Fair value of non-cash consideration varies for reasons other than the form of the consideration

RT Limited enters into a contract to build an office building for AT Limited over an 18-month period. AT Limited agrees to pay the construction entity ₹ 350 crore for the project. RT Limited will receive a bonus of 10 lakh equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.

Determine the transaction price.

Solution

The ultimate value of any shares the entity might receive could change for two reasons:

- 1) the entity earns or does not earn the shares and
- 2) the fair value per share may change during the contract term.

When determining the transaction price, the entity would reflect changes in the number of shares to be earned. However, the entity would not reflect changes in the fair value per share. Said another way, the share price of ₹ 100 is used to value the potential bonus throughout the life of the contract.

As a result, if the entity earns the bonus, its revenue would be ₹ 350 crore plus 10 lakh equity shares at ₹ 100 per share for total consideration of ₹ 360 crore.

Illustration 50 : Non-cash consideration - Free advertising

Production Company Y sells a television show to Television Company X. The consideration under the arrangement is a fixed amount of ₹ 1,000 and 100 advertising slots. Y determines that the stand-alone selling price of the show would be ₹ 1,500. Based on market rates, Y determines that the fair value of the advertising slots is ₹ 600.

Determine the transaction price.

Solution

Y determines that the transaction price is ₹ 1,600, comprising of ₹ 1,000 fixed amount plus the fair value of the advertising slots ie ₹ 600.

If the fair value of the advertising slots could not be reasonably estimated, then the transaction price would be ₹ 1,500 i.e. Y would use the stand-alone selling price of the goods or services promised for the non-cash consideration.

7.3.2 Customer-provided goods or services

If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

Illustration 51 : Customer-provided goods or services

MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay ₹ 25,000 per steering system and contributes tooling to be used in SK's production process.

The tooling has a fair value of ₹ 2 crore at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

SK Limited may use the tooling for other projects and determines that it obtains control of the tooling.

Determine the transaction price?

Solution

As a result, SK Limited includes the fair value of the tooling in the transaction price at contract inception, which it determines to be ₹ 27 crore (₹ 25 crore for the steering systems and ₹ 2 crore for the tooling).

7.4 Consideration payable to a customer

The rationale behind the accounting provisions related to “consideration payable to a customer” is that an entity should not overstate its revenue by amounts given to customers in a contract that it will receive back through the purchase of its goods or services.

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity’s goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity’s goods or services from the customer).

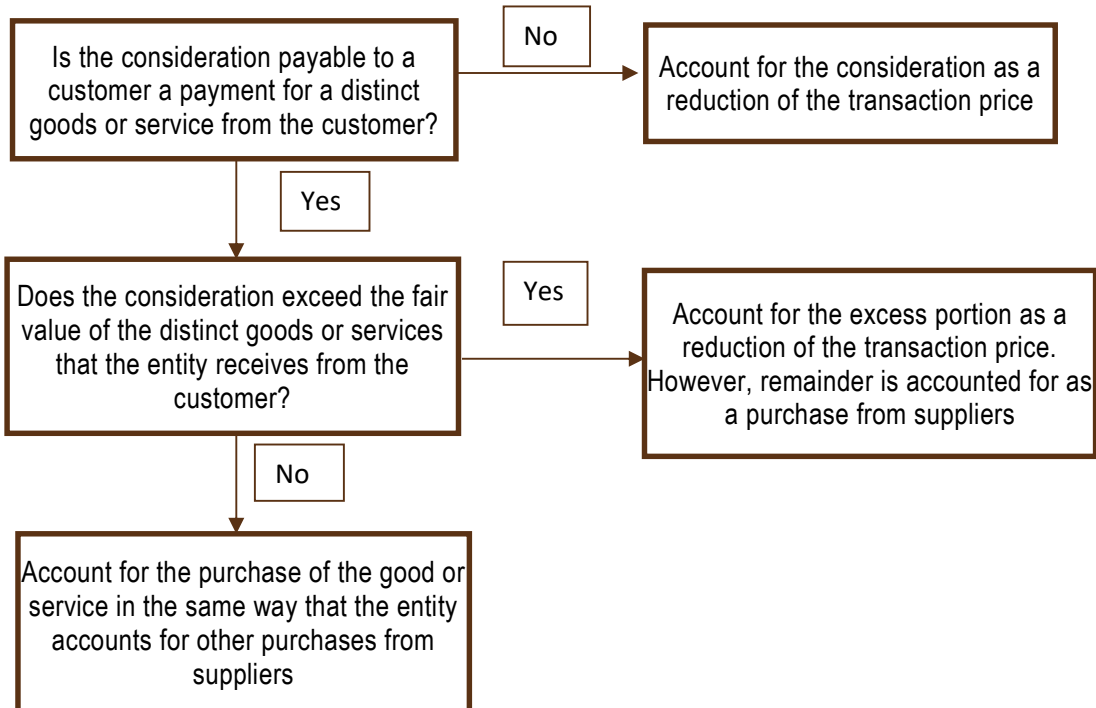
The key to appropriately accounting for consideration payable to a customer is determining whether the payment is made in exchange for a distinct goods or service:

- When the entity receives a goods or service from the customer, it applies the guidance in Step 2 in identifying its performance obligations to determine if that goods or service is distinct.

When an entity concludes that the consideration paid to a customer is in exchange for a distinct goods or service, it accounts for the distinct goods or service as it would any other purchase from a supplier, as long as the consideration paid does not exceed the fair value of the goods or services received. When the consideration exceeds the fair value of the distinct goods or services received, any excess is accounted for as a reduction in the transaction price. If the entity cannot reasonably estimate the fair value of the goods or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

- If, on the other hand, the entity concludes that the consideration paid to the customer is not in exchange for a distinct goods or service, the entity would reduce the transaction price by the amount it pays or owes the customer.

The below diagram summarises the guidance above:



If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with accounting guidance on “variable consideration” discussed earlier.

As per Ind AS 115.72, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:

- the entity recognizes revenue for the transfer of the related goods or services to the customer; and
- the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity’s customary business practices.

Consideration paid or payable to a customer can take many different forms. Therefore, entities will have to carefully evaluate each transaction to determine the appropriate treatment of such amounts. Some common examples of consideration paid to a customer are given below:

- Slotting fees** – Manufacturers of consumer products commonly pay retailers fees to have their goods displayed prominently on store shelves. Those shelves can be physical (i.e. in

a building where the store is located) or virtual (i.e. they represent space in an internet reseller's online catalogue). Generally, such fees do not provide a distinct goods or service to the manufacturer and are treated as a reduction of the transaction price.

Example 5

A producer entity sells energy drinks to a retailer, a convenience store. Producer also pays Retailer a fee to ensure that its products receive prominent placement on store shelves, to attract the customer's eyeballs so that chances of sales of its products are higher. The fee is negotiated as part of the contract for sale of the energy drinks. In this case, Producer should reduce the transaction price for the sale of the energy drinks by the amount of slotting fees paid to Retailer. Producer does not receive a goods or service that is distinct in exchange for the payment to Retailer.

2. **Co-operative advertising arrangements** – In some arrangements, a vendor agrees to reimburse a reseller for a portion of costs incurred by the reseller to advertise the vendor's products. The determination of whether the payment from the vendor is in exchange for a distinct goods or service at fair value will depend on a careful analysis of the facts and circumstances of the contract.

Example 6

Mobile-Co sells 1,000 phones to Retailer for ₹ 10,00,000. The contract includes an advertising arrangement that requires Mobile-Co to pay ₹ 1,00,000 toward a specific advertising promotion that Retailer will provide. The retailer will provide the advertising on strategically located billboards and in local advertisements. Mobile-Co could have elected to engage a third party to provide similar advertising services at a cost of ₹ 1,00,000. In this case, Mobile-Co should account for the payment to Retailer consistent with other purchases of advertising services. The payment from Mobile-Co to the Retailer is consideration for a distinct service provided by Retailer and reflects fair value. The advertising is distinct because Mobile-Co could have engaged a third party who is not its customer to perform similar services. The transaction price is ₹ 10,00,000 and is not affected by the payment made by Retailer for the sale of the phones. However, it is to be noted here that, if price paid to retailer for this service is not the fair value of such advertising services, then any excess paid to retailer over the fair value of said services should be reduced from transaction price.

3. **Price protection** – A vendor may agree to reimburse a retailer up to a specified amount for shortfalls in the sales price received by the retailer for the vendor's products over a specified period of time. Normally such fees do not provide a distinct goods or service to the manufacturer and are treated as a reduction of the transaction price.

Illustration 52 : Consideration payable to a customer

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least ₹ 15 crore of products during the year. The contract also requires the entity to make a non-refundable payment of ₹ 1.5 crore to the customer at the inception of the contract. The ₹ 1.5 crore payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.

Determine the transaction price.

Solution

The entity considers the requirements in paragraphs 70 – 72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct goods or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the ₹ 1.5 crore payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognizes revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each goods by 10 per cent $[(₹ 1.5 \text{ crore} \div ₹ 15 \text{ crore}) \times 100]$. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognizes revenue of ₹ 1.125 crore (₹ 1.25 crore invoiced amount less ₹ 0.125 crore of consideration payable to the customer).

Illustration 53 : Credits to a new customer

Customer C is in the middle of a two-year contract with Telco B Ltd., its current wireless service provider, and would be required to pay an early termination penalty if it terminated the contract today. If C cancels the existing contract with B Ltd. and signs a two-year contract with Telco D Ltd. for ₹ 800 per month, then D Ltd. promises at contract inception to give C a one-time credit of ₹ 2,000 (referred to as a 'port-in credit'). The amount of the port-in credit does not depend on the volume of service subsequently purchased by C during the two-year contract.

Determine the transaction price.

Solution

D Ltd. determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to D Ltd. Since, D

Ltd. does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction in the transaction price ₹ 17,200 [(₹ 800 x 24 month) – ₹ 2,000]. D Ltd. will recognize the reduction in the transaction price as the promised goods or services are transferred.



8. STEP 4: ALLOCATING THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Allocation objective- While allocating the transaction price, the objective of the entity should be to allocate the transaction price to each performance obligation (or distinct goods or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

To meet the above allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis as per the standard, except for allocating discounts and for allocating consideration that includes variable amounts.

Simply put, there are two exceptions to the general allocation guidance:

- allocating discounts, and
- allocating variable consideration

Under these exceptions, an entity allocates a disproportionate amount of the transaction price to specific performance obligations based on evidence that suggests the discount or variable consideration relates to those specific performance obligations.

8.1 Determining stand-alone selling price

To allocate the transaction price on a relative stand-alone selling price basis, an entity must first determine the stand-alone selling price of the distinct goods or service underlying each performance obligation. The stand-alone selling price is the price at which an entity would sell a promised goods or service separately to a customer.

The best evidence of a stand-alone selling price is - **the observable price of a goods or service when the entity sells that goods or service separately in similar circumstances and to similar customers.**

An entity shall determine the stand-alone selling price at contract inception of the distinct goods or service underlying each performance obligation in the contract and allocate the transaction

price in proportion to those stand-alone selling prices, to allocate the transaction price to each performance obligation on a relative stand-alone selling price basis. Stand-alone selling prices are determined at contract inception and are not updated to reflect changes between contract inception and when performance is complete. Furthermore, if the contract is modified and that modification is treated as a termination of the existing contract and the creation of a new contract (see 5.5.2 above), the entity would update its estimate of the stand-alone selling price at the time of the modification. If the contract is modified and the modification is treated as a separate contract (see 5.5.2.1 above), the accounting for the original contract would not be affected (and the stand-alone selling prices of the underlying goods and services would not be updated), but the stand-alone selling prices of the distinct goods or services of the new, separate contract would have to be determined at the time of the modification.

A contractually stated price or a list price for a goods or service **may be (but shall not be presumed to be)** the stand-alone selling price of that goods or service.

If a stand-alone selling price is not directly observable, for example, the entity does not sell the goods or service separately, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73 above. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

Evaluating the evidence related to estimating a stand-alone selling price may require significant judgment.

An entity should establish policies and procedures for estimating stand-alone selling price and apply those policies and procedures consistently to similar performance obligations. As a best practice, an entity should document its evaluation of the market conditions and entity-specific factors considered in estimating each stand-alone selling price, including factors that it considers to be irrelevant and the reasons why.

Suitable methods for estimating the stand-alone selling price of a goods or service include, but are not limited to, the following:

- (a) **Adjusted market assessment approach**—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins. Applying this approach will likely be convenient when an entity has sold the goods or service for a period of time (such that it

has data about customer demand), or a competitor offers similar goods or services that the entity can use as a basis for its analysis. However, applying this approach would be difficult when an entity is selling entirely new goods or service because in that case it may be difficult to anticipate market demand.

- (b) **Expected cost plus a margin approach**—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that goods or service. When determining which costs to include in the selling price analysis, an entity should develop and consistently apply a methodology that considers direct and indirect costs, as well as other relevant costs considered in its normal pricing practices, such as research and development costs. Determining the margin to use when applying a cost-plus-a-margin approach requires significant judgment, particularly when the entity is not planning to separately sell a product or service. Furthermore, using an expected cost-plus-margin approach may not be appropriate in many circumstances, such as when direct fulfillment costs are not easily identifiable or when costs are not a significant input in setting the price for the goods or services.
- (c) **Residual approach**—an entity may estimate the stand-alone selling price by reference to (1) the total transaction price, less (2) the sum of the observable stand-alone selling prices of other goods or services promised in the contract.

However, an entity may use a residual approach to estimate the stand-alone selling price of a goods or service only if one of the following criteria is met:

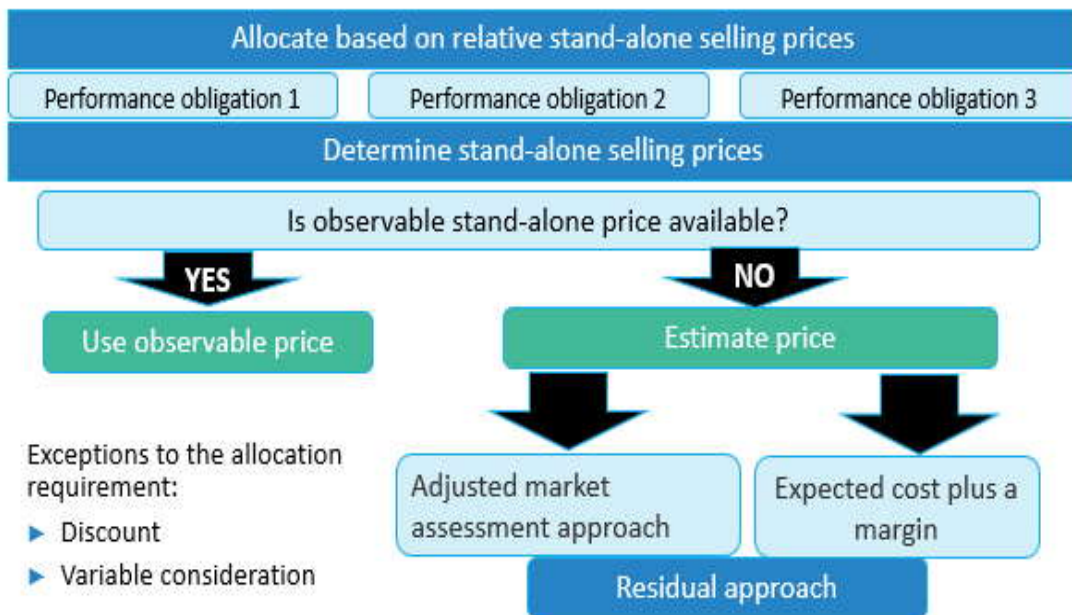
- (i) the entity sells the same goods or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or
- (ii) the entity has not yet established a price for that goods or service and the goods or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

An entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a goods or service where the discount is allocated entirely to one or more performance obligations in the contract.

A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, an entity may use a residual approach to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices and then use another

method to estimate the stand-alone selling prices of the individual goods or services relative to that estimated aggregate stand-alone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the stand-alone selling price of each promised goods or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective in paragraph 73 and the requirements for estimating stand-alone selling prices.

Below chart summarises the above concept:



8.1.1 Allocation of a discount

A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract.

Unless an entity has observable evidence (if (c) criteria below are fulfilled) that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services (as discussed earlier).

When to allocate discount to 'less than all' performance obligations?

As per Ind AS 115.82, an entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract **if all of the following criteria are met:**

- (a) the entity regularly sells each distinct goods or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;
- (b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and
- (c) the discount attributable to each bundle of goods or services described in (b) above is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

Note: As a **first step**, always allocate the discount entirely to one or more performance obligations in the contract (if applicable), and then as a **second step**, use the residual approach to estimate the stand-alone selling price of a goods or service.

Illustration 54 : Allocation methodology

An entity enters into a contract with a customer to sell Products A, B and C in exchange for ₹ 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs.

The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
	₹	
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach

Product C	<u>7,500</u>	Expected cost plus a margin approach
Total	<u>15,000</u>	

Determine the transaction price allocated to each product.

Solution

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (₹ 15,000) exceeds the promised consideration (₹ 10,000). The entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price (to nearest ₹100)	
	₹	
Product A	3,300	(₹ 5,000 ÷ ₹ 15,000 × ₹ 10,000)
Product B	1,700	(₹ 2,500 ÷ ₹ 15,000 × ₹ 10,000)
Product C	<u>5,000</u>	(₹ 7,500 ÷ ₹ 15,000 × ₹ 10,000)
Total	<u>10,000</u>	

Illustration 55 : Allocating a discount

An entity regularly sells Products X, Y and Z individually, thereby establishing the following stand-alone selling prices:

Product	Stand-alone selling price
	₹
Product X	50,000
Product Y	25,000
Product Z	<u>45,000</u>
Total	<u>1,20,000</u>

In addition, the entity regularly sells Products Y and Z together for ₹ 50,000.

Case A—Allocating a discount to one or more performance obligations

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for ₹ 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of

transaction price to Product Y and Z.

Case B—Residual approach is appropriate

The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is ₹ 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (₹ 15,000 – ₹ 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is ₹ 1,05,000 instead of ₹ 130,000.

Solution

Case A—Allocating a discount to one or more performance obligations

The contract includes a discount of ₹ 20,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method.

However, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has evidence that the entire discount of ₹ 20,000 should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

If the entity transfers control of Products Y and Z at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate ₹ 50,000 of the transaction price to the single performance obligation of Product X and recognize revenue of ₹ 50,000 when Products Y and Z simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of ₹ 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of ₹ 25,000) and Product Z (stand-alone selling price of ₹ 45,000) as follows:

Product	Allocated transaction price	
	₹	
Product Y	17,857	(₹ 25,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)
Product Z	<u>32,143</u>	(₹ 45,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)
Total	<u>50,000</u>	

Case B—Residual approach is appropriate

Before estimating the stand-alone selling price of Product Alpha using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract.

As in Case A, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has observable evidence that ₹ 1,00,000 should be allocated to those three products and a ₹ 20,000 discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

Using the residual approach, the entity estimates the stand-alone selling price of Product Alpha to be ₹ 30,000 as follows:

Product	Stand-alone selling price	Method
	₹	
Product X	50,000	Directly observable
Products Y and Z	50,000	Directly observable with discount
Product Alpha	<u>30,000</u>	Residual approach
Total	<u>130,000</u>	

The entity observes that the resulting ₹ 30,000 allocated to Product Alpha is within the range of its observable selling prices (₹ 15,000 – ₹ 45,000).

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is ₹ 1,05,000 instead of ₹ 1,30,000. Consequently, the application of the residual approach would result in a stand-alone selling price of ₹ 5,000 for Product Alpha (₹ 105,000 transaction price less ₹ 1,00,000 allocated to Products X, Y and Z).

The entity concludes that ₹ 5,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Alpha, because ₹ 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from ₹ 15,000 – ₹ 45,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of ₹ 1,05,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

8.1.2 Allocation of variable consideration

Variable consideration may be attributable to (1) the entire contract or (2) a specific part of the contract, such as either of the following:

- (a) one or more, but not all, performance obligations in the contract. For example, a contract may include two performance obligations: the construction of a building and the provision of services related to the ongoing maintenance of the property after construction. But a bonus for early completion may relate entirely to the construction of the building; or
- (b) one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index).

How to allocate variable consideration?

In accordance with Ind AS 115.85, an entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct goods or service that forms part of a single performance obligation **if both of the following criteria are met:**

- the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct goods or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct goods or service); and
- allocating the variable amount of consideration entirely to the performance obligation or the distinct goods or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

The general principles of allocation of transaction price shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 85 above.

Illustration 56 : Allocation of variable consideration

An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are ₹ 16,00,000 and ₹ 20,00,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of ₹ 16,00,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B.

For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be ₹ 20,00,000. Allocate the transaction price.

Case B — Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence A is a fixed amount of ₹ 6,00,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (ie the variable consideration) is ₹ 30,00,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is ₹ 4,00,000.

Allocate the transaction price and determine the revenue to be recognized for each licence and the contract liability, if any.

Solution

Case A—Variable consideration allocated entirely to one performance obligation

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (ie the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:

- (a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B).
- (b) allocating the expected royalty amounts of ₹ 20,00,000 entirely to Licence B is consistent with the allocation objective in paragraph 73 of Ind AS 115. This is because the entity's estimate of the amount of sales-based royalties (₹ 20,00,000) approximates the stand-alone selling price of Licence B and the fixed amount of ₹ 16,00,000 approximates the stand-alone selling price of Licence A. The entity allocates ₹ 16,00,000 to Licence A. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence B some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of Ind AS 115.

The entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognize revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognizes revenue for the sales-based royalty when those subsequent sales occur.

When Licence A is transferred, the entity recognizes as revenue the ₹ 16,00,000 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

To allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variable consideration entirely to Licence B would be inconsistent with the principle for allocating the transaction price. Allocating ₹ 6,00,000 to Licence A and ₹ 30,00,000 to Licence B does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences A and B of ₹ 16,00,000 and ₹ 20,00,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of ₹ 6,00,000 to Licences A and B on the basis of relative stand-alone selling prices of ₹ 16,00,000 and ₹ 20,00,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognize revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognizes as revenue ₹ 3,33,333 [$(₹ 20,00,000 \div ₹ 36,00,000) \times ₹ 6,00,000$] allocated to Licence B. When Licence A is transferred, the entity recognizes as revenue ₹ 2,66,667 [$(₹ 16,00,000 \div ₹ 36,00,000) \times ₹ 6,00,000$] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is ₹ 4,00,000. Consequently, the entity recognizes as revenue ₹ 2,22,222 [$(₹ 20,00,000 \div ₹ 36,00,000 \times ₹ 4,00,000)$] allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognizes a contract liability for the ₹ 1,77,778 [$(₹ 16,00,000 \div ₹ 36,00,000 \times ₹ 4,00,000)$] allocated to Licence A. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

8.2 Changes in the transaction price

After contract inception, the transaction price can change for various reasons, including the

resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

The following principles should be noted:

- An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. **Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception.**
- Amounts allocated to a satisfied performance obligation shall be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

When reallocating consideration because of a change in the transaction price, the entity continues to allocate the variable amount entirely to a performance obligation or to a distinct goods or service that forms part of a single performance obligation if the criteria in Ind AS 115.85 (as discussed above) continue to be met.

If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

However, when the transaction price changes after a modification, the entity should allocate the change in transaction price to the performance obligations identified before the modification if both:

- The change in the transaction price is attributable to variable consideration promised prior to the modification.
- The modification is accounted for as a termination of the old contract and the creation of a new contract.

An entity allocates all other changes in the transaction price to performance obligations under the modified contract (i.e. the performance obligations that were unsatisfied or partially satisfied immediately after the modification) as long as the modification was not accounted for as a separate contract.

Changes in the transaction price should be allocated entirely to one or more, but not all, distinct goods or services promised in a series that forms part of a single performance obligation if the criteria for allocating variable consideration are met.

Comparison with AS 7 and AS 9

Subsequent changes in transaction price are not specifically dealt with either AS 7 or AS 9 unlike in Ind AS 115.

Illustration 57 : Allocating a change in transaction price

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for ₹ 2 crore. The consultant can earn ₹ 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or ₹ 10 lakh bonus if it completes the software implementation by 31st December, 20X0.

The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

- Due diligence – ₹ 80 lakh
- Valuation – ₹ 20 lakh
- Software implementation – ₹ 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30th January, 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.

On 1st July, 20X0, the consultant notes that the project has progressed better than expected and believes that implementation will be completed by 30th September, 20X0 based on a revised forecast. As a result, the consultant updates its estimated transaction price to reflect a bonus of ₹ 20 lakh.

After reviewing its progress as of 1st July, 20X0, the consultant determines that it is 100 percent complete in satisfying its performance obligations for due diligence and valuation and 60 percent complete in satisfying its performance obligation for software implementation.

Determine the transaction price.

Solution

On 1st July, 20X0, the consultant allocates the bonus of ₹ 20 lakh to the software implementation performance obligation, for total consideration of ₹ 1.2 crore allocated to that performance obligation and adjusts the cumulative revenue to date for the software implementation services to ₹ 72 lakh (60 percent of ₹ 1.2 crore).

Illustration 58 : Discretionary credit

Telco G Ltd. grants a one-time credit of ₹ 50 to a customer in Month 14 of a two-year contract. The credit is discretionary and is granted as a commercial gesture, not in response to prior service issues (often referred to as a 'retention credit'). The contract includes a subsidised handset and a voice and data plan. G Ltd. does not regularly provide these credits and therefore customers do not expect them to be granted.

How this will be accounted for under Ind AS 115?

Solution

G Ltd. concludes that this is a change in the transaction price and not a variable consideration. Since, the credit does not relate to a satisfied performance obligation, the change in transaction price resulting from the credit is accounted for as a contract modification and recognized over the remaining term of the contract. If, in this example, rather than providing a one-time credit, G Ltd. granted a discount of ₹ 5 per month for the remaining contract term, then also G Ltd. would conclude that it was a change in the transaction price. It would apply the contract modification guidance and recognize the credit over the remaining term of the contract.



9. STEP 5: SATISFYING PERFORMANCE OBLIGATION

An entity shall recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised goods or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains **control** of that asset.

In other words, the transfer of 'control' is the key determinant under Ind AS 115. Decision making on how 'control' will be transferred to the customer is done at the inception of transaction.

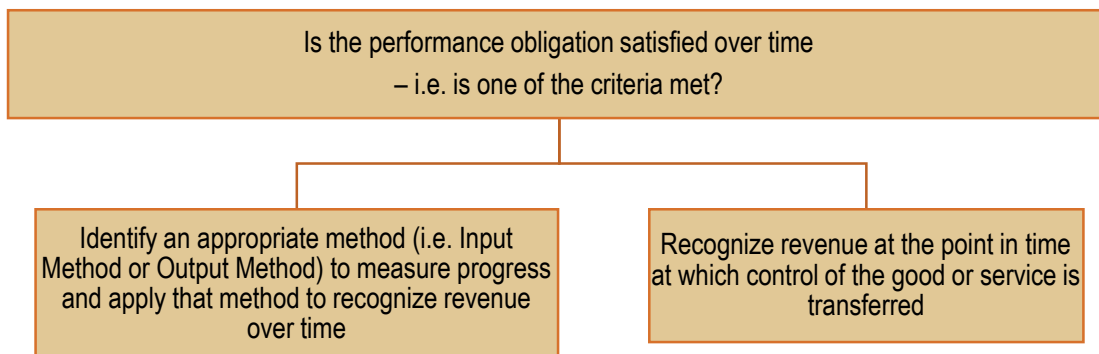
Following is a diagrammatic presentation of the aforesaid guidance:



Therefore, the key questions that need to be answered at contract inception to determine if the seller has satisfied its performance obligation are –

- Establish **what does transfer of control mean** in the context of the arrangement between the parties?

- Does the customer acquire **control over a period of time or at a point in time?**



9.1 What does transfer of control mean?

Control is...	
the ability	– The customer has a present right
to direct the use of	– The right enables it to: - deploy the asset in its activities - allow another entity to deploy the asset in its activities - prevent another entity from deploying the asset
and obtain the remaining benefits from	– The right also enables it to obtain potential cash flows directly or indirectly – e.g. through: - use of the asset - consumption of the asset - sale or exchange of the asset - pledging the asset - holding the asset
... an asset	

Control of an asset refers to –

- the **ability to direct the use** of, and obtain substantially all of the remaining benefits from, the asset.
- Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

- The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:
 - (a) using the asset to produce goods or provide services (including public services);
 - (b) using the asset to enhance the value of other assets;
 - (c) using the asset to settle liabilities or reduce expenses;
 - (d) selling or exchanging the asset;
 - (e) pledging the asset to secure a loan; and
 - (f) holding the asset.
- In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:
 - (a) The entity has a present right to payment for the asset;
 - (b) The customer has legal title to the asset;
 - (c) The entity has transferred physical possession of the asset;
 - (d) The customer has the significant risks and rewards of ownership of the asset;
 - (e) The customer has accepted the asset.

The standard indicates that an entity must determine, at contract inception, whether it will transfer control of a promised goods or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

To help entities determine whether control transfers over time (rather than at a point in time), the standard states below guidance:

9.2 Does the customer acquire control over a period of time or at a point in time?

9.2.1 Transfer of control over a period of time:

Per para 35 of Ind AS 115, an entity transfers control of a goods or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if **any** of the following criteria is met:

Criteria (a) – The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

Or

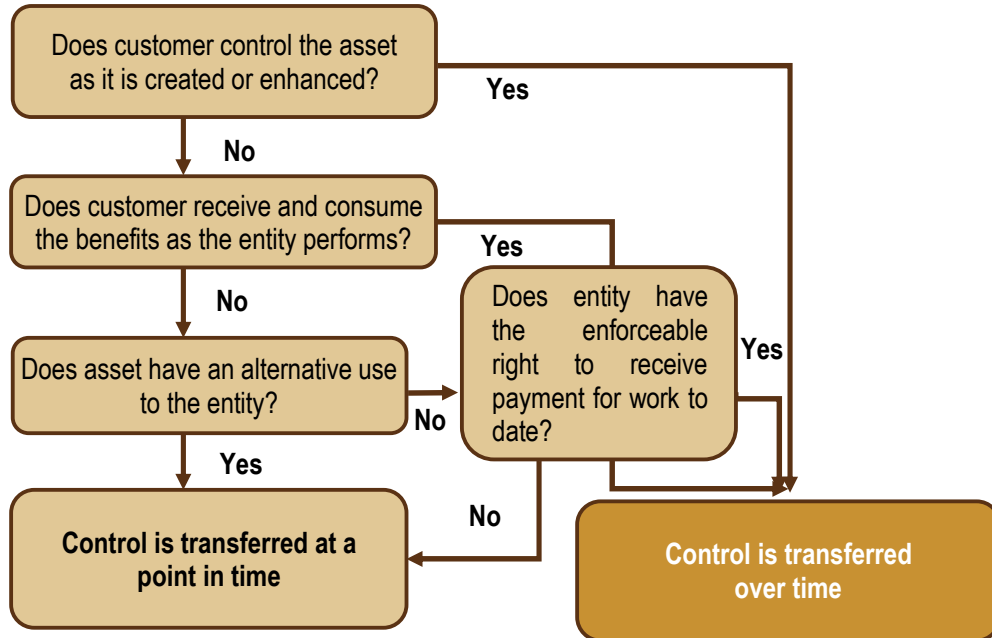
Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or

Or

Criteria (c) – the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Following diagram below depicts if the control is transferred over a period of time.

- If any of the criteria are met, then revenue is recognized over a period of time.
- If none of the criteria are met, then revenue is recognized at a point in time.



In this regard, it is important to understand how each of the above criteria are evaluated –

Criteria (a) – Customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs

This criterion is ordinarily applied in situations in which the benefits of seller's performance are immediately consumed by the customer, for eg.: routine or recurring services in which the consumer consumes the benefits immediately as the services are performed, which means that the customer obtains control of seller entity's output as soon as the entity performs.

Hence, in such situations, entity's performance is said to be performed over a period of time.

Illustration 59

Minitex Ltd. is a payroll processing company. Minitex Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognize the revenue?

Solution

Payroll processing is a single performance obligation. On a monthly basis, as Minitek Ltd carries out the payroll processing –

- The customer, ie, ABC Limited simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction.
- Further, once the services have been performed for a particular month, in case of termination of the agreement before maturity and contract is transferred to another entity, then such new entity will not need to re-perform the services for expired months.

Therefore, it satisfies the first criterion, ie, services completed on a monthly basis are consumed by the entity at the same time and hence, revenue shall be recognized over the period of time.

For certain performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In such cases, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

In making such determination, an entity shall make both of the following assumptions:

- (a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and
- (b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any work in progress.

Illustration 60

T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horizon') enters into a contract with T&L for transportation of its goods from India to Sri Lanka through sea. The voyage is expected to take 20 days from Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Colombo port.

Whether T&L's performance obligation is met over period of time?

Solution

T&L has a single performance to ship the goods from one port to another. The following factors are critical for assessing how services performed by T&L are consumed by the customer –

- As the voyage is performed, the service undertaken by T&L is progressing, such that no other entity will need to re-perform the service till so far as the voyage has been performed, if T&L was to deliver only part-way.
- The customer is directly benefitting from the performance of the voyage as & when it progresses.

Therefore, such performance obligation is said to be met over a period of time.

Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced. Refer guidance on “control” given at the beginning of this section.

- In such cases, the customer ordinarily obtains control of the asset whose work is in progress and therefore, the entity carrying out the work can recognize revenue over a period of time.
- Ordinarily, this criterion is applied to the following type of contracts with customers:
 - (a) Construction contracts, wherein the contractor engages to construct a specific asset for the customer on customer's land;
 - (b) Contracts with the government, wherein the government agency is ordinarily entitled to any work in process performed by the service provider.

Criteria (c) – the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Where a customer does not meet either criterion (a) or criterion (b), the seller entity evaluates the third and last criterion to determine if performance obligation is satisfied over a period of time.

- This criterion refers to situations in which an asset is created at customer's discretion, which the seller is restricted from using for any other purpose and at the same time, the seller entity reserves a right to seek payment for work in process. Therefore, this criterion is met if two factors exist simultaneously –
 - (i) The asset so created does not have an alternate use to the entity; and
 - (ii) Seller entity has a legally enforceable right to payment for performance completed to date.

Asset has no alternate use to Seller entity

This evaluation is done at contract inception and involves consideration of following factors –

- ❖ For the asset created - Seller is restricted contractually from readily directing the asset for another use during its creation or enhancement; or
- ❖ The seller is limited practically from readily directing the asset in its completed state for another use.

And

Legally enforceable right to payment for work completed

- ❖ An entity has a right to payment at all times that at least compensates for performance completed to date, i.e., an amount that approximates selling price of goods which is equal to cost of goods plus a reasonable profit margin
- ❖ Legally enforceable right comes from operation of law or legal precedent that could supplement or override contractual terms. This may be affected if company's customary business practice is to not enforce payment if customer defaults, etc.

Let's take a closer look at each of the above-mentioned factors.

❖ **Asset does not have alternate use to the seller entity:**

This evaluation is carried out at inception of transaction and is not reassessed unless the contract is substantially modified. In doing this assessment, the entity shall consider the practical limitations and/ or contractual restrictions in redirecting the asset for another use, like selling to another customer.

- A **contractual restriction** referred to above must be substantive, i.e., a customer should be able to enforce its right to the asset if at any time the seller tries to redirect the asset to another customer. Therefore, if any customer's right to an asset is inter-changeable with other equivalent assets, then the right is not substantive to restrict the seller entity from redirecting the use of the asset.
- A **practical limitation** exists when the seller entity would require incurring significant economic losses to direct the asset for another use, such that the seller is practically limited from doing so. This may occur, for example, if the costs of rework of the asset are significant to direct for another use, or a significant loss would occur upon selling the asset to another customer, etc.

❖ **Right to payment for performance completed to date**

- An entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity's failure to perform as promised.
- Such a right to enforce payment should result in **compensation for the costs incurred by the entity for work completed to date, plus a reasonable profit margin**. A meagre compensation for potential loss of profit, if the contract was to be terminated does not tantamount to legally enforceable right for work completed to date.
- Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:
 - (a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or
 - (b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.
- Sometimes, the right of the entity need not be a present unconditional right. Entity may have a right to seek payment only upon achievement of specific milestones or upon completion of entire performance obligation. In such case, entity would need to determine if it has a right to enforce payment, in case the contract was to be terminated prior to completion, for reasons other than company's failure to perform.
- Also, sometimes termination clauses in an agreement may not provide the customer with right to cancel or terminate. In such cases, if the customer seeks cancellation, the entity may still have a right to complete performance and seek payment for work carried out.
- Alternatively, if the contract provides for right to demand payment as work progresses, but customer may have a right to refund if he proposes to terminate the contract before completion. In such cases, entity cannot be said to have a right to enforce payment for work completed to date.

Illustration 61

AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory firm for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

Whether risk advisory firm's performance obligation is met over period of time?

Solution

AFS has a single performance to provide an opinion on the professional audit services proposed to be provided under the contract with the customer. Evaluating the criterion for recognizing revenue over a period of time or at a point in time, Ind AS 115 requires one of the following criteria to be met –

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits from services provided by AFS: Company shall benefit only when the audit opinion is provided upon completion. Further, in case the contract was to be terminated, any other firm engaged to perform similar services will have to substantially re-perform.

Hence, this criterion is not met.

- Criterion (b) – An asset created that customer controls: This is service contract and no asset created, over which customer acquires control.
- Criterion (c) – no alternate use to entity and right to seek payment:
 - ❖ The services provided by AFS are specific to the company – WBC and do not have any alternate use to AFS
 - ❖ Further, AFS has a right to enforce payment if the contract was early terminated, for reasons other than AFS's failure to perform. And the profit margin approximates what the entity otherwise earns.

Therefore, criterion (c) is met, and such performance obligation is said to be met over a period of time.

Illustration 62

Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in the business of building such satellites for various customers across the world, the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has a right to enforce payment for work completed to date.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

Solution

While evaluating the pattern of transfer of control to the customer, the Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the satellite is fully constructed, and no benefits are consumed as its constructed. Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
- Criterion (c) – no alternate use to entity and right to seek payment:
 - ❖ The asset is being specifically created for the customer. The asset is customised to customer's requirements, such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being put to alternate use.
 - ❖ Further, Space Ltd. has a right to enforce payment if the contract was terminated early, for reasons other than Space Ltd.'s failure to perform.

Therefore, criterion (c) is met and such performance obligation is said to be met over a period of time.

Illustration 63

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

Solution

The Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the asset is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: As per provided facts, the customer does not acquire control of the asset as it is created.
- Criterion (c) – no alternate use to entity and right to seek payment:
 - ❖ The customer has specific right over the asset and company does not have right to divert it for any alternate use. In other words, there is contractual restriction to use the asset for any alternate purpose.
 - ❖ In the event of early termination, Company has a right to retain any payments made by the customer. However, such payments need not necessarily compensate the selling price of the partially constructed asset, if the customer was to stop making payments.

Therefore, Company does not have a legally enforceable right to payment for work completed to date and the criterion under para 35 is not satisfied. Thus, revenue cannot be recognized over a period of time.

All above discussed three criteria can be summarized in below diagram:

	Criterion	Example
1.	The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs	Routine or recurring services – e.g. cleaning services, Routine transaction processing services, Hotel management services.
2.	The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced	Building an asset on a customer's site
3.	The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date	Building a specialized/highly customized asset that only the customer can use or building an asset according to a customer's specifications

When an entity has determined that a performance obligation is satisfied over time, the standard requires the entity to select a single revenue recognition method for the relevant performance obligation. The objective is to faithfully depict an entity's performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity's performance obligation). The standard provides two methods for recognizing revenue on contracts involving the transfer of goods and services over time: input methods and output methods.

Methods of measuring progress of a performance obligation satisfied over time

Output Methods	Input Methods
Recognize revenue based on direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.	Recognize revenue based on the entity's efforts or inputs to the satisfaction of a performance obligation.
For Example: Surveys of performance completed to date, appraisals of results achieved	For Example: Resources consumed labour hours expended, costs incurred, time elapsed or machine hours used

A. Output methods:

- Output methods recognize revenue on the basis of direct measurements of the value, to the customer, of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. Output method is selected if it would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. It may not be useful in depicting the entity's performance if it would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.
- **As a practical expedient** – if a company has a right to consideration from a customer in an amount which corresponds directly with the value billed to the customer of the entity's performance completed to date, then company may recognize revenue for the amount to which the entity has a right to invoice. For eg.: a service contract in which entity bills a fixed amount for each hour of service provided, etc.

B. Input methods:

- Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (e.g. resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight-line basis.
- While applying input method, a careful consideration should be given for events that do not depict a direct relationship between entity's inputs and transfer of control of goods or services. For example, when cost-based input method is used, an adjustment may be required in the following cases –
 - (a) When any cost incurred does not contribute to an entity's progress in satisfying performance obligation – any excess costs incurred owing to entity's inefficiencies that were not reflected in the price of the contract must be ignored for measuring progress of work. For eg: cost of wasted materials, labour or other resources, etc.
 - (b) When cost incurred is not proportionate to entity's progress in satisfying its performance obligation. In such cases, the best reflection is to adjust the input method to recognize revenue only to the extent of costs incurred. Such recognition of revenue to the extent of costs incurred is appropriate, if at contract inception, all the following conditions exist:
 - (i) The goods do not represent a distinct performance obligation;
 - (ii) Customer is expected to obtain control of the goods significantly before receiving the services;
 - (iii) Cost of such goods is significant relative to the total expected costs to complete the performance obligation; and
 - (iv) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

An entity shall apply a single method of measuring progress for each performance obligation satisfied over time, and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Illustration 64 : Measuring progress on straight line basis

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?

Solution

The entity shall determine if revenue should be recognized over a period of time by evaluating the conditions laid in para 35 of Ind AS 115.

- Applying the first criterion of para 35 to establish if the customer simultaneously receives and consumes the benefits, as the entity provides service – The health club provides access to services uniformly through the year. The extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The customer therefore simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available.
- Consequently, the entity's performance obligation is satisfied over time
- Once the pattern of satisfying performance obligation is defined, the Company then determines how progress should be measured. The services are uniformly provided to the customer through the year. Therefore, the best measure of progress is to recognize revenue on a straight line basis over the year.

Illustration 65 : Uninstalled materials

On 1st January, 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

<i>Particulars</i>	<i>Amount (₹)</i>
Transaction price	5,000,000
Expected costs:	
(a) Elevators	1,500,000
(b) Other costs	2,500,000
Total	4,000,000

The entity purchases the elevators, and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of 500,000 by 31st March, 20X1.

How will the Company recognize revenue, if performance obligation is met over a period of time?

Solution

Costs to be incurred comprise two major components – elevators and cost of construction service.

- (a) The elevators are part of the overall construction project and are not a distinct performance obligation
- (b) The cost of elevators is substantial to the overall project and are incurred well in advance.
- (c) Upon delivery at site, the customer acquires control of such elevators.
- (d) And there is no modification made to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

- The measure of progress should be made based on the percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (₹)
Transaction price	5,000,000
Costs incurred:	
(a) Cost of elevators	1,500,000
(b) Other costs	500,000
Measure of progress:	$500,000 / 2,500,000 = 20\%$
Revenue to be recognized:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 3,500,000 % of work completed = 20% Revenue to be recognized = 700,000
(b) Revenue for elevators	1,500,000 (equal to costs incurred)
Total revenue to be recognized	$1,500,000 + 700,000 = 2,200,000$

Therefore, for the year ended 31st March, 20X1, the Company shall recognize revenue of ₹ 2,200,000 on the project.

Other considerations in measuring progress of work:

Stand-Ready Obligations

When the nature of an entity's performance obligation is to stand ready to provide goods or services, it may be appropriate to utilize a time-based measure of progress.

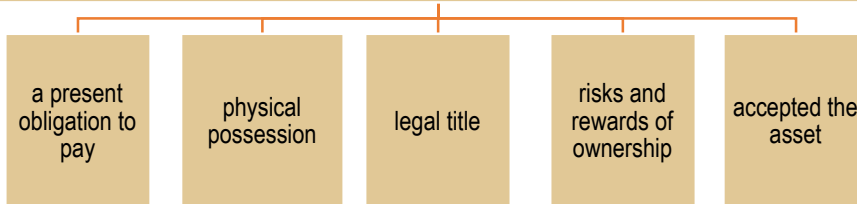
- When the pattern of benefit and the entity's efforts to fulfill the contract are not even throughout the contract period, a time-based method of measuring progress may not be appropriate.
- On the other hand, when an entity expects the customer will receive and consume the benefits of the entity's promise equally throughout the contract period, or if the entity does not know and cannot reasonably estimate how and when the customer will request performance, then a straight-line revenue attribution resulting from a time-based measure of progress may be appropriate.

9.2.2 Transfer of control at a point in time:

Where a company does not meet any of the aforementioned criteria for recognizing revenue over a period of time, then revenue shall be recognized at a point in time.

The following is an **indicative list** of indicators which may exist, to imply the point of time at which control of goods has been passed to the customer. This is not an exhaustive list and there may be more factors that may be considered to determine the point in time at which revenue shall be recognized:

Indicators that control has passed **include** a customer having



Indicator	Evaluation
The entity has a present right to payment	If a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
The customer has a legal title to the asset	- Legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.
The customer has physical possession of the asset	The customer's physical possession of an asset may indicate that the customer has the ability to direct the use of the asset. - However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls.
The customer has assumed significant risks & rewards of owning the asset	- Transfer of risks & rewards for an asset may indicate that the customer has the ability to direct the use of and obtain substantially all of the benefits from the asset. When evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control

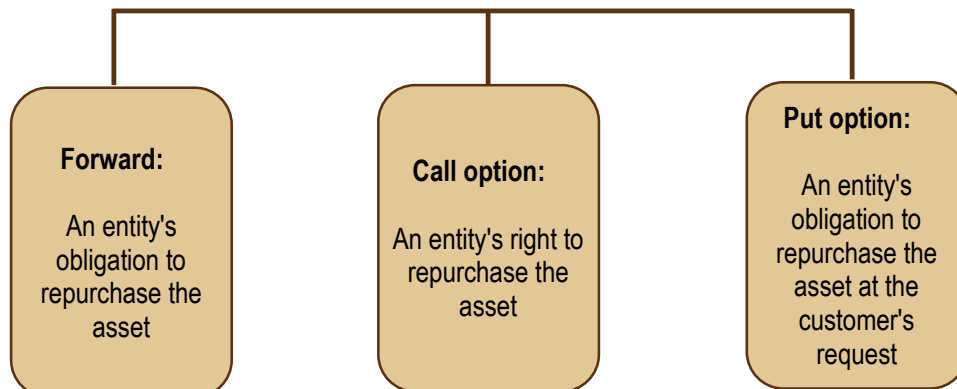
	of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
The customer has accepted the asset	Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a goods or service does not meet agreed-upon specifications. An entity shall consider such clauses to evaluate when a customer obtains control of a goods or service. - If an entity can objectively determine that control of a goods or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the goods or service. - However, if an entity cannot objectively determine that the goods or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance.

9.3 Repurchase agreements

When a company determines the timing of transfer of control, it is important to take into consideration any repurchase agreements that may have been executed by the Company.

A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

Repurchase agreements generally come in three forms:



A. Forward or call option:

- ❖ If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset.

Consequently, the entity shall account for the contract as either of the following:

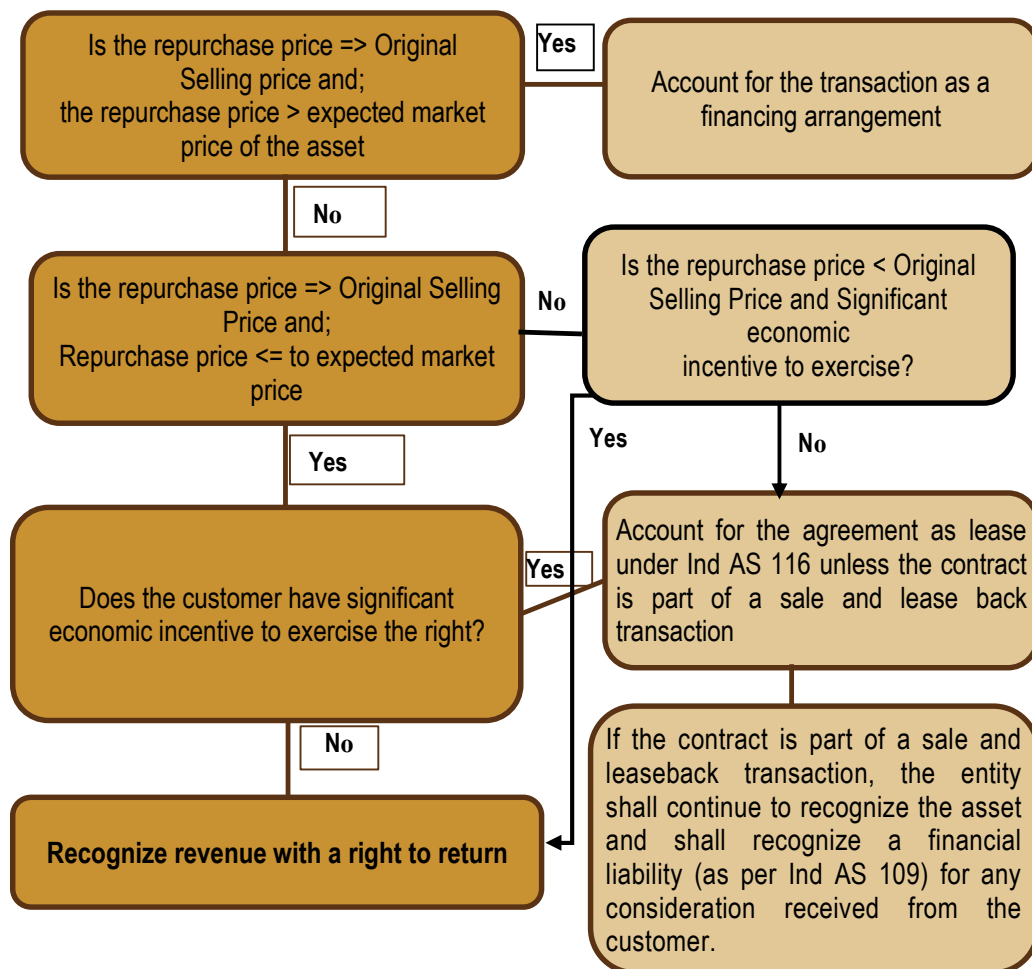
- (a) a lease in accordance with Ind AS 116, Leases, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognize the asset and shall recognize financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with Ind AS 109; or
 - (b) a financing arrangement, if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.
- ❖ When comparing the repurchase price with the selling price, an entity shall consider the time value of money.
 - ❖ If the repurchase agreement is a financing arrangement, the entity shall continue to recognize the asset and also recognize a financial liability for any consideration received from the customer.
 - ❖ The entity shall recognize the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, as processing or holding costs (for example, insurance).

- ❖ If the option lapses unexercised, an entity shall derecognize the liability and recognize revenue.

B. Put option

- ❖ If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, the entity shall account for the agreement as a lease in accordance with Ind AS 116, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognize the asset and shall recognize a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with Ind AS 109.
- ❖ To determine whether a customer has a significant economic incentive to exercise its right, an entity shall consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the right expires. For example, if the repurchase price is expected to significantly exceed the market value of the asset, this may indicate that the customer has a significant economic incentive to exercise the put option and hence the customer is expected to ultimately return the asset to the entity.
- ❖ If the repurchase price is equal to or greater than original selling price and more than the expected market value of the asset, the contract is in effect a financing arrangement.
- ❖ If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity shall account for the agreement as if it were the sale of a product with a right of return.
- ❖ If the customer does not have a significant economic incentive to exercise its right at a price that is lower than the original selling price of the asset, the entity shall account for the agreement as if it were the sale of a product with a right of return.

- ❖ The following decision tree may be useful to account for the arrangement –



- ❖ When comparing the repurchase price with the selling price, an entity shall consider the time value of money.
- ❖ If the option lapses unexercised, an entity shall derecognize the liability and recognize revenue.

Illustration 66

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for ₹ 1.1 million on or before 31st December, 20X1.

How would the entity account for this transaction?

Solution

In the above case, where the entity has a right to call back the goods upto a certain date –

- The customer cannot be said to have acquired control, owing to the repurchase right with the seller entity
- Since the original selling price (₹ 1 million) is lower than the repurchase price (₹ 1.1 million), this is construed to be a financing arrangement and accounted as follows:
 - (a) Amount received shall be recognized as 'liability'
 - (b) Difference between sale price and repurchase price to be recognized as 'finance cost' and recognized over the repurchase term.

Illustration 67

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 10,00,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before 31st December, 20X1. The market price for such goods is expected to be ₹ 7,50,000

How would the entity account for this transaction?

Solution

In the above case, where the entity has an obligation to buy back the goods upto a certain date–

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31st December, 20X1, ie, till the put option expires.
- Against payment of ₹ 10,00,000; the customer only has a right to use the asset and put it back to the entity for ₹ 9,00,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (ie, ₹ 10,00,000) and repurchase price (ie, ₹ 9,00,000) shall be recognized as lease income over the period of lease.
- At the end of repurchase term, ie, 31st December, 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (ie, ₹ 9,00,000).

9.4 Bill-and-hold

- ❖ A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.
- ❖ In such arrangements, the entity shall determine at which point does control transfer to the customer.

In some cases, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). While in other cases, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset

- ❖ In addition, the indicators defined earlier in this chapter for establishing transfer of control, **all the following criteria must be met:**
 - (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
 - (b) the product must be identified separately as belonging to the customer;
 - (c) the product currently must be ready for physical transfer to the customer; and
 - (d) the entity cannot have the ability to use the product or to direct it to another customer.
- ❖ Where an entity recognizes revenue on bill & hold basis, the entity shall determine if it has any additional performance obligations forming part of the transaction price, which would need to be segregated and accounted separately, when such performance obligations are met. (for eg.: custodial services for goods held, extended warranty, etc.) For identification of performance obligations, refer step 2 – identifying performance obligations.

Illustration 68

An entity enters into a contract with a customer on 1st April, 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts

meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31st March, 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognize revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

Solution

In the facts provided above, the entity has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2-4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations –

- (i) Sale of machinery
- (ii) Sale of spare parts
- (iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- Sale of machinery: Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognized on 31st March, 20X3.
- Sale of spare parts: The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if all below criteria are met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory.

(b) the product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c) the product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery.
(d) the entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.

- Custodial services: Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

9.5 Licences of intellectual property

Ind AS 115 provides application guidance specific to the recognition of revenue for licences of intellectual property, which differs from the recognition model for other promised goods and services.

Considering the fact that licences include a wide range of features and economic characteristics, an entity will need to evaluate the nature of its promise to grant a licence of intellectual property in order to determine whether the promise is satisfied (and revenue is recognized) over time or at a point in time.

A licence will either provide:

- a right to access the entity's intellectual property throughout the licence period, which results in revenue that is recognized over time; or
- a right to use the entity's intellectual property as it exists at the point in time in which the licence is granted, which results in revenue that is recognized at a point in time.

The standard states that licences of intellectual property establish a customer's rights to the intellectual property of an entity and may include licences for any of the following: software and

technology, media and entertainment (e.g. motion pictures and music), franchises, patents, trademarks and copyrights.

9.5.1 Right to access

A licence that provides an entity with the right to access intellectual property is satisfied over time 'because the customer simultaneously receives and consumes the benefit from the entity's performance as the performance occurs', including the related activities undertaken by entity. This conclusion is based on the determination that when a licence is subject to change (and the customer is exposed to the positive or negative effects of that change), the customer is not able to fully gain control over the licence of intellectual property at any given point in time, but rather gains control over the licence period.

Example 7

Pogo has created a popular television show called "Chhota Bheem". Pogo grants a three-year license to Toy Manufacturer for use of the character "Chhota Bheem" on its toys. As per the contract, Pogo will continue to produce the show, popularize the character, carry out marketing activities. Toy Manufacturer produces and sells "Chhota Bheem" toys. In this case, the license provides access to Pogo's Intellectual Property (IP). Pogo will undertake activities that significantly affect the IP by production and marketing of the show, development of the characters. Toy manufacturer is directly exposed to any positive or negative effects by Pogo's activities ie. how the show is received by kids and their parents. These activities are not separate performance obligations as they do not transfer a goods or service to Toy Manufacturer separate from the license. Hence, Pogo will recognize revenue over time.

9.5.2 Right to use

In contrast, when the licence represents a right to use the intellectual property as it exists at a specific point in time, the customer gains control over that intellectual property at the beginning of the period for which it has the right to use the intellectual property. This timing may differ from when the licence was granted.

Illustration 69

An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixed consideration of ₹ 50,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable.

Determine how the revenue will be recognized?

Solution

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. The entity concludes that its only performance obligation is to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (i.e. the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording. Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognizes all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

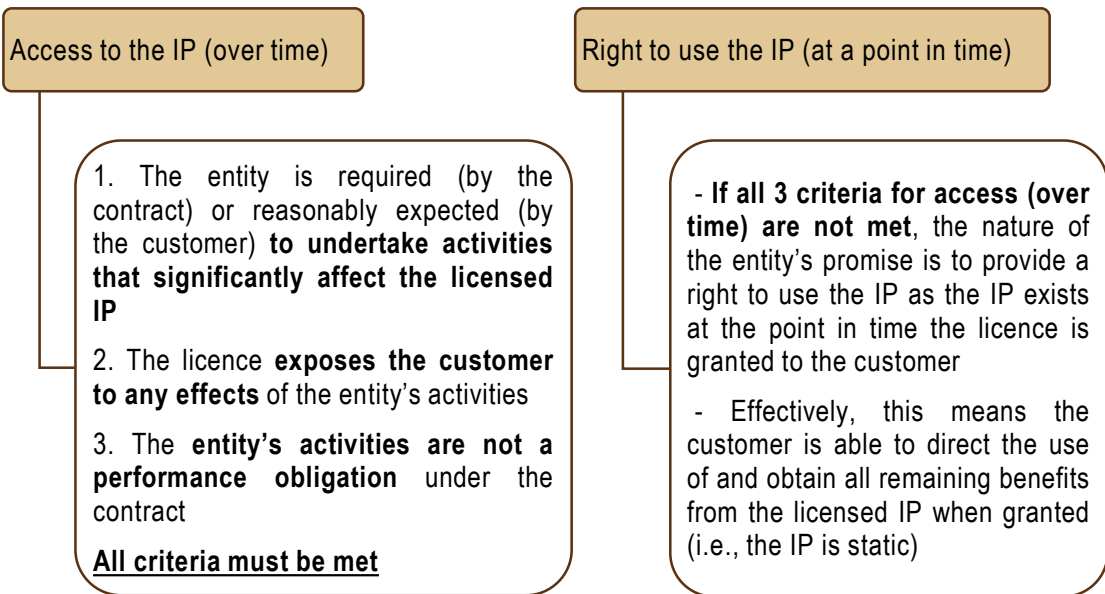


Illustration 70 : Assessing the nature of a software licence with unspecified upgrades

Software Company X licenses its software application to Customer Y. Under the agreement, X will provide updates or upgrades on a when-and-if-available basis; Y can choose whether to

install them. Y expects that X will undertake no other activities that will change the functionality of the software.

Determine the nature of license.

Solution

Based on the facts given in question it can be concluded that, although the updates and upgrades will change the functionality of the software, they are not activities considered in determining the nature of the entity's promise in granting the licence. The activities of X to provide updates or upgrades are not considered because they transfer a promised goods or service to Y – i.e. updates or upgrades are distinct from the licence. Therefore, the software licence provides a right to use the IP that is satisfied at a point in time.

Illustration 71 : Assessing the nature of a film licence and the effect of marketing activities

Film Studio C grants a licence to Customer D to show a completed film. C plans to undertake significant marketing activities that it expects will affect box office receipts for the film. The marketing activities will not change the functionality of the film, but they could affect its value.

Determine the nature of license.

Solution

C would probably conclude that the licence provides a right to use its IP and, therefore, is transferred at a point in time. There is no expectation that C will undertake activities to change the form or functionality of the film. Because the IP has significant stand-alone functionality, C's marketing activities do not significantly affect D's ability to obtain benefit from the film, nor do they affect the IP available to D.

Illustration 72 : Assessing the nature of a team name and logo

Sports Team D enters into a three-year agreement to license its team name and logo to Apparel Maker M. The licence permits M to use the team name and logo on its products, including display products, and in its advertising or marketing materials.

- (i) *Determine the nature of license in the above case.*
- (ii) *Modifying above facts that, Sports Team D has not played games in many years and the licensor is Brand Collector B, an entity that acquires IP such as old team or brand names and logos from defunct entities or those in financial distress. B's business model is to*

license the IP, or obtain settlements from entities that use the IP without permission, without undertaking any ongoing activities to promote or support the IP

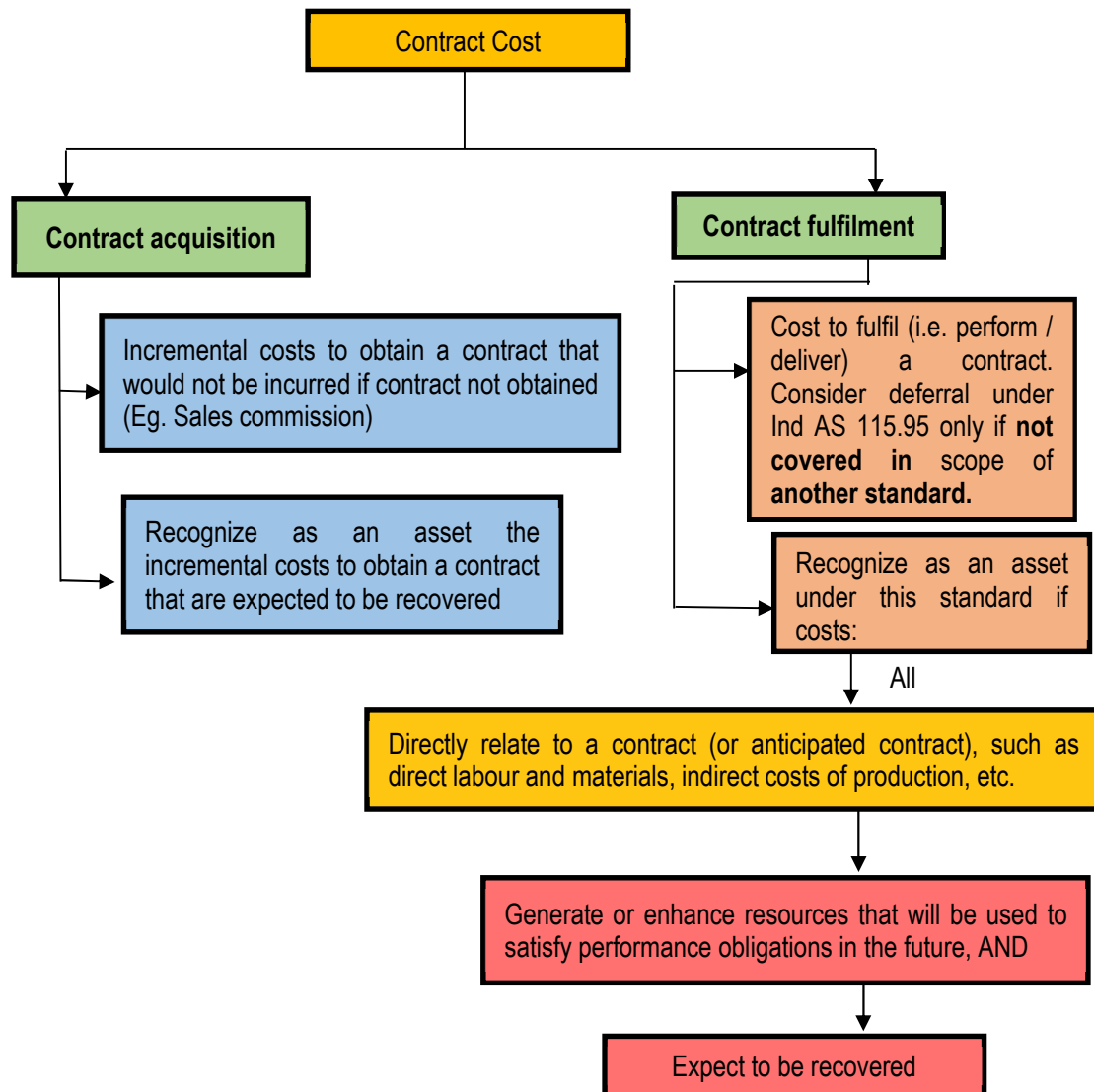
Would the answer be different in this situation?

Solution

- (i) The nature of D's promise in this contract is to provide M with the right to access the sports team's IP and, accordingly, revenue from the licence will be recognized over time. In reaching this conclusion, D considers all of the following facts:
- M reasonably expects D to continue to undertake activities that support and maintain the value of the team name and logo by continuing to play games and field a competitive team throughout the licence period. These activities significantly affect the IP's ability to provide benefit to M because the value of the team name and logo is substantially derived from, or dependent on, those ongoing activities.
 - The activities directly expose M to positive or negative effects (i.e. whether D plays games and fields a competitive team will have a direct effect on how successful M is in selling its products featuring the team's name and logo).
 - D's ongoing activities do not result in the transfer of a goods or a service to M as they occur (i.e. the team playing games does not transfer a goods or service to M).
- (ii) Based on B's customary business practices, Apparel Maker M probably does not reasonably expect B to undertake any activities to change the form of the IP or to support or maintain the IP. Therefore, B would probably conclude that the nature of its promise is to provide M with a right to use its IP as it exists at the point in time at which the licence is granted.



10. CONTRACT COSTS



10.1 Costs to obtain a contract (contract acquisition costs)

Entities may incur various costs to obtain or acquire a contract with a customer, including, but not limited to, legal fees, advertising expenses, travel expenses, and salespersons' salaries and commissions.

Incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Once an entity has determined that costs incurred relate to a specific contract with a customer, it should then determine if the costs meet the conditions for capitalisation. Incremental costs to obtain a contract that an entity expects to recover should be capitalised, while costs to obtain a contract that do not qualify for capitalisation should be expensed as incurred.

The test to determine if a cost is incremental is to ask whether the entity would have incurred the cost had one or both of the parties decided to walk away just before signing the arrangement. In this context, any legal costs (for example, to draft or negotiate the contract) or salaries for salespeople would be incurred regardless of whether the contract is finalized. Therefore, these costs are not incremental. On the other hand, a commission paid only upon the successful signing of the contract would be incremental and should be capitalized.

As a practical expedient, Ind AS 115 allows an entity to expense the incremental costs of obtaining a contract as incurred if the amortisation period of the asset that the entity would have otherwise recognized is one year or less.

Cost	Capitalize or expense	Reason
Commission paid only upon successful signing of a contract	Capitalize	Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing.
Travel expenses for sales person pitching a new client contract	Expense	Because the costs are incurred regardless of whether the new contract is won or lost, the entity incurs the costs, unless they are expressly reimbursable.
Legal fees for drafting terms of arrangement for parties to approve and sign	Expense	If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract.
Salaries for sales people working exclusively on obtaining new clients	Expense	Salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
Bonus based on quarterly sales target	Capitalize	Bonuses based solely on sales are incremental costs to obtain a contract.
Commission paid to sales manager based on contracts obtained by the sales manager's local employees	Capitalize	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract. Ind AS 115 does not differentiate costs based on the function or title of the employee that receives the commission.

Comparison with AS 7 and AS 9

Contract acquisition cost is not specifically dealt with in either in AS 7 or AS 9. Let's take an illustration to understand the treatment in AS 7 / AS 9 and how it is different from Ind AS:

Example 8

A software company has agreed to pay a special commission of 1% of the contract value to a sales consultant who has agreed to work based on the successful bidding of the proposal to a customer. In case the contract is not signed by the company and the customer, for whatever reason, then there is no commission to be paid to the sales consultant.

The contract value is ₹ 1 crore over 3 years and the company has signed the contract with the customer after successful bidding with the help of the sales consultant.

In this context, the accounting differences will be as follows:

Particulars	Treatment under Ind AS 115	Treatment under AS 9
1 st year of operations - Contract acquisition cost of ₹ 1 crore	- Amortization as expense of the year ₹ 33.33 lakhs - Contract asset ₹ 66.67 lakhs	Expense of ₹ 1 crore as sales commission
2 nd year of operations - Contract acquisition cost of ₹ 1 crore	- Amortization as expense of the year ₹ 33.33 lakhs - Contract asset ₹ 33.34 lakhs	No accounting treatment
3 rd year of operations - Contract acquisition cost of ₹ 1 crore	- Amortization as expense of the year ₹ 33.34 lakhs - Contract asset of nil	No accounting treatment

10.2 Costs to fulfil a contract (contract fulfilment costs)

If costs incurred in fulfilling a contract with a customer are covered under another Standard (such as Ind AS 2 'Inventories' and Ind AS 16 'Property, Plant, and Equipment'), an entity accounts for those costs in accordance with those Standards. If not, an entity recognizes an asset for such costs, provided all of the criteria mentioned below are met:

- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved), including:
 - (i) direct labour
 - (ii) direct materials

- (iii) allocations that relate directly to the contract or contract activities (for example, contract management and supervision costs and depreciation of tools and equipment and right-of-use assets used in fulfilling the contract)
- (iv) costs that are explicitly chargeable to the customer
- (v) other costs that the entity incurs only because it entered into the contract (e.g. payments to subcontractors)
- (b) the costs generate or enhance resources of the entity that will be used to satisfy performance obligations in the future
- (c) the entity expects to recover the costs, for e.g. through the expected margin

The following costs should be expensed as incurred:

- (a) general and administrative costs that are not explicitly chargeable to the customer
- (b) costs of wasted materials, labour, or other resources that were not reflected in the contract price
- (c) costs that relate to satisfied performance obligations
- (d) costs related to remaining performance obligations that cannot be distinguished from costs related to satisfied performance obligations.

Costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

Illustration 73

Customer outsources its information technology data centre

Term = 5 years plus two 1-yr renewal options

Average customer relationship is 7 years

Entity spends ₹ 4,00,000 designing and building the technology platform needed to accommodate out-sourcing contract:

Design services	₹ 50,000
Hardware	₹ 140,000
Software	₹ 100,000
Migration and testing of data centre	<u>₹ 110,000</u>
TOTAL	<u>₹ 400,000</u>

Solution

Design services	₹ 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	₹ 140,000	Account for asset under Ind AS 16
Software	₹ 100,000	Account for asset under Ind AS 38
Migration and testing of data centre	₹ 110,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	₹ 400,000	

10.3 Amortisation and impairment

Under Ind AS 115, an entity amortises capitalised contract costs on a systematic basis consistent with the pattern of transferring the goods or services related to those costs. If an entity identifies a significant change to the expected pattern of transfer, it updates its amortisation to reflect that change in estimate in accordance with Ind AS 8.

An entity recognizes an impairment loss in earnings if the carrying amount of an asset exceeds the remaining amount of consideration that the entity expects to receive in connection with the related goods or services less any directly related contract costs yet to be recognized. When determining the amount of consideration, it expects to receive, an entity ignores the constraint on variable consideration previously discussed, and adjusts for the effects of the customer's credit risk.

Before recognizing an impairment loss under the revenue recognition guidance, an entity recognizes impairment losses associated with assets related to the contract that are accounted in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38).

An entity would reverse a previously recognized impairment loss when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognized previously.

Illustration 74 : Amortisation

An entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with Ind AS 115. The initial term of the contract is five years but it can be renewed for

subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by entity is seven years.

Determine appropriate method of amortisation?

Solution

The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one year renewals) because that is the period over which the entity expects to provide services under the contract to which the capitalised costs relate.



11. PRESENTATION & DISCLOSURE

11.1 Presentation

Under Ind AS 115, an entity presents a contract in its balance sheet as a contract liability, a contract asset, or a receivable, depending on the relationship between the entity's performance and the customer's payment at the reporting date. An entity shall present any unconditional rights to consideration separately as a receivable.

An entity presents a contract as a contract liability if the customer has paid consideration, or if payment is due as of the reporting date but the entity has not yet satisfied a performance obligation by transferring a goods or service. Conversely, if the entity has transferred goods or services as of the reporting date but the customer has not yet paid, the entity recognizes either a contract asset or a receivable. An entity recognizes a contract asset if its right to consideration is conditioned on something other than the passage of time; otherwise, an entity recognizes a receivable.

A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. An entity shall account for a receivable in accordance with Ind AS 109. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognized shall be presented as an expense.

An entity shall also present separately the amount of excise duty included in the revenue recognized in the statement of profit and loss. This is an additional requirement inserted due to the Indian context in Ind AS 115.

11.2 Disclosure

Ind AS 115 requires many new disclosures about contracts with customers. The following table provides a summary:

Disclosures	
Disclosure area	Summary of requirements
General	- revenue recognized from contracts with customers, separately from its other sources of revenue - impairment losses on receivables or contract assets
Disaggregation of revenue	- categories that depict the nature, amount, timing, and uncertainty of revenue and cash flows - sufficient information to enable users of financial statements to understand the relationship with revenue information disclosed for reportable segments under Ind AS 108 'Operating Segments'
Information about contract balances	- including opening and closing balances of contract assets, contract liabilities, and receivables (if not separately presented) - revenue recognized in the period that was included in contract liabilities at the beginning of the period and revenue from performance obligations (wholly or partly) satisfied in prior periods - explanation of relationship between timing of satisfying performance obligations and payment - explanation of significant changes in the balances of contract assets and liabilities
Information about performance obligations	- when the entity typically satisfies performance obligations - significant payment terms - nature of goods and services - obligations for returns, refunds and similar obligations - types of warranties and related obligations
Transaction price allocated to the remaining performance obligations	transaction price allocated to the performance obligations that are unsatisfied and an explanation of when the entity expects to recognize such revenue.
Timing of satisfaction of performance obligations	- performance obligations that an entity satisfies over time: - methods used to recognize revenue - why the methods used provide a faithful depiction - performance obligations satisfied at a point in time: - judgements made in evaluating when a customer obtains control

Information about significant judgements	judgements impacting the expected timing of satisfying performance obligations transaction price and amounts allocated to performance obligations (e.g. estimating variable consideration and assessing if constrained and allocating to performance obligations).
Transaction price and amount allocated to performance obligations	- determining transaction price, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration - estimate of variable consideration is constrained - measuring obligations for returns, refunds and other similar obligations - allocating the transaction price, discounts and variable consideration to a specific part of the contract - reconcile the amount of revenue recognized in the statement of profit and loss with the contracted price
Assets recognized from the costs to obtain or fulfil a contract	- judgements made in determining costs amount of the costs incurred - to obtain or fulfil a contract with a customer - amortisation method used - closing balances by main category and amortisation expense
Practical expedients	practical expedient elected by an entity in either paragraph 63 (about the existence of a significant financing component) or paragraph 94 (about the incremental costs of obtaining a contract)



12. SERVICE CONCESSION ARRANGEMENTS

12.1 About Arrangement

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.
- Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has

traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

- A feature of these service arrangements is the public service nature of the obligation undertaken by the operator.
- Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:
 - (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.
 - (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

12.2 Accounting Principles

12.2.1 Treatment of the operator's rights over the infrastructure

- Infrastructure shall not be recognized as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator.
- The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

12.2.2 Recognition and measurement

- Since the operator acts as a service provider, he shall recognize and measure revenue in accordance with Ind AS 115 for the services it performs. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

- If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.
- The nature of the consideration i.e. whether financial asset or intangible asset determines its subsequent accounting treatment.
- The operator shall account for revenue and costs relating to construction or upgrade services.
- The operator shall account for revenue and costs relating to operation services in accordance with Ind AS 115.

12.2.3 Consideration given by the grantor to the operator

- If the operator provides construction or upgrade services, the consideration received or receivable by the operator shall be recognized at its fair value. The consideration may be rights to:
 - (a) a financial asset, or
 - (b) an intangible asset.
- The operator shall recognize a financial asset to the extent that
 - it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law.
 - it has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.
- The operator shall recognize an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.
- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognized initially at the fair value of the consideration received or receivable.

12.2.4 Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognized and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.

12.2.5 Borrowing costs incurred by the operator

- Borrowing costs attributable to the arrangement shall be recognized as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service).
- If the operator does not have a contractual right to receive an intangible asset, borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement.

12.2.6 Financial asset

- For recognition of financial asset, Ind AS 32, Ind AS 107 and Ind AS 109 shall be applied. The amount due from or at the direction of the grantor is accounted at:
 - (a) amortised cost;
 - (b) fair value through other comprehensive income; or
 - (c) fair value through profit or loss.
- If the amount due from the grantor is measured at amortised cost or fair value through other comprehensive income, Ind AS 109 requires interest calculated using the effective interest method to be recognized in profit or loss.

12.2.7 Intangible asset

For recognition and measurement of intangible asset, one has to apply Ind AS 38 for guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.

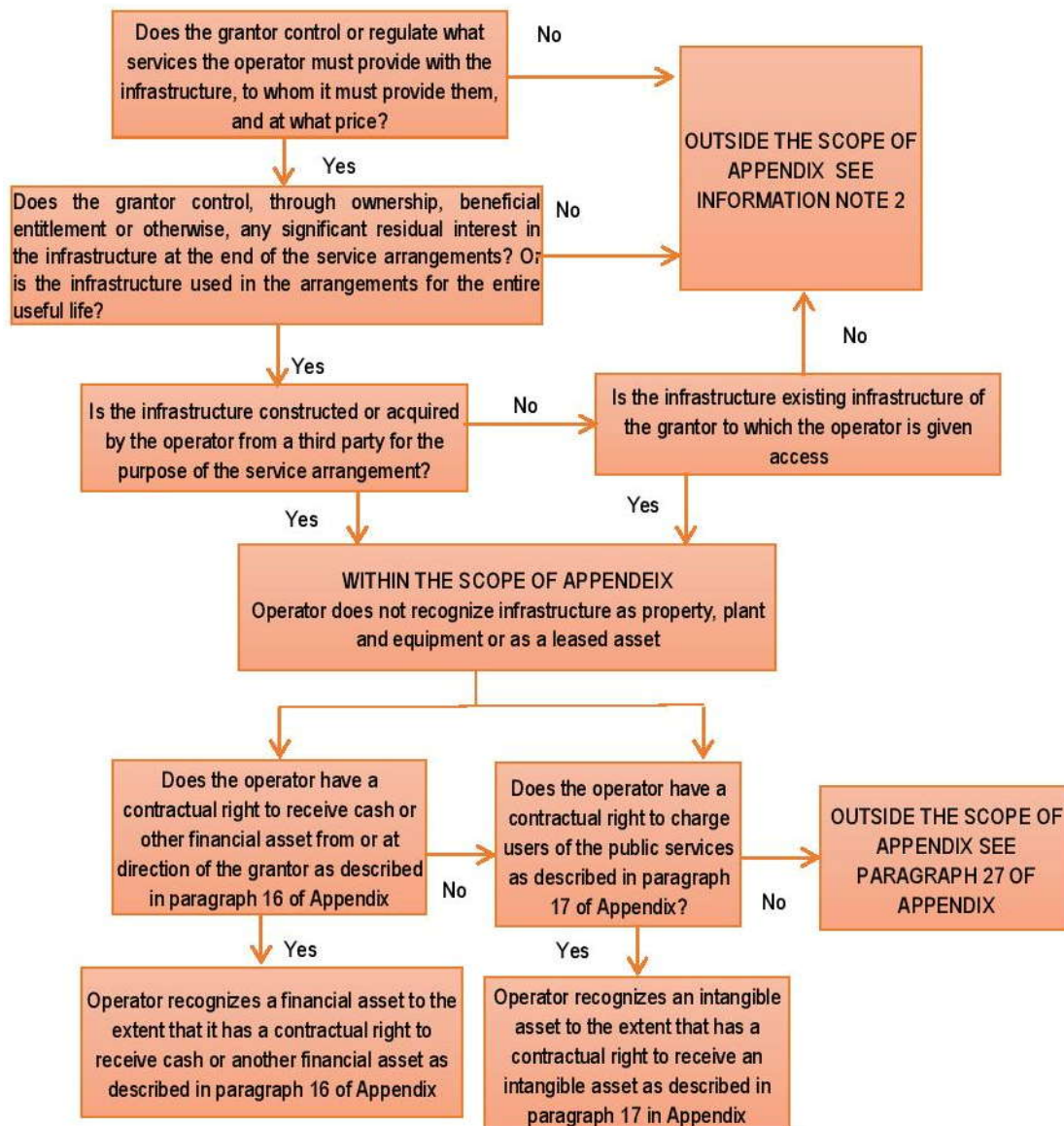
Comparison with AS 7 and AS 9

Service concession arrangements are specifically dealt with in detail unlike with AS 9 or AS 7. Also, there's a specific mention about recognition of financial asset or intangible asset as per Ind AS 115 which is not mentioned in either AS 7 or AS 9.

12.2.8 Items provided to the operator by the grantor

- Infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognized as property, plant and equipment of the operator.
- The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in Ind AS 20. They are recognized as assets of the operator, measured at fair value on initial recognition.
- The operator shall recognize a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.

Information note 1**Accounting framework for public-to-private service arrangements**



12.3 Service Concession Arrangements: Disclosures

- All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator and a grantor shall disclose the following in each period:
 - a description of the arrangement;

- (b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
 - (c) the nature and extent (eg quantity, time period or amount as appropriate) of:
 - (i) rights to use specified assets;
 - (ii) obligations to provide or rights to expect provision of services;
 - (iii) obligations to acquire or build items of property, plant and equipment;
 - (iv) obligations to deliver or rights to receive specified assets at the end of the concession period;
 - (v) renewal and termination options; and
 - (vi) other rights and obligations (eg major overhauls);
 - (d) changes in the arrangement occurring during the period; and
 - (e) how the service arrangement has been classified.
- An operator shall disclose the amount of revenue and profits or losses recognized in the period on exchanging construction services for a financial asset or an intangible asset.
 - The disclosures required in accordance with paragraph 6 of this Appendix shall be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg toll collections, telecommunications and water treatment services).

Illustration 75

A Ltd. is in the business of infrastructure and has two divisions; (I) Toll Roads and (II) Wind Power. The brief details of these business and underlying project details are as follows:

1. Bhilwara-Jabalpur Toll Project - The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to ₹ 50 crore as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:

- *Total Expenses estimated to be incurred on the project ₹ 100 crore;*
- *Fair Value of the construction services is ₹ 110 crore;*
- *Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crore;*

- Finance revenue over the period of operation phase is ₹ 15 crore:
 - Other income relates to the services provided during the operation phase.
- II. *Kolhapur- Nagpur Expressway - The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be ₹ 110 crore. The fair value of such construction cost is approximately ₹ 200 crore. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGAAP, A Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.*
- (i) *What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning.*
- (ii) *What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning.*
- (iii) *Also, suggest suitable accounting entries for the preparation of financial statements as per Ind AS for the above 2 projects.*

Solution

- (i) Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, the operator recognizes a financial asset to the extent it has a contractual right to receive cash.
- (ii) Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognize an intangible asset to the extent it receives the right (a licence) to charge users of the public service.

(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project**Journal Entries**

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:		
1	Financial asset A/c Dr.	110	
	To Construction revenue		110
	[To recognize revenue relating to construction services, to be settled in case]		
2	Cost of construction (profit or loss) Dr.	100	
	To Bank A/c (As and when incurred)		100
	[To recognize costs relating to construction services]		
	During the operation phase:		
3	Financial asset Dr.	15	
	To Finance revenue (As and when received or due to receive)		15
	[To recognize interest income under the financial asset model]		
4	Financial asset Dr.	75	
	To Revenue [(200-110) – 15]		75
	[To recognize revenue relating to the operation phase]		
5	Bank A/c Dr.	200	
	To Financial asset		200
	[To recognize cash received from the grantor]		

Kolhapur-Nagpur Expressway -Intangible asset**Journal Entries**

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:		
1	Cost of construction (profit or loss) Dr.	110	
	To Bank A/c (As and when incurred)		110
	[To recognize costs relating to construction services]		

2	Intangible asset	Dr.	200	
	To Revenue			200
	[To recognize revenue relating to construction services provided for non-cash consideration]			
	During the operation phase:			
3	Amortisation expense	Dr.	200	
	To Intangible asset (accumulated amortisation)			200
	[To recognize amortisation expense relating to the operation phase over the period of operation]			
4	Bank A/c	Dr.	?	
	To Revenue			?
	[To recognize revenue relating to the operation phase]			

Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.



13. EXTRACTS OF FINANCIAL STATEMENTS FROM LISTED ENTITIES

Following is the extract from the financial statements of the listed entity 'Hindustan Unilever Limited' for the financial year 2021-2022 with respect to 'Revenue from Contract with Customers' and its accounting policy thereon.

(All amounts in ₹ crores, unless otherwise stated)

Particulars	Note	Yearended 31st March, 2022	Yearended 31st March, 2021
INCOME			
Revenue from operations	25	52,446	47,028
Other income	26	258	410
TOTAL INCOME		52,704	47,438

NOTE 25 REVENUE FROM OPERATIONS**Sale of products:**

Revenue from sale of goods is recognised when control of the products being sold is transferred to our customer and when there are no longer any unfulfilled obligations. The performance obligations in our contracts are fulfilled at the time of dispatch, delivery or upon formal customer acceptance depending on customer terms.

Revenue is measured on the basis of contracted price, after deduction of any trade discounts, volume rebates and any taxes or duties collected on behalf of the Government such as goods and services tax, etc. Accumulated experience is used to estimate the provision for such discounts and rebates. Revenue is only recognised to the extent that it is highly probable a significant reversal will not occur.

Our customers have the contractual right to return goods only when authorised by the Group. An estimate is made of goods that will be returned and a liability is recognised for this amount using a best estimate based on accumulated experience.

Sale of services:

Income from Group owned salon is recognised when services are rendered.

Display income is recorded as per the term of the contract entered with the respective franchisee / parties.

Revenue from services are measured at fair value of the consideration received or receivable, after deduction of any sort of discounts and any taxes or duties collected on behalf of the government such as goods and services tax.

Income from services rendered:

Income from services rendered is recognised based on agreements/arrangements with the customers as the service is performed and there are no unfulfilled obligations.

Commission income on consignment sales:

Commission income on consignment sales (Consignment selling agency fees) is charged for rendering of services and for the use of the Group's sales and distribution network. Such revenue is recognised in the accounting period in which the services are rendered in accordance with the agreement with the parties.

Government grants:

The Group is entitled to 'Scheme of budgetary support' under Goods and Service Tax Regime in respect of eligible manufacturing units located in specified regions. Such grants are measured at amount receivable from the Government and are recognised as other operating revenue when there is a reasonable assurance that the Group will comply with all necessary conditions attached to that.

The Group has received approval under the Production Linked Incentive Scheme (PLI) of the Government of India for specific product categories. Incentive under the scheme is subject to meeting certain committed investments and defined incremental sales threshold. Such grants are recognised as other operating revenue when there is a reasonable assurance that the Group will comply with all necessary conditions attached to that.

Income from such grants is recognised on a systematic basis over the periods to which they relate.

	Year ended 31st March, 2022	Year ended 31st March, 2021
Sale of products	51,472	46,269
Sale of services	76	52
Other operating revenue*		
Income from services rendered	294	222
Commission income on consignment sales	315	264
Government grants (GST budgetary support and Production linked incentives) #	140	108
Others (including scrap sales, rentals, etc)	149	113
Total	52,446	47,028

Previous period figures have been re-classified from Others for better presentation

Reconciliation of Revenue from sale of products & services with the contracted price

	Year ended 31st March, 2022	Year ended 31st March, 2021
Contracted Price	57,340	51,955
Less: Trade discounts, volume rebates, etc	(5,792)	(5,634)
Sale of products and Services	51,548	46,321

* There is no material adjustment made to contract price for revenue recognised as other operating revenue.

NOTE 26 OTHER INCOME

Interest income is recognised using the effective interest rate (EIR) method. Dividend income on investments is recognised when the right to receive dividend is established. Refer Note 38 on financial instruments for policy on measurement at fair value through profit or loss.

	Year ended 31st March, 2022	Year ended 31st March, 2021
Interest income on		
Bank deposits	102	216
Current investments	80	6
Others (including interest on Income tax refunds)	16	124
Dividend income from		
Non-current investments	1	1
Fair value gain/(loss)		
Investments measured at fair value through profit or loss*	59	63
Total	258	410

*Includes realised gain on sale of investment of ₹52 crores (31st March, 2021: ₹52 crores).

(Source: Annual Report 2021-2022 – Hindustan Unilever Limited)



14. SIGNIFICANT DIFFERENCES IN IND AS 115 *VIS-À-VIS* AS 7 AND AS 9

S. No.	Particular	Ind AS 115	AS 7 and AS 9
1.	<i>Framework of Revenue Recognition</i>	Ind AS 115 gives a framework of revenue recognition within a standard. It specifies the core principle for revenue recognition which requires the 'revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services'.	AS 7 and AS 9 do not provide any such overarching principle to fall upon in case of doubt. There is no emphasis on performance obligation under the contract with customer.
2.	<i>Comprehensive Guidance on Recognition and Measurement of Multiple Elements within a Contract with Customer:</i>	Ind AS 115 gives comprehensive guidance on how to recognize and measure multiple elements within a contract with customer.	AS 7 and AS 9 do not provide comprehensive guidance on this aspect.
3.	<i>Coverage</i>	Ind AS 115 comprehensively deals with all types of performance obligation contracts with customers. However, it does not deal with revenue from 'interest' and 'dividend' which are covered in financial instruments standard.	AS 7 covers only revenue from construction contracts which is measured at consideration received / receivable. AS 9 deals only with recognition of revenue from sale of goods, rendering of services, interest, royalties and dividends.
4.	<i>Measurement of</i>	As per Ind AS 115, revenue is measured at transaction price, i.e.,	As per AS 9, Revenue is the gross inflow of cash,

	<i>Revenue</i>	the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.	receivables or other considerations arising in the course of the ordinary activities. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. As per AS 7, revenue from construction contracts is measured at consideration received / receivable and to be recognized as revenue as construction progresses if certain conditions are met.
5.	<i>Recognition of Revenue</i>	As per Ind AS 115, revenue is recognized when the control is transferred to the customer. It introduces a 5-step model for revenue recognition.	As per AS 9, revenue is recognized when significant risks and rewards of ownership is transferred to the buyer. As per AS 7, revenue is recognized when the outcome of a construction contract can be estimated reliably, contract revenue should be recognized by reference to the stage of completion of the contract activity at the reporting date.
6.	<i>Multiple element or linked transactions</i>	Ind AS 115 gives comprehensive guidance on how to recognize and measure multiple elements / performance obligations within a contract with customer.	AS 7 and AS 9 provide no specific guidance for multiple element or linked transactions.

7.	<i>Capitalisation of Costs</i>	Ind AS 115 provides guidance on recognition of costs to obtain and fulfil a contract, as asset.	AS 7 and AS 9 do not deal with such capitalisation of costs.
8.	<i>Guidance on combining contracts and variable and contingent consideration</i>	Ind AS 115 provides guidance on combining contracts entered into at or near the same time with the same customer (or related parties of the customer), guidance on treatment of variable and contingent consideration.	AS 7 and AS 9 do not deal with such aspects.
9.	<i>Adjustment for time value of money</i>	As per Ind AS 115, transaction price is adjusted for the effect of time value of money when a significant financing component exists.	As per AS 9, revenue is not adjusted for time value of money.
10.	<i>Guidance on Service Concession Arrangements</i>	Ind AS 115 gives guidance on service concession arrangements and disclosures thereof.	AS does not provide such guidance.
11.	<i>Disclosure Requirements</i>	Ind AS 115 contains detailed disclosure requirements.	Less disclosure requirements are prescribed in AS.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!



TEST YOUR KNOWLEDGE

Questions

1. Q TV released an advertisement in Deshabandhu, a vernacular daily. Instead of paying for the same, Q TV allowed Deshabandhu a free advertisement spot, which was duly utilised by Deshabandhu. How revenue for these non-monetary transactions in the area of advertising will be recognized and measured?
2. A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 2.5 per unit. How should revenue be measured in this case?
3. Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ₹ 50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are ₹ 40,00,000 including ₹ 10,00,000 for the air conditioners.

Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at 31st March, 20X1, other costs incurred excluding the air conditioners are ₹ 6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognized for the year ended March 20X1?

4. An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for ₹ 20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry.

P Ltd. pays a non-refundable deposit of ₹ 1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is ₹ 12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognize revenue from sale of machinery to P Ltd. in accordance with Ind AS 115?

5. Entity I sells a piece of machinery to the customer for ₹ 2 million, payable in 90 days. Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast ₹ 1.75 million, which is sufficient to cover entity I's cost of sales (₹ 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts.

Entity I concludes that it is highly probable that it will collect ₹ 1.75 million, and such amount is not constrained under the variable consideration guidance.

What is the transaction price in this arrangement?

6. On 1st January 20X8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
₹ 100	1 - 1,000,000 containers
₹ 90	1,000,001 - 3,000,000 containers
₹ 85	3,000,001 containers and above

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer.

Entity J sells 700,000 containers to the customer during the first quarter ended 31st March 20X8 for a contract price of ₹ 100 per container.

How should entity J determine the transaction price?

7. Entity K sells electric razors to retailers for C 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for C 10 per unit.

Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.

How should entity K determine the transaction price?

8. A manufacturer enters into a contract to sell goods to a retailer for ₹ 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract.

Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.

How should the manufacturer determine the transaction price?

9. Electronics Manufacturer M sells 1,000 televisions to Retailer R for ₹ 50,00,000 (₹ 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next six months (₹)	Probability
0	70%

₹ 500	20%
₹ 1,000	10%

Determine the transaction price.

10. Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either ₹ 1,10,000 or ₹ 1,30,000.

Outcome	Consideration (₹)	Probability
Project completes on time	1,30,000	90%
Project is delayed	1,10,000	10%

Determine the transaction price.

11. Franchisor Y Ltd. licenses the right to operate a store in a specified location to Franchisee F. The store bears Y Ltd.'s trade name and F will have a right to sell Y Ltd.'s products for 10 years. F pays an up-front fixed fee. The franchise contract also requires Y Ltd. to maintain the brand through product improvements, marketing campaigns etc. Determine the nature of license.

Answers

1. Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange. The current scenario, on the contrary, will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services because both of the entities deal in different mode of media, i.e., one is print media and another is electronic media and both parties are acting as customers and suppliers for each other.

Further, in the current scenario, it seems it is for consumption by the said parties and hence it does not fall under paragraph 5(d). It may also be noted that, even if it was to facilitate sales to customers or potential customers, it would not be scoped out since the parties are not in the same line of business.

As per paragraph 47 of Ind AS 115, "An entity shall consider the terms of the contract and

its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both”.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

In accordance with the above, Q TV and Deshabandhu should measure the revenue promised in the form of non-cash consideration as per the above referred principles of Ind AS 115.

2. Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

However, the current scenario will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services.

As per paragraph 47 of Ind AS 115, “an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both”.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of noncash consideration) at fair value.

On the basis of the above, revenue recognized by A Ltd. will be the consideration in the form of power units that it expects to be entitled for talktime sold, i.e. ₹ 50,000 (20,000 units x ₹ 2.5). The revenue recognized by B Ltd. will be the consideration in the form of talk time that it expects to be entitled for the power units sold, i.e., ₹ 50,000 (1,00,000 minutes x ₹ 0.50).

3. Paragraph B19 of Ind AS 115 inter alia, states that, “an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring

progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer".

In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity's progress in satisfying the performance obligation. The costs incurred to procure the air conditioners (₹ 10,00,000) are significant relative to the total costs to completely satisfy the performance obligation (₹ 40,00,000). Also, Company X is not involved in manufacturing or designing the air conditioners.

Company X concludes that including the costs to procure the air conditioners in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph B19 of Ind AS 115, the entity adjusts its measure of progress to exclude the costs to procure the air conditioners from the measure of costs incurred and from the transaction price. The entity recognizes revenue for the transfer of the air conditioners at an amount equal to the costs to procure the air conditioners (i.e., at a zero margin).

Company X assesses that as at March, 20X1, the performance is 20 per cent complete (i.e., ₹ 6,00,000 / ₹ 30,00,000). Consequently, Company X recognizes the following-

As at 31st March, 20X1

	Amount in ₹
Revenue	18,00,000
Cost of goods sold	16,00,000
Profit	2,00,000

Revenue recognized is calculated as (20 per cent × ₹ 40,00,000) + ₹ 10,00,000.

(₹ 40,00,000 = ₹ 50,00,000 transaction price – ₹ 10,00,000 costs of air conditioners.)

Cost of goods sold is ₹ 6,00,000 of costs incurred + ₹ 10,00,000 costs of air conditioners.

4. As per paragraph 9 of Ind AS 115, "An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:
 - (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
 - (b) the entity can identify each party's rights regarding the goods or services to be transferred;
 - (c) the entity can identify the payment terms for the goods or services to be transferred;

- (d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognized, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

- (a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);
- (b) P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and
- (c) P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

Further, para 15 states that when a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognize the consideration received as revenue only when either of the following events has occurred:

- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- (b) the contract has been terminated and the consideration received from the customer is non-refundable.

Para 16 states that an entity shall recognize the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9

are subsequently met. Depending on the facts and circumstances relating to the contract, the liability recognized represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of ₹ 1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration, nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

5. Entity I is likely to provide a price concession and accept an amount less than ₹ 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ₹ 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for ₹ 1.75 million and therefore contract exists.
6. The transaction price is ₹ 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of ₹ 90. Entity J concludes that based on a transaction price of ₹ 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty is resolved. Revenue is therefore recognized at a selling price of ₹ 90 per container as each container is sold. Entity J will recognize a liability for cash received in excess of the transaction price for the first 1 million containers sold at ₹ 100 per container (that is, ₹ 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

For the quarter ended 31st March, 20X8, entity J recognizes revenue of ₹ 63 million (700,000 containers x ₹ 90) and a liability of ₹ 7 million [700,000 containers x (₹ 100 - ₹ 90)].

Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

7. Entity K records sales to the retailer at a transaction price of ₹ 47.50 (₹ 50 less 25% of ₹ 10). The difference between the per unit cash selling price to the retailers and the

transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.

8. The transaction price is ₹ 950, because the expected reimbursement is ₹ 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognize a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.
9. After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be ₹ 4,800 per television – i.e. $(₹ 5,000 \times 70\%) + (₹ 4,500 \times 20\%) + (₹ 4,000 \times 10\%)$.
10. Because there are only two possible outcomes under the contract, C determines that using the most likely amount provides the best prediction of the amount of consideration to which it will be entitled. C estimates the transaction price to be ₹ 1,30,000, which is the single most likely amount.
11. The licence provides F access to the IP as it exists at any point in time in the licence period. This is because:
 - Y Ltd. is required to maintain the brand, which will significantly affect the IP by affecting F's ability to obtain benefit from the brand;
 - any action by Y Ltd. may have a direct positive or negative effect on F; and
 - these activities do not transfer a goods or service to F.

Therefore, Y Ltd. recognizes the up-front fee over the 10-year franchise period.

[illegible]

DIVISION II OF SCHEDULE III TO THE COMPANIES ACT, 2013



Division II

Financial Statements for a company whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015.

GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENT OF A COMPANY REQUIRED TO COMPLY WITH Ind AS

1. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
2. Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.
4. (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required-
 - (a) narrative description or disaggregation of items recognised in those statements; and
 - (b) information about items that do not qualify for recognition in those statements.

- (ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.
5. Depending upon the **Total Income** of the company, the figures appearing in the Financial Statements shall be rounded off as below:

Total Income	Rounding off
(i) less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof
(li) one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

6. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.
7. Financial Statements shall disclose all 'material' items, i.e, the items if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
8. For the purpose of this Schedule, the terms used herein shall have the same meanings assigned to them in Indian Accounting Standards.
9. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

Note: This Schedule sets out the minimum requirements for disclosure on the face of the Financial Statements, i.e, Balance Sheet, Statement of Changes in Equity for the period, the Statement of profit and Loss for the period (The term 'Statement of Profit and Loss' has the same meaning as Profit and Loss Account) and Notes. Cash flow statement shall be prepared, where applicable, in accordance with the requirement of the relevant Indian Accounting Standard.

Line items, sub-line items and sub-totals shall 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 to cater to industry or sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 2013 or under the Indian Accounting Standards.

PART I -BALANCE SHEET

Name of the Company.....

Balance Sheet as at

(` in.....)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1	2	3	4
(1)	ASSETS			
	Non-current assets			
	(a) Property, Plant and Equipment (b) Capital work-in-progress (c) Investment Property (d) Goodwill (e) Other Intangible assets (f) Intangible assets under development (g) Biological Assets other than bearer plants (h) Financial Assets (i) Investments (ii) Trade receivables (iii) Loans (i) Deferred tax assets (net) (j) Other non-current assets			
(2)	Current assets			
	(a) Inventories (b) Financial Assets (i) Investments (ii) Trade receivables (iii) Cash and cash equivalents			

	(iv) Bank balances other than (iii) above (v) Loans (vi) Others (to be specified) (c) Current Tax Assets (Net) (d) Other current assets			
	Total Assets			
	EQUITY AND LIABILITIES Equity (a) Equity Share capital (b) Other Equity			
(1)	LIABILITIES Non-current liabilities (a) Financial Liabilities (i) Borrowings (ia) Lease liabilities (ii) Trade Payables: (A) total outstanding dues of micro enterprises and small enterprises; and (B) total outstanding dues of creditors other than micro enterprises and small enterprises. (iii) Other financial liabilities (other than those specified in item (b), to be specified) (b) Provisions (c) Deferred tax liabilities (Net) (d) Other non-current liabilities			
(2)	Current liabilities (a) Financial Liabilities (i) Borrowings (ia) Lease liabilities (ii) Trade payables: (A) total outstanding dues of micro enterprises and small enterprises; and			

(B) total outstanding dues of creditors other than micro enterprises and small enterprises			
(iii) Other financial liabilities (other than those specified in item (c))			
(b) Other current liabilities			
(c) Provisions			
(d) Current Tax Liabilities (Net)			
Total Equity and Liabilities			

see accompanying notes to the financial statements

STATEMENT OF CHANGES IN EQUITY

Name of the Company.....

A. Equity Share Capital

(1) **Current reporting period**

Balance at the beginning of the current reporting period	Changes in Equity Share Capital due to prior period errors	Restated balance at the beginning of the current reporting period	Changes in equity share capital during the current year	Balance at the end of the current reporting period

(2) **Previous reporting period**

Balance at the beginning of the previous reporting period	Changes in Equity Share Capital due to prior period errors	Restated balance at the beginning of the previous reporting period	Changes in equity share capital during the previous year	Balance at the end of the previous reporting period

B. Other Equity

(1) Current Reporting Period

	Share application on money pending allotment	Equity component of compound financial instruments	Reserves and Surplus				Debt Instruments through other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of Other Comprehensive Income (specify nature)	Money received against share capital	Total
			Capital Reserve	Securities Premium	Other Reserves (specify nature)	Retained Earnings								
Balance at the beginning of the current reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the current reporting period														
Total comprehensive Income for the current year														
Dividends														
Transfer to retained earnings														
Any other change (to be specified)														
Balance at the end of the current reporting period														

(1) Previous Reporting Period

	Share application on money pending allotment	Equity component of compound financial instruments	Reserves and Surplus				Debt Instruments through other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of Other Comprehensive Income (specify nature)	Money received against share capital	Total
			Capital Reserve	Securities Premium	Other Reserves (specify nature)	Retained Earnings								
Balance at the beginning of the previous reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the previous reporting period														
Total comprehensive Income for the previous year														
Dividends														
Transfer to retained earnings														
Any other change (to be specified)														
Balance at the end of the previous reporting period														

Note: Re-measurement of defined benefit plans and fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss shall be recognised as a part of retained earnings with separate disclosure of such items alongwith the relevant amounts in the Notes or shall be shown as a separate column under Reserves and Surplus.

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

1. An entity shall classify an asset as current when-
 - (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
 - (b) it holds the asset primarily for the purpose of trading;
 - (c) it expects to realise the asset within twelve months after the reporting period; or
 - (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current.

2. The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents, When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.
3. An entity shall classify a liability as current when-
 - (a) it expects to settle the liability in its normal operating cycle;
 - (b) it holds the liability primarily for the purpose of trading;
 - (c) the liability is due to be settled within twelve months after the reporting period; or
 - (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

4. A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6. A company shall disclose the following in the Notes:

A Non-Current Assets

- I. Property, Plant and Equipment
 - (i) Classification shall be given as:
 - (a) Land
 - (b) Buildings

- (c) Plant and Equipment
- (d) Furniture and Fixtures
- (e) Vehicles
- (f) Office equipment
- (g) Bearer Plants
- (h) Others (specify nature)
 - (ii) Assets under lease shall be separately specified under each class of assets
 - (iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, **amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property ,Plant and Equipment)** and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

II. Investment Property

A reconciliation of the gross and net carrying amounts of each class of property at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

III. Goodwill

A reconciliation of the gross and net carrying amount of goodwill at the beginning and end of the reporting period showing additions, impairments, disposals and other adjustments.

IV. Other Intangible assets

- (i) Classification shall be given as:
 - (a) Brands or trademarks
 - (b) Computer software
 - (c) Mastheads and publishing titles
 - (d) Mining rights
 - (e) Copyright, patents, other intellectual property rights, services and operating rights
 - (f) Recipes, formulae, models, designs and prototypes

- (g) Licenses and franchises
- (h) Others (specify nature)
- (ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, **amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets)** and other adjustments and the related amortization and impairment losses or reversals shall be disclosed separately.

V. Biological Assets other than bearer plants

A reconciliation of the carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments shall be disclosed separately.

VI. Investment

- (i) Investments shall be classified as:
 - (a) Investments in Equity Instruments;
 - (b) Investments in Preference Shares;
 - (c) Investments in Government or trust securities;
 - (d) Investments in debentures or bonds;
 - (e) Investments in Mutual Funds;
 - (f) Investments in partnership firms; or
 - (g) Other investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate that are-

- (i) subsidiaries,
- (ii) associates,
- (iii) joint ventures, or
- (iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). Investment in partnership firms along with names of the firms, their partners, total capital and the shares of each partner shall be disclosed separately.

- (ii) The following shall also be disclosed:

- (a) Aggregate amount of quoted investment and market value thereof:
- (b) Aggregate amount of unquoted investment: and
- (c) Aggregate amount of impairment in value of investment.

VII. Trade Receivables

- (i) Trade receivables shall be sub-classified as;
 - (a) Trade Receivables considered good - Secured;
 - (b) Trade Receivables considered good - Unsecured;
 - (c) Trade Receivables which have significant increase in Credit Risk; and
 - (d) Trade Receivables - credit impaired
- (ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- (iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
- (iv) For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment*					Total
	Less than 6 months	6 months- 1 year	1-2 years	2-3 years	More than 3 years	
<i>(i) Undisputed Trade receivables – considered good</i>						
<i>(ii) Undisputed Trade Receivables – which have significant increase in credit risk</i>						
<i>(iii) Undisputed Trade Receivables – credit impaired</i>						

(iv) Disputed Trade Receivables – considered good						
(v) Disputed Trade Receivables – which have significant increase in credit risk						
(vi) Disputed Trade Receivables – credit impaired						

** similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.*

Unbilled dues shall be disclosed separately

VIII. Loans

- (i) Loans shall be classified as-
 - (a) Loans to related parties (giving details thereof); and
 - (b) Other loans (specify nature).
- (ii) Loans Receivables shall be sub-classified as:
 - (a) Loans Receivables considered good - Secured;
 - (b) Loans Receivables considered good - Unsecured;
 - (c) Loans Receivables which have significant increase in Credit Risk; and
 - (d) Loans Receivables - credit impaired;

The above shall also be separately sub-classified as-

 - (a) Secured, considered good;
 - (b) Unsecured, considered good; and
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.
- (iv) Loans due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

- IX. Other financial assets
 - (i) Security Deposits
 - (ii) Bank deposits with more than 12 months maturity
 - (iii) Others (to be specified)
 - X. Other non-current asset: Other non-current assets shall be classified as
 - (i) Capital Advances; and
 - (ii) Advances other than capital advances;
 - (1) Advances other than capital advances shall be classified as:
 - (a) Security deposits;
 - (b) Advances to related parties (giving details thereof; and
 - (c) Other advances (specify nature).
 - (2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated, In case advances are of the nature of a financial asset as per relevant Ind AS, these are to be disclosed under other financial assets separately.
 - (iii) Others (specify nature).
- B. Current Assets
 - I. Inventories
 - (i) Inventories shall be classified as-
 - (a) Raw materials;
 - (b) Work in-progress;
 - (c) Finished goods;
 - (d) Stock-in-trade (in respect of goods acquired for trading);
 - (e) stores and spares;
 - (f) Loose tools; and
 - (g) Others (specify nature).
 - (ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
 - (iii) Mode of valuation shall be stated.

II. Investment

- (i) Investments shall be classified as-
 - (a) Investments in Equity Instruments;
 - (b) Investment in Preference Shares;
 - (c) Investment in government or trust securities;
 - (d) Investments in debentures or bonds;
 - (e) Investments in Mutual Funds;
 - (f) Investment in partnership firms; and
 - (g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate that are-

- (i) subsidiaries,
- (ii) associates,
- (iii) joint ventures, or
- (iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid)

- (ii) The following shall also be disclosed
 - (a) Aggregate amount of quoted investments and market value thereof;
 - (b) Aggregate amount of unquoted investments;
 - (c) Aggregate amount of impairment in value of investments,

III. Trade Receivables

- (i) Trade receivables shall be sub-classified as:
 - (a) Trade Receivables considered good - Secured;
 - (b) Trade Receivables considered good - Unsecured;
 - (c) Trade Receivables which have significant increase in Credit Risk; and
 - (d) Trade Receivables - credit impaired.
- (ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- (iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies

respectively in which any director is a partner or a director or a member should be separately stated.

- (iv) For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment*					Total
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – which have significant increase in credit risk						
(iii) Undisputed Trade Receivables – credit impaired						
(iv) Disputed Trade Receivables– considered good						
(v) Disputed Trade Receivables – which have significant increase in credit risk						
(vi) Disputed Trade Receivables – credit impaired						

* similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately**IV. Cash and cash equivalents**

Cash and cash equivalents shall be classified as-

- a. Balances with Banks (of the nature of cash and cash equivalents);
- b. Cheques, drafts on hand;
- c. Cash on hand; and
- d. Others (specify nature).

V. Loans**(i) Loans shall be classified as:**

- (a) Loans to related parties (giving details thereof); and
- (b) others (specify nature).

(ii) Loans Receivables shall be sub-classified as:

- (a) Loans Receivables considered good - Secured;
- (b) Loans Receivables considered good - Unsecured;
- (c) Loans Receivables which have significant increase in Credit Risk; and
- (d) Loans Receivables - credit impaired.

(iii) Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.**(iv) Loans due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.**

VA. Other Financial Assets: This is an all-inclusive heading, which incorporates financial assets that do not fit into any other financial asset categories, such as, Security Deposits.

VI. Other current assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

Other current assets shall be classified as-

- (i) Advances other than capital advances
 - (1) Advances other than capital advances shall be classified as:
 - (a) Security Deposits;
 - (b) Advances to related parties (giving details thereof);
 - (c) Other advances (specify nature)
 - (2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
 - (a) Earmarked balances with banks (for example for unpaid dividend) shall be separately stated.
 - (b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
 - (c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

D. Equity

I. Equity Share Capital

For each class of equity share capital:

- (a) the number and amount of shares authorised;
- (b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
- (c) par value per Share;
- (d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;
- (e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
- (f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

- (g) shares in the company held by each shareholder holding more than five per cent. shares specifying the number of shares held;
- (h) shares reserved for issue under options and contracts or commitments for the sale of shares or disinvestment, including the terms and amounts;
- (i) for the period of five years immediately preceding the date at which the Balance Sheet is prepared
 - aggregate number and class of shares allotted as fully paid up pursuant to contract without payment being received in cash;
 - aggregate number and class of shares allotted as fully paid up by way of bonus shares; and
 - aggregate number and class of shares bought back;
- (j) terms of any securities convertible into equity shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
- (k) calls unpaid (showing aggregate value of calls unpaid by directors and officers);
- (l) forfeited shares (amount originally paid up).
- (m) A company shall disclose Shareholding of Promoters* as under:

Shares held by promoters at the end of the year				% Change during the year***
S. No	Promoter name	No. of Shares**	% of total shares	
Total				

*Promoter here means promoter as defined in the Companies Act, 2013.

**Details shall be given separately for each class of shares

***Percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.

II. Other Equity

- (i) 'Other Reserves' shall be classified in the notes as-
 - (a) Capital Redemption Reserve;
 - (b) Debenture Redemption Reserve;
 - (c) Share Options Outstanding Account; and

(d) Others- (specify the nature and purpose of each reserve and the amount in respect thereof);

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

- (ii) Retained Earnings represents surplus i.e. balance of the relevant column in the Statement of Changes in Equity;
- (iii) A reserve specifically represented by earmarked investments shall disclose the fact that it is so represented;
- (iv) Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'retained earnings'. Similarly, the balance of 'Other Equity', after adjusting negative balance of retained earnings, if any, shall be shown under the head 'Other Equity' even if the resulting figure is in the negative; and
- (v) Under the sub-head 'Other Equity', disclosure shall be made for the nature and amount of each item.

E. Non-Current Liabilities

I. Borrowings

- (i) borrowings shall be classified as-
 - (a) Bonds or debentures
 - (b) Term loans
 - (I) from banks
 - (II) from other Parties
 - (c) Deferred payment liabilities
 - (d) Deposits
 - (e) Loans from related parties
 - (f) Liability component of compound financial instruments
 - (g) Other loans (specify nature);
- (ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
- (iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;
- (iv) bonds or debentures (along with the rate of interest, and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity

or conversion, starting from farthest redemption or conversion date, as the case may be, where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due;

- (v) particulars of any redeemed bonds or debentures which the company has power to reissue shall be disclosed;
- (vi) terms of repayment of term loans and other loans shall be stated; and
- (vii) period and amount of default as on the balance sheet date in repayment of borrowings and interest shall be specified separately in each case.

III. Provisions

The amounts shall be classified as-

- (a) Provision for employee benefits; and
- (b) Others (specify nature).

IV. Other non-current liabilities

- (a) Advances; and
- (b) Others (specify nature).

F. Current Liabilities

I. Borrowings

- (i) Borrowings shall be classified as-
 - (a) Loans repayable on demand
 - (I) from banks
 - (II) from other parties
 - (b) Loans from related parties
 - (c) Deposits
 - (d) Other loans (specify nature);
- (ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case;
- (iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;
- (iv) period and amount of default as on the balance sheet date in repayment of borrowings and interest, shall be specified separately in each case;

- (v) Current maturities of long-term borrowings shall be disclosed separately.

II. Other Financial Liabilities

Other Financial liabilities shall be classified as-

- (a) Interest accrued;
- (b) Unpaid dividends;
- (c) Application money received for allotment of securities to the extent refundable and interest accrued thereon;
- (d) Unpaid matured deposits and interest accrued thereon;
- (e) Unpaid matured debentures and interest accrued thereon; and
- (f) Others (specify nature).

'Long term debt' is a borrowing having a period of more than twelve months at the time of origination.

III. Other current liabilities

The amounts shall be classified as-

- (a) revenue received in advance;
- (b) other advances (specify nature); and
- (c) others (specify nature);

IV. Provisions

The amounts shall be classified as-

- (i) provision for employee benefits; and
- (ii) others (specify nature)

FA. Trade Payables

The following details relating to micro, small and medium enterprises shall be disclosed in the notes:

- (a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;
- (b) the amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006), along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;
- (c) the amount of interest due and payable for the period of delay in making payment (which has been paid but beyond the appointed day during the year) but without adding the

interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

- (d) the amount of interest accrued and remaining unpaid at the end of each accounting year; and
- (e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.

Explanation.- The terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise' and 'supplier', shall have the same meaning as assigned to them under clauses (b), (d), (e), (h), (m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

FB. For trade payables due for payment, following ageing schedule shall be given:

Trade Payables ageing schedule

(Amount in ₹)

Particulars	Outstanding for following periods from due date of payment*				Total
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
(i) MSME					
(ii) Others					
(iii) Disputed dues – MSME					
(iv) Disputed dues - Others					

*Similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

G. The presentation of liabilities associated with group of assets classified as held for sale and non-current assets classified as held for sale shall be in accordance with the relevant Indian Accounting Standards (Ind ASs)

H. Contingent Liabilities and Commitments (to the extent not provided for)

- (i) Contingent Liabilities shall be classified as-
 - (a) claims against the company not acknowledged as debt;
 - (b) guarantees excluding financial guarantees; and
 - (c) other money for which the company is contingently liable.
- (ii) Commitments shall be classified as-

- (a) estimated amount of contracts remaining to be executed on capital account and not provided for;
 - (b) uncalled liability on shares and other investments partly paid; and
 - (c) other commitments (specify nature).
- I. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and title related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on irredeemable preference shares shall also be disclosed separately.
- J. Where in respect of an issue of securities made for a specific purpose the whole or part of amount has not been used for the specific purpose at the Balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.
- JA. Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.
- L. Additional Regulatory Information

(i) Title deeds of Immovable Properties not held in name of the Company

The company shall provide the details of all the immovable properties (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in following format and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative# of promoter*/ director or employee of promoter/d irector	Property held since which date	Reason for not being held in the name of the company**
PPE -	Land Building	-	-	-	-	**also indicate if in dispute

Investment property	Land					
-	Building					
PPE retired from active use and held for disposal	Land					
	Building					
Others						

#Relative here means relative as defined in the Companies Act, 2013.

*Promoter here means promoter as defined in the Companies Act, 2013.

- (ii) The Company shall disclose as to whether the fair value of investment property (as measured for disclosure purposes in the financial statements) is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.
- (iii) Where the Company has revalued its Property, Plant and Equipment (including Right-of-Use Assets), the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.
- (iv) Where the company has revalued its intangible assets, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.
- (v) The following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, directors, KMPs and the related parties (as defined under Companies Act, 2013), either severally or jointly with any other person, that are:
 - (a) repayable on demand; or
 - (b) without specifying any terms or period of repayment,

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
<i>Related Parties</i>		

(vi) Capital-Work-in Progress (CWIP)

- (a) For Capital-work-in progress, following ageing schedule shall be given:

CWIP aging schedule

(Amount in Rs.)

CWIP	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Project in progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

- (b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in ₹)

CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

(vii) Intangible assets under development:

- (a) For Intangible assets under development, following ageing schedule shall be given:

Intangible assets under development aging schedule

(Amount in ₹)

Intangible assets under development	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Project in progress					
Projects temporarily suspended					

* Total shall tally with the amount of Intangible assets under development in the balance sheet.

- (b) **For Intangible assets under development, whose completion is overdue or has exceeded its cost compared to its original plan, the following Intangible assets under development completion schedule shall be given**:**

(Amount in ₹)

CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

****Details of projects where activity has been suspended shall be given separately.**

(viii) Details of Benami Property held

Where any proceeding has been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, the company shall disclose the following:

- Details of such property,
- Amount thereof,
- Details of Beneficiaries,
- If property is in the books, then reference to the item in the Balance Sheet,
- If property is not in the books, then the fact shall be stated with reasons,
- Where there are proceedings against the company under this law as an abetter of the transaction or as the transferor then the details shall be provided,
- Nature of proceedings, status of same and company's view on same.

(ix) where the Company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following:

- whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts;
- if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

(x) Wilful Defaulter*

Where a company is a declared wilful defaulter by any bank or financial Institution or other lender, following details shall be given:

- (a) Date of declaration as wilful defaulter,
- (b) Details of defaults (amount and nature of defaults)

* wilful defaulter" here means a person or an issuer who or which is categorized as a wilful defaulter by any bank or financial institution (as defined under the Companies Act, 2013) or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India.

(xi) Relationship with Struck off Companies

Where the company has any transactions with companies struck off under section 248 of the Companies Act, 2013 or section 560 of Companies Act, 1956, the Company shall disclose the following details, namely:

Name of struck off Company	Nature of transactions with struck off Company	Balance Outstanding	Relationship with the Struck off company, if any, to be disclosed
	Investments in securities		
	Receivables		
	Payables		
	Shares held by struck off company		
	Other outstanding balances (to be specified)		

(xii) Registration of charges or satisfaction with Registrar of Companies (ROC)

Where any charges or satisfaction yet to be registered with ROC beyond the statutory period, details and reasons thereof shall be disclosed.

(xiii) Compliance with number of layers of companies

Where the company has not complied with the number of layers prescribed under clause (87) of section 2 of the Act read with the Companies (Restriction on number of Layers) Rules, 2017, the name and CIN of the companies beyond the specified layers and the relationship or extent of holding of the company in such downstream companies shall be disclosed.

(xiv) Following Ratios to be disclosed:

- (a) Current Ratio,
- (b) Debt-Equity Ratio,
- (c) Debt Service Coverage Ratio,
- (d) Return on Equity Ratio,
- (e) Inventory turnover ratio,
- (f) Trade Receivables turnover ratio,
- (g) Trade payables turnover ratio,
- (h) Net capital turnover ratio,
- (i) Net profit ratio,
- (j) Return on Capital employed,
- (k) Return on investment.

The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

(xv) Compliance with approved Scheme(s) of Arrangements

Where the Scheme of Arrangements has been approved by the Competent Authority in terms of sections 230 to 237 of the Companies Act, 2013, the company shall disclose that the effect of such Scheme of Arrangements have been accounted for in the books of account of the Company in accordance with the Scheme and in accordance with accounting standards' and any deviation in this regard shall be explained.

(xvi) Utilisation of Borrowed funds and share premium:

- (A) *Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall*
 - (i) *directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or*
 - (ii) *provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries; the company shall disclose the following:*
 - (I) *date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.*

- (II) *date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries alongwith complete details of the ultimate beneficiaries.*
- (III) *date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries*
- (IV) *declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).*

(B) Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall

- (i) *directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or*
- (ii) *provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:*
 - (I) *date and amount of fund received from Funding parties with complete details of each Funding party.*
 - (II) *date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries alongwith complete details of the other intermediaries or ultimate beneficiaries.*
 - (III) *date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries*
 - (IV) *declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).]*

7. When a company applies an accounting policy retrospectively or makes a restatement of items in the financial statements or when it reclassifies items in its financial statements, the company shall attach to the Balance Sheet, a "Balance Sheet" as at the beginning of the earliest comparative period presented.
8. Share application money pending allotment shall be classified into equity or liability in accordance with relevant Indian Accounting Standards. share application money to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable shall be separately shown under 'Other financial liabilities'.
9. Preference shares including premium received on issue, shall be classified and presented as 'Equity' or 'Liability' in accordance with the requirements of the relevant Indian Accounting Standards. Accordingly, the disclosure and presentation requirements in that regard applicable

to the relevant class of equity or liability shall be applicable mutatis mutandis to the preference shares. For instance, plain vanilla redeemable preference shares shall be classified and presented under 'non-current liabilities' as 'borrowings' and the disclosure requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares.

10. Compound financial instruments such as convertible debentures, where split into equity and liability components, as per the requirements of the relevant Indian Accounting Standards, shall be classified and presented under the relevant heads in 'Equity' and 'Liabilities'
11. Regulatory Deferral Account Balances shall be presented in the Balance Sheet in accordance with the relevant Indian Accounting Standards.

PART II - STATEMENT OF PROFIT AND LOSS

Name of the Company.....

Statement of Profit and Loss for the period ended.....

	Particulars	Note No.	Figures as at the end of current reporting period	Figures for the previous reporting period
I	Revenue from operations			
II	Other Income			
III	Total Income (I + II)			
IV	EXPENSES			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expenses			
	Other expenses			
	Total expenses (IV)			
V	Profit/(loss) before exceptional items and tax (I-IV)			
VI	Exceptional Items			
VII	Profit/ (loss) before exceptions items and tax(V-VI)			
VIII	Tax expense: (1) Current tax (2) Deferred tax			
IX	Profit (Loss) for the period from continuing operations (VII - VIII)			
X	Profit/(loss) from discontinued operations			

XI	Tax expenses of discontinued operations			
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)			
XIII	Profit/(loss) for the period (IX+XII)			
XIV	Other Comprehensive Income A. (i) Items that will not be reclassified to profit or loss (ii) Income tax relating to items that will not be reclassified to profit or loss B. (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be reclassified to profit or loss			
XV	Total Comprehensive Income for the period (XIII+XIV) Comprising Profit (Loss) and Other comprehensive Income for the period)			
XVI	Earnings per equity share (for continuing operation): (1) Basic (2) Diluted			
XVII	Earnings per equity share (for discontinued operation): (1) Basic (2) Diluted			
XVIII	Earning per equity share (for discontinued & continuing operation) (1) Basic (2) Diluted			

see accompanying notes to the financial statements

GENERAL INSTRUCTIONS FOR PREPARING OF STATEMENT OF PROFIT AND LOSS

1. The provisions of this Part shall apply to the income and expenditure account, in like manner as they apply to a Statement of Profit and Loss,

2. The Statement of Profit and Loss shall include:
 - (1) Profit or loss for the Period;
 - (2) Other Comprehensive Income for the periodThe sum of (1) and (2) above is "Total Comprehensive Income"
3. Revenue from operations shall disclose separately in the notes
 - (a) sale of products (including Excise Duty);
 - (b) sale of services;
 - (ba) Grants or donations received (relevant in case of section 8 companies only); and
 - (c) other operating revenues.
4. Finance Costs: Finance costs shall be classified as-
 - (a) interest;
 - (b) dividend on redeemable preference shares;
 - (c) exchange differences regarded as an adjustment to borrowing costs; and
 - (d) other borrowing costs (specify nature).
5. Other income: other income shall be classified as-
 - (a) interest Income;
 - (b) dividend Income; and
 - (c) other non-operating income (net of expenses directly attributable to such income)
6. Other Comprehensive Income shall be classified into-
 - (A) Items that will not be reclassified to profit or loss
 - (i) Changes in revaluation surplus;
 - (ii) Re-measurements of the defined benefit plans;
 - (iii) Equity Instruments through Other Comprehensive Income;
 - (iv) Fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss;
 - (v) Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and
 - (v) Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and

- (vi) Others (specify nature).
- (B) Items that will be reclassified to profit or loss;
 - (i) Exchange differences in translating the financial statements of a foreign operation;
 - (ii) Debt instruments through Other Comprehensive Income;
 - (iii) The effective portion of gains and loss on hedging instruments in a cash flow hedge;
 - (iv) Share of other comprehensive income in Associates and Joint Ventures, to the extent to be classified into profit or loss; and
 - (v) Others (specify nature)
- 7. Additional Information: A Company shall disclose by way of notes, additional information regarding aggregate expenditure and income on the following items:
 - (a) employee Benefits expense (showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) share based payments to employees, (iv) staff welfare expenses).
 - (b) depreciation and amortisation expense;
 - (c) any item of income or expenditure which exceeds one per cent of the revenue from operations or ₹ 10,00,000, whichever is higher, in addition to the consideration of 'materiality' as specified in clause 7 of the General Instructions for Preparation of Financial Statements of a Company;
 - (d) interest Income;
 - (e) interest Expense
 - (f) dividend income;
 - (g) net gain or loss on sale of investments;
 - (h) net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
 - (i) payments to the auditor as (a) auditor, (b) for taxation matters, (c) for company law matters, (d) for other services, (e) for reimbursement of expenses;
 - (j) in case of companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities; and
 - (k) details of items of exceptional nature;
 - (l) **Undisclosed income**

The Company shall give details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under

the Income Tax Act, 1961 (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and shall also state whether the previously unrecorded income and related assets have been properly recorded in the books of account during the year.

(m) Corporate Social Responsibility (CSR)

Where the company covered under section 135 of the Companies Act, the following shall be disclosed with regard to CSR activities:-

- (i) amount required to be spent by the company during the year,*
- (ii) amount of expenditure incurred,*
- (iii) shortfall at the end of the year,*
- (iv) total of previous years shortfall,*
- (v) reason for shortfall,*
- (vi) nature of CSR activities,*
- (vii) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,*
- (viii) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year shall be shown separately.*

(n) Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:-

- (i) profit or loss on transactions involving Crypto currency or Virtual Currency,*
- (ii) amount of currency held as at the reporting date,*
- (iii) deposits or advances from any person for the purpose of trading or investing in Crypto Currency or virtual currency.*

8. Changes in Regulatory Deferral Account Balances shall be presented in the Statement of Profit and Loss in accordance with the relevant Indian Accounting Standards

PART III - GENERAL INSTRUCTIONS FOR THE PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

1. Where a company is required to prepare Consolidated Financial Statements, i.e., consolidated balance sheet, consolidated statement of changes in equity and consolidated statement of profit and loss, the company shall mutatis mutandis follow the requirements of this Schedule as applicable to a company in the preparation of balance sheet, statement of changes in equity and statement of profit and loss. In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules 2015, including the following, namely:
 - (i) Profit or loss attributable to 'non-controlling interest' and to 'owners of the parent' in the statement of profit and loss shall be presented as allocation for the period. Further, 'total comprehensive income for the period attributable to 'non-controlling interest' and to 'owners of the parent shall be presented in the statement of profit and loss as allocation for the period. The aforesaid disclosures for 'total comprehensive income shall also be made in the statement of changes in equity. In addition to the disclosure requirements in the Indian Accounting Standards, the aforesaid disclosures shall also be made in respect of 'other comprehensive Income
 - (ii) 'Non-controlling interests' in the Balance Sheet and in the Statement of Changes in Equity, within equity, shall be presented separately from the equity of the 'owners of the parent'.
 - (iii) Investments accounted for using the equity method.
2. In Consolidated Financial Statement, the following shall be disclosed by the way of additional information

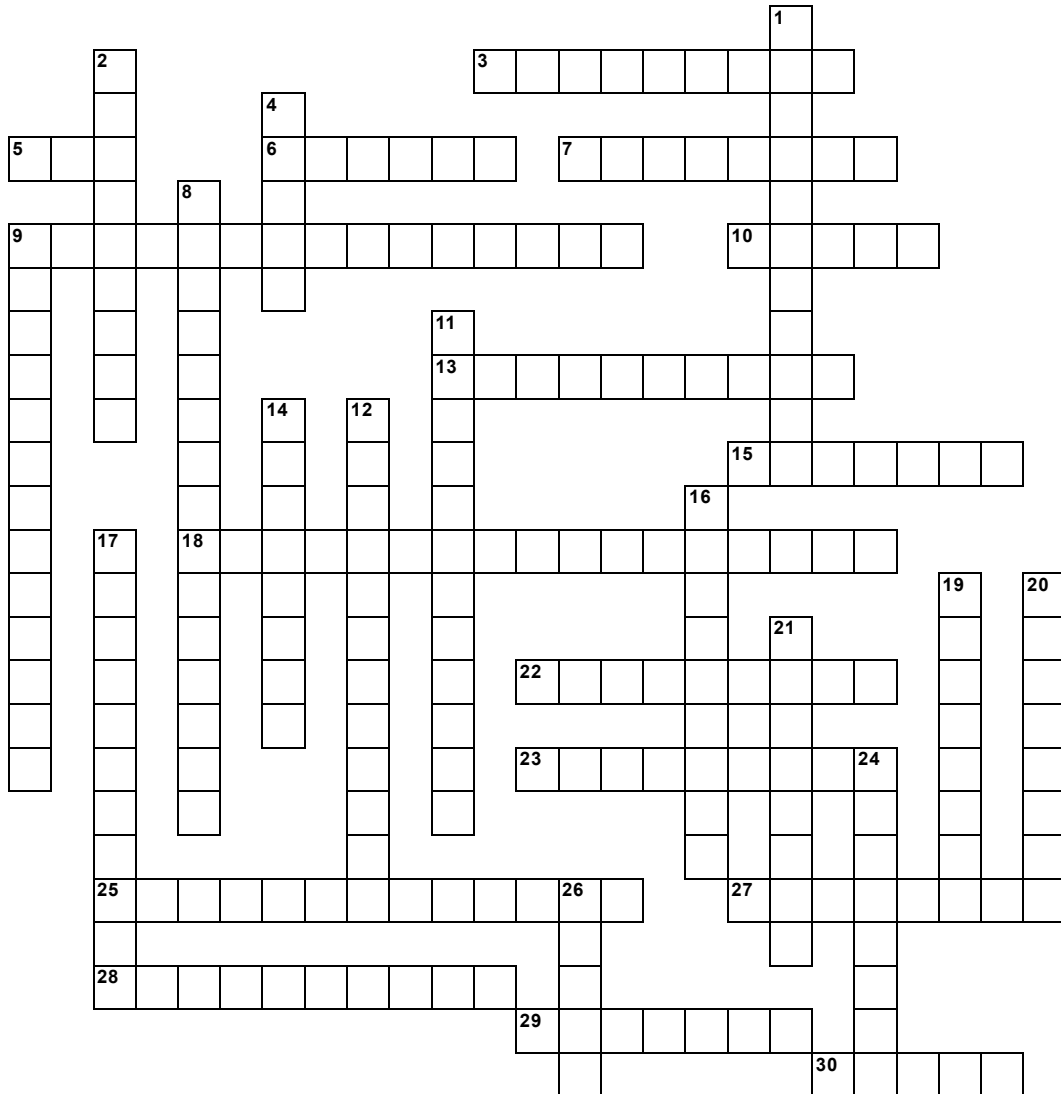
Name of the entity in the Group	Net Asset i.e. total assets minus total liabilities		Share in profit or loss		Share in other comprehensive income		Share in total comprehensive income	
	As % of consolidated net assets	Amount	As % of consolidated profit or loss	Amount	As % of consolidated other comprehensive income	Amount	As % of total comprehensive income	Amount
Parent								
Subsidiaries In								
dian								
1.								
2.								
3.								
Foreign								

1.								
2.								
3.								
Non-Controlling Interest in all subsidiaries								
Associates (Investment as per the equity method)								
Indian								
1.								
2.								
3.								
Foreign								
1.								
2.								
3.								
Joint Venture (Investment as per the equity method)								
Indian								
1.								
2.								
3.								
Foreign								
1.								
2.								
3.								
Total								

3. All subsidiaries, associates and joint venture (whether Indian or Foreign) will be covered under consolidated financial statement.
4. An entity shall disclose the list of subsidiaries or associates or joint venture which have been consolidated in the consolidated financial statement along with the reason of not consolidating.

[illegible]

IND AS PUZZLERS: TEST YOUR ACCOUNTING ACUMEN*

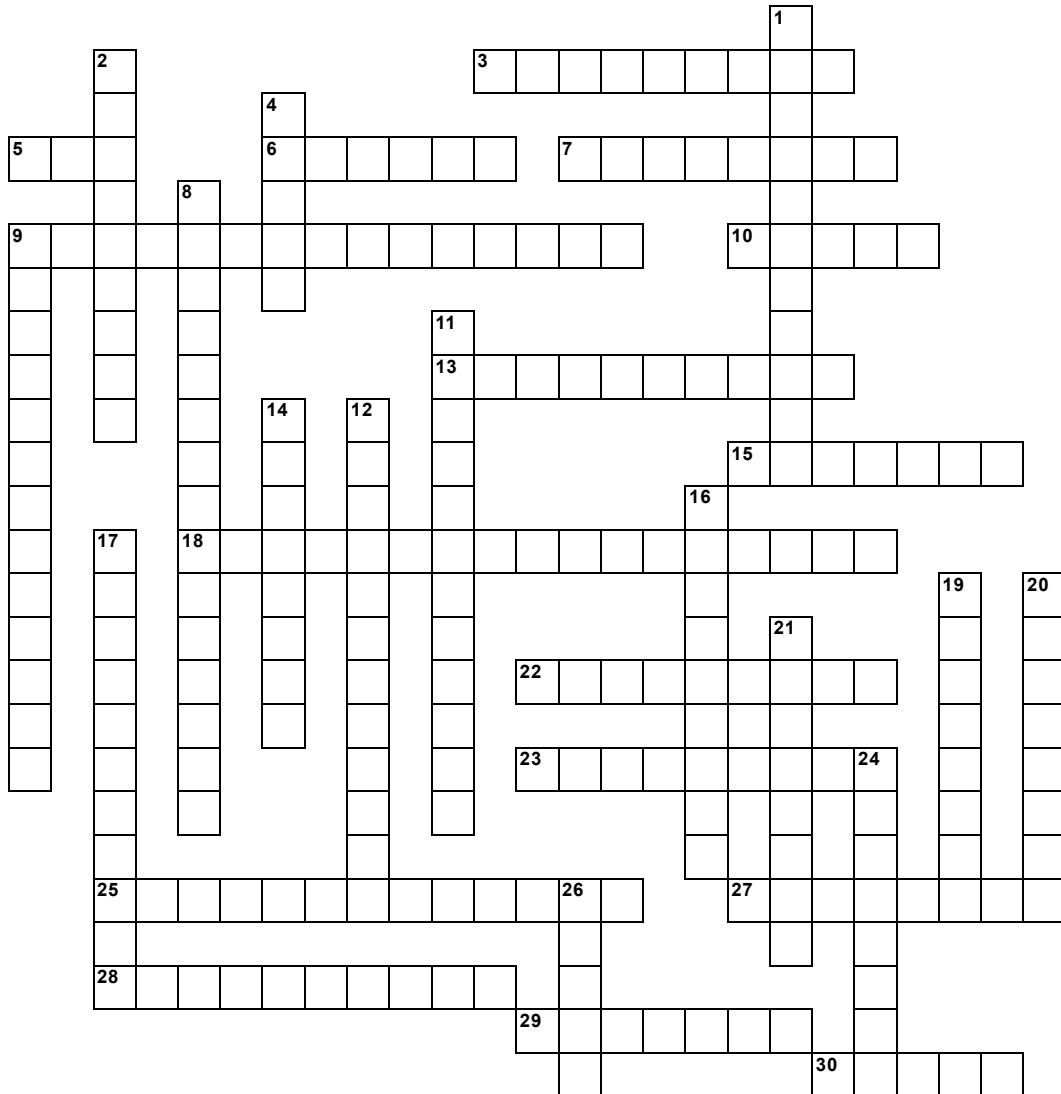


ACROSS:

3. Objective of Ind AS 34 is to prescribe the principles for recognition and measurement in complete or _____ financial statements for an interim period. (9)

*Related to Chapters of Module 1 only

IND AS PUZZLERS: TEST YOUR ACCOUNTING ACUMEN*



ACROSS:

3. Objective of Ind AS 34 is to prescribe the principles for recognition and measurement in complete or _____ financial statements for an interim period. (9)

*Related to Chapters of Module 1 only

5. Ind AS are the IFRS converged standards issued by the Central Government of India through _____. (Abbreviation 3)
6. An entity shall not _____ the amounts recognised in its financial statements to reflect non-adjusting events occurred after the reporting period. (5)
7. Under Ind AS Conceptual Framework, _____ representation means financial information must be complete, neutral, free from error, relevant, understandable, and complete. (8)
9. _____ are short-term, highly liquid investments that are readily convertible to known amounts of cash. (4,11)
10. Prior period errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights, or misinterpretations of facts, and _____. (5)
13. Negative cash flow from _____ denotes that company is unable to generate cash from its main business activity. (10)
15. As per conceptual framework, a _____ depiction is being non-bias in the selection or presentation of financial information. (7)
18. _____ is an entity's obligation to transfer goods or services to a customer for which the consideration is received or due from the customer. (8,9)
22. In the absence of observable inputs, _____ techniques such as income approach or market approach may be used. (9)
23. As per Ind AS 1, if compliance with a requirement in an Ind AS would be so misleading that it would conflict with the _____ of financial statements set out in the Conceptual Framework, the entity shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure. (9)

25. Ind AS 1 state that applying a requirement is _____ when the entity cannot apply it after making every reasonable effort to do so. (13)
27. Cash flows arising from _____ paid or received in the case of a financial institution should be classified as cash flows from operating activities. (8)
28. Cash flows arising from taxes on income shall be _____ disclosed under cash flows from operating activities unless they can be specifically identified with financing and investing activities. (10)
29. The entity shall not recognise _____ when it transfers products to customers but shall recognise those amounts received (or receivable) as a refund liability. (7)
30. _____ is the present economic resource controlled by the entity as a result of past events. (5)

DOWN:

1. A _____ obligation is a distinct promise to transfer a good or service to a customer as part of a contract. (11)
2. Transaction costs do not include _____ costs. (9)
4. Ind AS 113 provides guidance on how to determine fair _____ for financial reporting purposes. (5)
8. A change in accounting policy is applied _____. (15)
9. Entities have to consider variable _____, such as discounts, rebates, and performance bonuses, when determining the transaction price. (13)
11. Financial statements should be prepared on a _____ basis unless management either intends to liquidate the entity or to cease trading. (5,7)
12. The asset held primarily for the purpose of trading is known as _____. (7,5)

14. Fair value is the price that would be received to sell an asset or paid to _____ a liability in an orderly transaction between market participants at the measurement date. (8)
16. Ind AS 113 establishes a fair value _____ that categorizes inputs into three levels based on their reliability and observability. (9)
17. As per conceptual framework, _____ are present obligations of the entity to transfer economic resources. (11)
19. Ind AS are accompanied by mandatory _____ that is integral part of Ind AS to assist entities in applying their requirements. (8)
20. An entity whose financial statements comply with Ind AS shall make an _____ and unreserved statement of such compliance in the notes. (8)
21. Even if the _____ is declared after the reporting period but before the financial statements are approved for issue, it is disclosed in the notes to financial statements. (8)
24. The exercise of prudence means that assets and income are not overstated, and liabilities and _____ are not understated. (8)
26. _____ two are observable inputs other than quoted prices in active markets. (5)

To know the answer of the above Ind AS Puzzle, scan the QR Code

