GFRS – PART – II - :- INDEX:-

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ABOUT

CA VINOD KUMAR AGARWAL

(AIR-2nd, 4th & 24th IN FOUNDATION, INTER & FINAL RESPECTIVELY)

SUMMARY

Founder Member of A.S. Foundation, India's Leading Academy for C.A. Course, CA Vinod Kumar Agarwal is a fellow member of ICAI and a past member of the Board of Studies, ICAI. With a teaching experience of twenty years, he has guided more than 1,00,000 students and is ranked as one of the best teachers for Accounts and Financial Management at Intermediate level and Financial Reporting and SFM at Final Level.

He has authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management, and his books have sold more than 2,00,000 copies.

PUBLICATIONS AND ACHIEVEMENTS

- A merit holder in all the three levels of exams conducted by ICAI (2nd rank, 4th rank, and 24th rank in CA Foundation, CA Intermediate and CA Final respectively).
- Scored 99 marks in Accountancy in CA Foundation.
- Authored books on Accounts, Advanced Auditing for CA Final, Auditing for Intermediate, Accounting Standards, Ind AS, Costing and Financial Management.
- Complied a book "No Truth, Only Interpretations", a book on motivation, inspiration and guidance.
- Compiled a book, "Mind Candy", a book on motivation.
- Compiled a book, "Sweet Voice", a book on inspirational quotes.
- Working experience with India's top firms Firms like M/s. S.B. Billimoria and A.F. Ferguson (both member firm of Deloitte).
- Published article in the Students Newsletter of ICAI on "Valuation of Equity Shares" and "Stock Market Index".
- Presented a paper on "Corporate Governance and Role of Auditor" in National Students Conference held in Goa.

EDUCATION

- Passed the Certified Public Accountant (CPA) (USA) exam in 2007.
- Post-graduation from Pune University with First Class.
- Graduation from B.M.C.C, Pune with distinction.
- Passed the Diploma in Business Finance Conducted by ICFAI, Hyderabad.
- Passed the Derivative Module test conducted by National Stock Exchange.
- Also appeared for UPSC exam and cleared Mains twice.

TEACHING EXPERIENCE

- Teaches Accounts, Advanced Accountancy, Financial management and Economics for Finance at CA Intermediate Level and Financial Reporting and Strategic Financial Management (SFM) at CA Final level.
- Pioneer of creating and distributing video tutorials in pen drives/google drive among students.
- Produced All India Toppers (1st Rank) in CPT examination and final examination apart from more than 250 all India merit- holders.
- More than 30000 Facebook subscribers, more than 31000 YouTube subscribers.
- Sold more than 40000 video lectures in pen-drive and google-drive mode.
- In 2019, launched a brand VKNOW, to become a national brand for digital learning.

TEACHING APPROACH

- Simple and effective way of teaching through concept building, class-room practice, home-exercise, and power-point presentation.
- A large variety of problems are solved in the class to meet the examination requirements.
- Notes are updated frequently covering amendments and exam problems.

IFRS 5	NON CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATION

1. INTRODUCTION

Non-current assets are those which do not meet the definition of current assets as per IAS 1. The Standard lays down the criteria to be met for classification of such assets as held for sale, and the principles governing measurement and requirements as to disclosure. It is a requirement in the Standard that items classified as non-current assets held for sale should be reflected as a separate line item so as to distinguish these from other elements of financial information in the Financial Statements.

2. DEFINITIONS

Cash-generatingunit - The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Component of an entity - Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

Costs to sell - The incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense.

Current asset - 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 IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Discontinued operation- A component of an entity that either has been disposed of or is classified as held for sale and:

a) Represents a separate major line of business or geographical area of operations,

b) Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or

c) Is a subsidiary acquired 'exclusivelywith a view to resale.

Disposal group - 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. The term group also includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80-87 of IAS 36 Impairment of Assets or if it is an operation within such a cash-generating unit.

Fair value - is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IFRS 13 Fair Value Measurement.)

Firm purchase commitment- An agreement with an unrelated party, binding on both parties and usuallylegallyenforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance highly probable.

Highly probable– Significantlymore likely than probable.

Non-current asset - An asset that does not meet the definition of a current asset.

Probable - More likelythan not.

Recoverable amount - The higher of an asset's fair value less costs to sell and its value in use.

Value in use - The present value of estimated future cash flows expected to arise from the continuing use of an asset and from itsdisposal at the end of its useful life.

3. SCOPE

All non-current assets and disposal groups when classified as held for sale shall be measured, presented and disclosed as per this IFRS.

- **EXCEPTIONS**
  - ✓ deferred taxes (IAS 12 *Income Taxes*).
  - ✓ assets arising from employee benefits (IAS 19 *Employee Benefits*).
  - ✓ financial assets under IFRS 9 *Financial Instruments.*
  - ✓ non-current assets that are measured at fair value less costs to sell in
  - ✓ accordance with IAS 41 *Agriculture*.
  - ✓ groups of contracts within the scope of IFRS 17 Insurance Contracts.
  - ✓ non-current assets that are accounted for in accordance with the fair value model in IAS 40 Investment Property.

are required to be measured under respective standards rather than under this IAS, because these assets are carried at fair values in accordance with the respective standards as well.

When non-current assets and disposal groups meet the criteria to be classified as held for sale, it will get reclassified as current assets.

4. WHEN WILL AN ENTITY SHALL CLASSIFY A NON-CURRENT ASSET OR A DISPOSAL GROUP AS HELD FOR SALE ?

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

PROBLEM 1 :

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in chandni chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.

All IFRS 5 criteria for held for sale classification were first met at 1st October 20X1. The outlet will be sold in June 20X2.

Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analysis

SOLUTION 1 :

5. CLASSIFICATION OF NON-CURRENT ASSETS (OR DISPOSAL GROUPS) AS HELD FOR SALE

The following criteria are to be met:

- The asset or disposal group should be availablefor sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups)

- the sale should be highly probable
  - Entity's management should have approved the plan to sell the asset.
  - Active steps should have been initiated to locate the buyer and to complete the sale at a price reasonable in relation to its current fair value.
  - The sale is expected to be effected within **one year from the date of its classification.**
  - The plan is unlikely to be withdrawn and is not likely to undergo significant changes.
- The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

If the above criteria are met after the reporting period, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the reporting period but before the authorisation of the financial statements for issue, the entity shall disclose the information in the notes.

QUESTION : 2

The Board of directors of a company has decided to sale a line of business. Accordingly, an action plan has been prepared. Also the necessary resolution has been initiated for approval of the shareholders. Are the assets of the business line available for immediate sale? When should the company classify the group of assets as a disposal group ?

SOLUTION 2 :

QUESTION : 3

An entity committed to a plan of selling Head Quarter Building and has appointed a real estate dealer to find a buyer. The entity intends to vacate the building once the construction of a new building is completed (which is targeted to be within one year of the plan to sell). Does it satisfy the condition that the asset is available for immediate sale?

SOLUTION 3 :

QUESTION : 4 :

An entity is committed to a plan of selling a manufacturing facility and is considering an accounting proposal to classify the assets and liabilities of the facility as disposal group. There is some pending orders. It wishes to immediately sale the factory with a clause that backlog orders will be completed under the guidance of the seller. Does it satisfy the condition that the asset is available for immediate sale?

SOLUTION 4 :

QUESTION : 5

E Ltd. buys a building in an auction with an intent to resell. The management has a plan to renovate the property and install lift before selling which will be completed within a short period of three months. Is it possible to classify the property as held for sale under IFRS 5?

SOLUTION 5 :

QUESTION : 6

E Ltd. acquired all assets of F Ltd. including a building. It plans to sell that building immediately after getting the possession. The management expects to get possession of the building within a prescribed short period of three months, and is confident to complete the sell within a year. Is it possible to classify the property as held for sale?

SOLUTION 6 :

PROBLEM 7 :

On November 30, 20X1, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.

Can the property be classified as held for sale at the reporting date i.e. December 31, 20X1?

SOLUTION 7 :

PROBLEM 8 :

On March 1, 20X1, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on March 31, 20X1, it is expected that the factory will be sold by February 28, 20X2. However, in May 20X1, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on June 26, 20X1. Should the factory be shown as held for sale as on March 31, 20X1?

SOLUTION 8 :

6. CLASSIFICATION OF NON-CURRENT ASSETS (OR DISPOSAL GROUPS) AS HELD FOR DISTRIBUTION TO OWNERS

- A non-current asset (or disposal group) is classified as held for distribution to owners when the entity is committed to distribute the asset (or disposal group) to the owners.
- Assets must be available for immediate distribution in their present condition and the distribution must be highly probable.
- Actions to complete the distribution must have been initiated and should be expected to be completed within one year from the date of classification.
- Actions required to complete the distribution should indicate that it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn.
- The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

7. A NON-CURRENT ASSET OR A DISPOSAL GROUP THAT IS TO BE ABANDONED

- A non-current asset or a disposal group that is to be abandoned shall not be classified as held for sale, since, such abandonment would imply that the carrying amount would be recovered through its continued use or that the asset or disposal group is closed off rather being sold.
- The disposal group to be abandoned would however be treated as a discontinued operation if certain conditions are fulfilled.
- The adjustments to carrying amounts, by way of depreciation, amortisation etc. of such asset can be continued until the asset is abandoned.
- An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

8. WHAT IF THE SALE COULD NOT BE COMPLETED WITHIN ONE YEAR?

Extension of the expected sale period beyond one year due to events and circumstances not within the control of the entity does not preclude an asset or a disposal group from being classified as held for sale provided the entity remains committed to its plan for sale.

9. INITIAL MEASUREMENT - NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

Non-current assets classified as held for sale shall be measured at **the lower of**

- **its carrying amount and**
- **fair value less costs to sell**

The carrying amount of these assets shall be arrived at by applying the respective applicable IFRSs immediately before such classification. (The implication is that the asset will be subject to depreciation / amortisation / impairment provisions up to the date of reclassification).

PROBLEM 9 :

An item of property, plant and equipment that is measured on the cost basis should be measured in accordance with IAS 16.

Entity ABC owns an item of property and it was stated at the following amounts in its last financial statements:

31st December 20X1

Cost	**12,00,000**
Depreciation	**(6,00,000)**
Net book value	**6,00,000**

The asset is depreciated at an annual rate of 10% (1,20,000)

During July 20X2 entity ABC decides to sell the asset and on 1st August it meets the conditions to be classified as held for sale. Analyse.

SOLUTION 9 :

10. INITIAL MEASUREMENT - NON-CURRENT ASSETS CLASSIFIED AS HELD FOR DISTRIBUTION TO OWNERS

An entity shall measure a non-current asset (or disposal group) classified as held for distribution to owners at the lower of its carrying amount and fair value less costs to distribute.

11. NEWLY ACQUIRED ASSETS

In some cases, an asset may be newly acquired. Such a non current asset acquired with the intention to sell shall be measured at lower of carrying amount (for example, cost) had it not been so classified and fair value less costs to sell.

12. NON-CURRENT ASSET ACQUIRED IN A BUSINESS COMBINATION

A non-current asset acquired in a business combination (IFRS 3),with an intention to sell, shall be measured at fair value less cost to sell (rather than at Fair Value itself).

13. DEPRECIATION OR AMORTISATION

Depreciation or amortisation shall cease from the point in time when the asset stood reclassified as non-current asset held for sale or while it is part of a disposal group classified as held for sale.

Interest and other expenses attributable to liabilities (forming part of a disposal group) shall continue to be recognised.

14. SUBSEQUENT MEASUREMENT

In case of disposal groups, there may be assets, whose measurement provisions are governed by other specific relevant Standards (such as Deferred Tax assets, Employee benefit related assets, Financial Assets, Investment properties carried at fair values, biological assets accounted for in accordance with the Standard on Agriculture, contractual Rights under Insurance Contracts).

The carrying amount of those assets shall be arrived at by applying the applicable IFRSs before remeasurement of "fair value less cost to sell" in respect of the disposal group.

15. "COST TO SELL"

When the sale period exceeds one year, the component "cost to sell" shall be measured at **present value** and any future increase in such present value shall be presented as finance cost.

PROBLEM 10:

A plant's fair value is Rs 250,000.Its cost of disposal after 2 years will be Rs 20,000. The PV of cost to sell is Rs 17,500.What is fair value less cost to sell today?

SOLUTION 10 :

16. IMPAIRMENT AND REVERSALOF IMPAIRMENT LOSS

Impairment loss is recognised for any initial or subsequent write down of the of the asset to fair value less cost to sell.

When and if a reversal of such impairment were to occur at any later date, the amount of reversal shall be restricted to the cumulative amount of impairment loss earlier recognised on the asset in accordance with this IFRS or in accordance with IAS 36.

PROBLEM 11 :

On June 1, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 20X1 and the sale is expected to be completed by March 31, 20X2. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

Particulars	Carrying value as on December 31, 20X0	Carrying value as on July 31, 20X1
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on December 31, 20X0 is ` 2,000 and as on July 31, 20X1 is ` 1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., December 31, 20X1. The fair value as on December 31, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

1. **Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?**
2. **The measurement of the manufacturing unit as on the date of classification as held for sale.**
3. **The measurement of the manufacturing unit as at the end of the year.**

SOLUTION 11 :

Assessing whether the manufacturing unit can be classified as held for sale

The manufacturing unit can be classified as held for sale due to the following reasons:

(a) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is July 31, 20X1, i.e., the date at which management becomes committed to the plan.

(b) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(c) A firm purchase agreement has been entered with the buyer.

(d) The sale is expected to be complete by March 31, 20X2, i.e., within one year from the date of classification.

Measurement of the manufacturing unit as on the date of classification as held for sale

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable IFRS.

This has been done and the carrying value of the disposal group as on July 31, 20X1 is determined at ` 2,600. The difference between the carrying value as on December 31, 20X0 and July 31, 20X1 is accounted for as per the relevant IFRS i.e., (IAS 2 for inventory and IFRS 9 for debtors, creditors and loans).

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The fair value less cost to sell of the disposal group as on July 31, 20X1 is ` 1,750 (i.e.1,850- 100). This is lower than the carrying value of ` 2,600. Thus an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of IFRS 5 based on their carrying value. Thus, the assets will be measured as under:

Particulars	Carrying value – July 31, 20X1	Impairment	Carrying value as per Ind AS 105 – July 31, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	-	1,050
Inventory	400	-	400
Creditors	(250)	-	(250)
Loans	(1,850)	-	(1,850)
	2,600	**(850)**	**1,750**

Measurement of the manufacturing unit as on the date of classification as at the year end

The measurement as at the year-end shall be on similar lines as done above.

The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective Standards.

The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.

PROBLEM 12 :

E Ltd. plans to dispose of a group of assets and liabilities which satisfy held for sale recognition criteria set out in IFRS 5.

Given below are the details of these assets and liabilities.

	Carrying amount before classification as held for sale
Goodwill	
Building	
Property, Plant & Equipment	
Inventories	
Advance to suppliers	
Financial assets through other comprehensive income	
Total Assets	
Deferred tax liabilities	
Payables to suppliers	
10% Loans	
Defined Benefit Obligation	
Total Liabilities	
Net Assets	

Fair value less costs to sell = 2200

How should the entity recognise various assets and liabilities of the disposal group on classification of held for sale as per IFRS 5 ?

SOLUTION 12 :

17. CHANGES TO A PLAN OF SALE OR DISTRIBUTION TO OWNERS

The non-current asset held for sale or as held for distribution to owners shall be re-classified as held for use if it does not meet any of the criteria laid down for classification under held-for-sale category.

At the time of reclassification, the measurement of non-current asset shall be **at the lower of:**

- **its carrying amount before the asset was classified as held for sale** or as held for distribution to owners **, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset not been classified as held for sale** or as held for distribution to owners **, and**
- **its recoverable amount at the date of the subsequent decision not to sell or distribute.**

The resulting adjustments shall be reflected in profit or loss from continuing operations unless the assets were revalued before classification as held for sale or as held for distribution to owners , in which case the adjustments shall be treated as revaluation increase and decrease.

PROBLEM 13 :

On 1st April 2010, the carrying value of an asset was Rs. 60,000 when it was classifies as held for sale. Had it not been classified as held for sale, then the depreciation for 2011 and 2012 would have amounted to Rs. 6,000 each year and there would not have been any impairment loss. On 31st March 2012, the carrying value of the asset held for sale was Rs. 50,000 and the company does not want to sell it any more. The recoverable amount of the asset is Rs. 49,000. What is the revised carrying value?

SOLUTION 13 :

PROBLEM 14 :

S Ltd purchased a property for Rs 6,00,000 on 1 April 20X1. The useful life of the property is 15 years. On 31 March 20X3 S ltd classify the property as held for sale. The impairment testing provides the estimated recoverable amount of Rs 4,70,000. The fair value less cost to sell on 31 March 20X3 was Rs 4,60,000. On 31 March 20X4 management change the plan as property no longer met the criteria of held for sale. The recoverable amount as at 31 March 20X4 is Rs 5,00,000.

Value the property at the end of 20X3 and 20X4

SOLUTION 14 :

(a) Value of property immediately before the classification as held for sale as per IAS 16 as an 31st March, 20x3

On initial classification as held for sale on 31 March 20X3, the value will be lower of:

Carrying amount Rs 4,70,000

Fair Value less Cost to sell Rs 4,60,000

On 31 March 20X3 Non-current classified as held for sale will be recorded at Rs 4,60,000.

	`	
Purchase Price	6,00,000	
Less: Accumulated Depreciation	80,000	(for two years)
Less: Impairment loss	50,000	(5,20,000-4,70,000)
Carrying Amount	4,70,000	

Depreciation of Rs 40,000 and Impairment Loss of Rs 60,000 (50,000 +10,000) is charged in profit or loss for the year ended 31 March 20X3.

On 31 March 20X4 held for sale property is reclassified as criteria doesn't met. The value will be lower of:

Carrying amount had the asset is not classified as held for sale	
Carrying amount immediately before classification	4,33,846
on 31 March 20X3	4,70,000
Less Depreciation based on 13 years balance life	36,154
Recoverable Amount	5,00,000

Property will be valued at 4,33,846 on 31 March 20X4

Adjustment to the carrying amount of 26,154 (4,60,000 - 4,33,846) is charged to the profit or loss.

18. RECLASSIFICATION OF AN ASSET (OR DISPOSAL GROUP) DIRECTLY FROM BEING HELD FOR SALE TO BEING HELD FOR DISTRIBUTION TO OWNERS or VICE VERSA

- If an entity reclassifies an asset (or disposal group) directly from being held for sale to being held for distribution to owners, or directly from being held for distribution to owners to being held for sale, then the change in classification is considered a continuation of the original plan of disposal.
- The entity shall apply the classification, presentation and measurement requirements in this IFRS that are applicable to the new method of disposal.

19. IF AN ENTITY DECIDES NOT TO DISPOSE OF ONE OR MORE ITEMS WITHIN A DISPOSAL GROUP

- The reclassification principles will be applied for the asset for which the decision to dispose of has been reversed.
- Assets and liabilities comprising the new (revised) disposal group, shall be subjected to the classification criteria and measurement principles will be applied accordingly.

20. PRESENTATION REQUIREMENTS

Three important requirements relating to presentation of items classified under non-current assets held for sale, in the SOFP, are:

- **Assets** so classified shall be presented **separately from other assets.**
- **Liabilities** forming part of a disposal group shall be presented **separately from other liabilities**.
- These assets and liabilities **shall not be netted off.**
  - The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the statement of financial position or in the notes.
  - An entity shall present separately any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.

PROBLEM 15 :

How would these assets be shown in SOFP?

1. **A property given on rental**
2. **machinery used for production**
3. **A car not in use for which prsopective buyer is being looked for ?**
4. **A property worth Rs 5 Lacs with furniture worth Rs 1 Lac and a loan taken of Rs 3 Lacs taken specifically for the property. Advertisements have been issued about intention to sell the properties with the loan thereof.**

SOLUTION 15 :

21. DISCLOSURES

The Standard requires the following disclosures in respect of a discontinued operation:

In the financial statements

- a **single amount in the statement of comprehensive income** comprising the total of
  - post-tax profit or loss of discontinued operations and
  - post-tax gain or loss recognised either at the stage of initial measurement, or on subsequent sale of assets or disposal groups that constitute the discontinued operations.
- Net cash flows attributable to operating, financing and investing activities of discontinued operation. These disclosures may be presented either in the notes or in the financial statements.
- Amount of income from continued and discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of comprehensive income.

In the notes or financial statements

- An analysis of the single amount disclosed in the statement of comprehensive income into;
  - Revenue, expenses and pre-tax profit or loss of discontinued operations;
  - Related income tax expense;
  - Gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and the related income tax expense.

Other requirements of disclosures include:

- Where discontinued operations stand identified in the current period, the corresponding prior-period items require to be restated (or re-presented).
- In some situations, discontinued operations would have been disposed of in the previous period itself, subject to certain uncertainties. In the subsequent period, these uncertainties get removed, necessitating certain adjustments to previously reported amounts. The nature and amounts pertaining to adjustments of this nature need to be disclosed separately.
- An entity may cease to classify a component of an entity as held for sale, the results of such component that were previously presented in discontinued operations shall be reclassified and included in · income from continuing operations for all periods presented. Since the re-statement principles under IAS 8, will not apply to this situation, the changes made in the prior-year figures will be described as 'represented' and not as restated.
  - An entity that is committed to a sale plan involving loss of control of a subsidiary shall disclose the when the subsidiary is a disposal group that meets the definition of a discontinued operation.
  - An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:
    (a) a description of the non-current asset (or disposal group);
    (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
    (c) the gain or loss recognised in accordance with paragraphs 20–22 and, if not separately presented in the statement of comprehensive income, the caption in the statement of comprehensive income that includes that gain or loss;
    (d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with IFRS 8 *Operating Segments*.

22. MAJOR CHANGES IN IND AS 105 VIS-À-VIS IFRS 5

1. **Classification of a Non-current Asset**: IFRS 5 prescribes the conditions for classification of a non-current asset (or disposal group) as held for sale. In Ind AS 105, a clarification has also been added that the non-current asset (or disposal group) cannot be classified as held for sale, if the entity intends to sell it in a distant future.
2. **Non-current Assets accounted as per the Fair Value Model**: IFRS 105 deals with non-current assets that are accounted for in accordance with the fair value model in IAS 40. Since Ind AS 40 prohibits the use of fair value model, this has not been included in Ind AS 105.
3. **Presentation of Discontinued Operations**: IFRS 5 requires presentation of discontinued operations in the separate income statement, where separate income statement is presented. This requirement is not provided in Ind AS 105 consequential to the removal of option regarding two statement approach in Ind AS 1. Ind AS 1 requires that the components of profit or loss and

components of other comprehensive income shall be presented as a part of the statement of profit and loss.

4. **Transitional Provisions**: Ind AS 101 provides transitional relief, similar to the transitional provisions in IFRS 5, that while applying Ind AS 105, an entity may use the transitional date circumstances to measure such assets or operations at the lower of carrying value and fair value less cost to sell. This would facilitate smooth convergence with Ind AS.

PROBLEMS FOR SELF PRACTICE

PROBLEM : 16

On 31st December 2009 the directors of Omega decided to dispose of two properties in different locations. Both properties were actively marketed by the directors from 1st January 2010 and sales are expected before the end of July 2010. Summary details of the two properties are as follows:

Property	Carrying Amount	Depreciable Amount	Estimated Future Economic Life	Estimated fair Value Less costs to sell
	31st March 2009	31st March 2009	31st March 2009	31st December 2009
	Rs. '000	Rs. '000	Rs. '000	Rs. '000
A	25000	15000	30 years	28000
B	22000	16000	40 years	18000

Property A was available for sale without modifications from 1st January 2010 onwards. On 31 March 2010 the directors of Omega were reasonable confident that a sale could be secured for Rs. 28 million. However, after the year-end property prices in the area in which property A is located started to Decline. This was due to an unexpected adverse local economic event in April 2010. Following this event the directors of Omega estimated that property A Would now be sold for Rs. 22 million less selling costs and they are very confident that this lower price can be achieved.

Property B need repair work carried out on it before a sale could be completed. This repair work was carried out in the two-week period beginning 10 April 2010. The costs of this repair work are reflected in the estimated fair value less costs to sell figure for property B of Rs. 18 million . Compute:

The carrying values of both properties in the SOFP of Omega at 31st March 2010.

The amounts charged to the statement of Profit & Loss in respect of both properties for the year 31st March 2010.

SOLUTION : 16

- From 1 January 2010 property A would be regarded as held for sale under the principles of Ind AS 105 - non-current assets held for sale and discontinued operations. The property is available for immediate sale in its present condition and is being actively marketed at a reasonable price. On the other hand property B would not, since it cannot be sold until necessary repairs are carries out.
- Property A would be depreciated up to the date of classification as held for sale but not thereafter. Therefore, depreciation of 375 (15000 X 1/30 X 9/12) would be necessary in the year to 31 March 2010. The property would be removed from non-current assets and shown in current assets or in a separate section of the assets side of the SOFP.
- It would be measured at the lower of its carrying value of the date of classification of 24625 (25000 -375) and its fair value less costs to sell of 28000 - 24625 in this case. The decline in property prices affecting this property relates to an economic event occurring after the reporting date. Therefore,

it would be regarded as a non-adjusting event after the reporting date. The event would be disclosed as a note to the financial statements but the decline in value would not be recognized.

- Property B would be depreciated for the whole period and would remain in non-current assets. The depreciation required for the year ended 31 March 2010 would be 400 (16000 X 1/14) The fact that its fair value less costs to sell is estimated at Rs. 18 million whilst the carrying value prior to any write down is 21600 (22000 - 400) is prima facie evidence of impairment. Given that the property is to be sold - even though it cannot be classified as held for sale at 31 March 2010 - this is the best indicator of the recoverable amount of the property.

Summary of Accounting treatments

- **SOFP at 31 March 2010.**
- Non-current assets 18000
- Current assets (or non-current assets held for sale) 24625
- **Statement of profit & loss for the year ended 31 March 2010.**
- Depreciation 775 (375 + 400)
- Impairment 3600 (21600 - 18000)

PROBLEM : 17

Omega follows the cost model when measuring its property, plant and equipment. One of its properties was carried in the SOFP at 31 March 2007 at Rs. 6 million. The depreciable amount of this property was estimated at Rs. 3.6 million at 31 March 2007 and the estimated future economic life of the property at 31 March 2007 was 18 years. Omega depreciates its properties on a monthly basis.

- **On 1 January 2008 Omega decided to dispose of the property as it was surplus to requirements**
- **and began to actively seek a buyer. On 1 January 2008 Omega estimated that the Market value of the property was Rs. 7.1 million and that the costs of selling the property would be Rs. 80000. These estimates remained appropriates at 31 March 2008.**
- **The Property was sold on 1 June 2008 for Net proceeds of Rs. 7 million.**
- **Required**
- **Explain, with relevant calculations, how the property would be treated in the financial statements of Omega for the year ended 31 March 2008 and the year ending 31 March 2009.**

SOLUTION : 17

- **<u>Year ended 31 March 2008 (Rs. '000)</u>**
- On 1 January 2008 the property would be designated as "held for Sale". The implications of this treatment are that the property would cease to be depreciated and be classified in a separate section of the statement of financial position - non-current assets held for sale.
- The depreciation on the property to the date of classification as held for sale would be 150 (3600 X 1/18 X 9/12) and this would be charged as on operating expense in the income statement.
- The carrying value of the property immediately before reclassification of 5850 (6000 - 150) would be compared with its 'fair value less costs to sell' of 7020 (7100 - 80) The new carrying value of the property is the lower of these two amounts - in this case 5850.
- **<u>Year ended 31 March 2009 (Rs. '000)</u>**
- No Depreciation will be charged on the property.
- At the date of Sale the profit on sale 1150 (7000 - 5850) will be reported in the income statement.

PROBLEM : 18

Epsilon prepares financial statements to 31st March each year. On 1 October 2011, Epsilon decided to dispose of a business component. This business component is a disposal group that satisfied the criteria for classification as held for sale at 1 October 2011. The carrying values of the relevant assets and liabilities of the component in the financial statements of Epsilon on 1st October 2011, measured individually in accordance with applicable IFRS, were as follows:

$'000

Goodwill	**10,000**
PPE estimated future useful economic life 4 years	**25,000**
Net current assets	**5,000**
	40,000

On 1 October 2011, the directors of Epsilon estimated that the fair value less costs to sell of this disposal group was $28 million. The group was disposed of on 30 April 2012 for $31 million. This was in line with a revised estimate made or 31 March 2012. The profit after tax of the business component for the year ended 31 Mar 12 was $3 million

i) **Compute the carrying amount of the goodwill and PPE of the business component on 1 October 2011 immediately after classification as held for sale.**

ii) Compute the carrying amount of the goodwill and PPE of the business component on 31 March 2012.

iii) Show the minimum amounts that must be presented on the face of the SOCI for the year ended 31 March 2012 concerning the business component.

SOLUTION : 18

Impairment loss on 1 October 2011 $'000

Carrying amount of the business component	40
Fair value less costs to sell off the business component	28
Impairment loss	12

Allocation of Impairment loss $million

First	Goodwill	10-10	NIL
Then	PPE PPE is part of a disposal group classified as held for sale, so will not be further depreciated after 1 October 2011	25-2	23
	Net current assets (Outside the scope of IFRS 5)		5
			28

Assume that by 31 March 2012 the estimated disposal proceeds of the business had increased to $31 million. This means that part of the impairment loss has reversed.

Maximum reversal that can be done (31 million - 25 million) = 6 million

$million

Goodwill	The reversal of an impairment loss on goodwill is not permitted.	NIL
PPE	Restoring its carrying amount before impairment, i.e. $25 million.	2
	Total reversal of impairment loss	2

The business component is a discontinued operation because it is a component of Delta that has been classified as held for sale by 31 March 2012.

Therefore Delta will disclose a single amount on the face of the statement of comprehensive income. comprising

1) Profit after tax of $3 million and
2) Net amount recognised as an impairment loss of $10 million (Impairment loss $12 million - Reversal of impairment loss $2 million)

PROBLEM : 19

Delta is an entity which prepares financial statements to 30 September each year. Each year the financial statements are authorised for issue on 30 November. During the year ended 30 September 2013 the following transactions occurred :

On 1 June 2013, Delta decided to dispose of the trade and assets of a business which it had acquired several ago. This disposal does not involve Delta withdrawing from a particular market sector. The carrying values on 1 June 2013 of the assets to be cilsnosed of were –

	$million
Goodwill	**10**
Property, plant and equipment	**20**
Patents and trademarks	**08**
Investories	**15**
Trade receivables	**10**
	63

Delta offered the business for sale at a price of $46.5 million, which was considered to be reasonably achievable. Delta estimated that the direct costs of selling the business would be $500,000. These estimates have not changed since 1 June 2013 and Delta estimates that the business will be sold by 31 March 2014 at the latest.

None of the assets of the business had suffered obvious impairment as on 1 June 2013. At that date the inventories and trade receivables of the business were already stated at no more than their recoverable amounts.

SOLUTION : 19

The business is held for sale from 1 June 2013, as it satisfies the criterions laid down by IFRS 5 Non-Current Assets Held For Sale –

1) The business is available for sale in the present condition
2) The business is being actively marketed at a reasonable price
3) The sale is expected to be completed within one year of the date of classification.

On classification as held for sale -

1) The assets are measured at the lower of their current carrying amounts at the date of classification and their fair value less costs to sell
2) Separately classified under current assets in the statement of financial position.
3) No further depreciation is charged on these assetse $million

Carrying Amount		63
Fair Value Less cost To sell	(46.5 - 0.5)	46
Impairment Loss		17

Allocation of impairment loss — **$million**

Order	Asset	Carrying Amount	Impairment	Carrying Amount after Impairment
1st	Goodwill	10	10	Nil
The remaining impairment loss of $7 million ($17 million — $10 million) allocated to the property, plant and equipment and the patents on a pro-rata basis.				
2nd	Property , plant and equipment	20	5	15
2nd	Patents and trademarks	08	2	6
None of the remaining impairment loss will be allocated to inventories or trade receivables as their recoverable amounts are at least equal to their existing carrying amounts (being current assets).				

PROBLEM : 20

Omega prepares financial statements under International Financial Reporting Standards. In the year ended 30 September 2012, the following events occurred:

(a) On 1 July 2012, Omega decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with Omega collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1 July 2012, the carrying amounts of the relevant assets of the division were as follows:

- **Purchased goodwill $600,000**
- **Property , plant and equipment (average remaining estimated useful life two years) $2 million.**
- **Inventories $1 million.**

From 1 July 2012, Omega began to actively market the division and has received a number of serious enquiries. On 1 Julv 2012, the directors estimated that they would receive $3.2 million from the sale of the division. Since 1 July 2012, market conditions have improved and on 31 October 2012 Omega received and accepted a firm offer to purchase the division for $3.3 million. The sale is expected to be completed on 31 December 2012. $3.3 million can be assumed to be a reasonable estimate of the value of the division on 30 September 2012.

During the period from 1 July 2012 to 30 September 2012, inventories of the division costing $800,000 were sold for $1,200,000. On 30 September 2012, the total cost of the inventories of the division was $900,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

Show how the proposed sale of the division will be reported in the financial statements of Omega for the year ended 30 September 2012, giving relevant explanations where appropriate. You should indicate the extent to which relevant transactions and balances need to be separately disclosed and when the separate disclosures can be made in the notes, rather than in the primary financial statements themselves.

SOLUTION : 20

1) Under IFRS 5 Non-current Assets Held for sale and discontinued operations, the division is classified as held for sale from 1 July 2012 as all criterion for that classification are fulfilled
   a) The division is available for immediate sale,
   b) Is being actively marketed at a reasonable price, and
   c) The sale is expected to be completed within one year.

2) On the basis of this classification, the assets of the division will be measured at the lower of their existing carrying amounts and their fair value less costs to sell. $million

Fair value less costs to sell of the division		32
Carrying Amount of assets Of the division		36
Impairment loss	(36000000 - 32000000)	0.4

3) The Impairment Loss is allocated to Goodwill. Carrying amount of goodwill of ($600,000 - $400,000) = $200,000.

4) The increased expectation of the selling price $100,000 ($3.3 million — $3.2 million) will be treated as a reversal of an impairment loss. However impairment of goodwill cannot be reversed and so it is not recognised.

Presentation in Statement of financial position

The assets of the division are presented separately from other assets $million

Property, plant and equipment	Not depreciated after 1 July 2012	2
Inventories	Year-end cost	0.09
Goodwill (after impairment)		0.2

Presentation in Statement of Profit or Loss

The division will be regarded as a discontinued operation in the year ended 30 September 2012. The statement of profit or loss should be disclosed, as a single amount, the post-tax profit or loss of the division and the impairment loss arising on the re-measurement of the division on classification as held for sale. Further analysis of this single amount can be presented on the face of the statement of comprehensive income, but it can also be presented in the notes to the financial statements.

IAS 19 EMPLOYEE BENEFITS

1. INTRODUCTION

Employee benefits, as the name suggests comprises of benefits that are payable to the employee as a result of an employer- employee relationship. Employee benefits will also include benefits provided to the dependents of employees.

Employment may be part-time, full-time, permanent, temporary or on casual basis.

For this standard employee includes directors and other managerial personnel.

The standard prescribes the accounting and recognition of employee benefits, the two key aspects being recognition of liability when the benefits are to be paid in the future, and recognising expense when the entity consumes the economic benefit arising from service provided by employee.

2. OBJECTIVE

This standard prescribes the guidelines for the entity to deal with the accounting treatment of employee benefits and related disclosure requirements. This standard requires that the entity should recognize the following:

- An expense for the consumption of economic benefits relating to the employee services provided in exchange for employee benefits and
- A liability when the employee has rendered the services in return for the related employee benefits to be paid in the future

3. SCOPE

This standard is applicable for the accounting treatment of all employee benefits which may be formal, legislative or informal and are categorized as following under this standard:

a) Short Term Employee benefits which are payable within 12 months from the end of the year of services, such as salaries, wages, compensated annual leaves and annual profit shares

b) Post Employment Benefits which fall due after the formal retirement of an employee, such as pensions or other retirement benefits

c) Other Long Term Benefits which are due after 12 months from the end of year of services, such as sabbatical leave and long term service awards

d) Termination benefits

Employee benefits are settled in the form of cash or in kind (i.e. provision of goods or services) and may be provided directly to employee or to their dependents

However, this standard does not deal with the following:

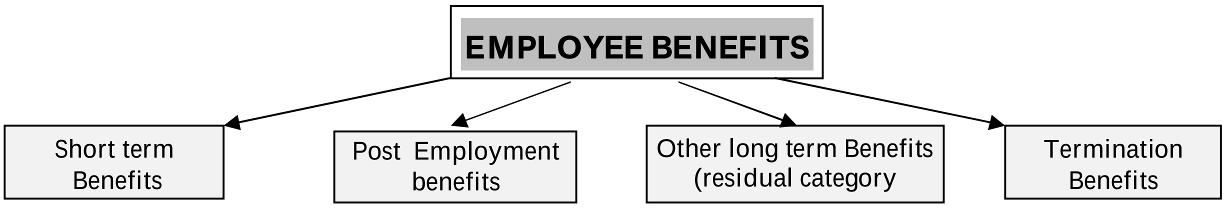
a) Employee benefits which are covered under IFRS 2 Share Based payment

b) Reporting requirements by the retirement benefit plan which are covered under IAS 26

4. EMPLOYEE BENEFITS:

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

5. FORMS OF EMPLOYEE BENEFITS:



- **Short-term employee benefits** are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service. **(Examples –Salaries, Wages, Annual bonuses, Compensated annual leaves, Annual profit shares)**

  Post-employment benefits are employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.

  Other long-term employee benefits are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.

  Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

  (a) an entity's decision to terminate an employee's employment before the normal retirement date; or

  (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment

6. RECOGNITION PRINCIPLES:

Though the standard prescribes four different methods, the recognition can be narrowed down to two principles.

- Accrual basis of accounting
- Applying present value concept and recognising a future liability at present value as on the reporting date.

7. DEFINITIONS

Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligationto pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees.

The **net defined benefit liability (asset)** is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

The **deficit or surplus** is:

(a) the present value of the defined benefit obligation less

(b) the fair value of plan assets (if any).

The **asset ceiling** is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The **present value of a defined benefit obligation** is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

Plan assets comprise:

(a) assets held by a long-term employee benefit fund; and

(b) qualifying insurance policies.

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i) the remaining assets of the fund are sufficient to meet allthe related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

A **qualifying insurance policy** is an insurance policy* issued by an insurer that is not a related party (as defined in IAS **24, Related Party Disclosures)** of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and

(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13, **Fair Value Measurement.)**

Service cost comprises:

(a) current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;

(b) past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and

(c) any gain or loss on settlement.

Net interest on the net defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time.

Re-measurements of the net defined benefit liability (asset) comprise:

(a) actuarial gains and losses;

(b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and

(c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from:

(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and

(b) the effects of changes in actuarial assumptions.

The **return on plan assets** is interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:

- any costs of managing plan assets; and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.

A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

8. SHORT-TERM EMPLOYEE BENEFITS:

All short-term employee benefits are to be recognized on an undiscounted basis (actual cost).

The expenses in relation to the revenue derived from the employees are to be accrued.

If the amount paid already exceeds the amount expected to be payable, then the excess is to be recognized as prepaid expense.

In case of capitalisation of self-constructed PPE (IAS 16) or IAS 2 Inventories a part of the cost can be included as cost of an asset.

The standard provides additional guidance on recognition and measurement of **short-term compensated absences** and **profit sharing and bonus plans.** These forms of short-term benefits require an element of estimation. The standard does not require actuarial valuation of these estimates as these are not complex estimations and the entity can make a reliable estimate on its own.

9. SHORT TERM COMPENSATED ABSENCES

The entity may pay its employees for certain absences such as sickness, maternity, paternity, holiday or short term disability leaves. Therefore the entity will account for the related cost of short term compensated absences as follows:

Short term compensated absences can be –

a) Accumulating Compensated Absences

The compensated absences which are carried forward to the next year and can be utilized in future years if the current year's entitlement is not utilized in full are termed as accumulating compensated absences. These may be vested or non-vested.

i) Vested Accumulating Compensated Absences

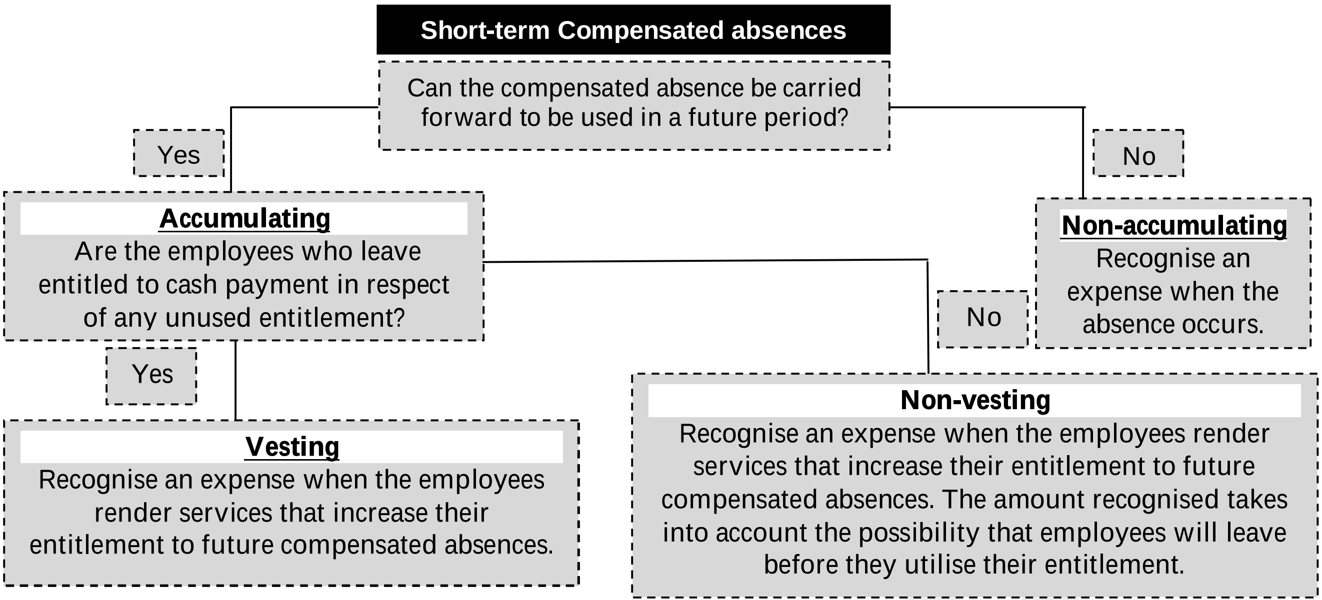
The accumulating compensated absences, for which employees are granted a separate additional cash payment in respect of unused leaves upon leaving the entity are termed as vested accumulating compensated absences. The entity becomes liable when employees provide the services that increases their entitlement to future paid leaves therefore, at each reporting date the entity should recognize an expense and provision in respect of the unused vested accumulating compensated absences with the relating expected amount payable.

ii) Non-vested Accumulating Compensated Absences

The accumulating compensated absences, for which employees are not granted a separate additional cash payment in respect of unused leaves upon leaving the entity are termed as vested accumulating compensated absences however, these may be used in future periods. The entity becomes liable when employees provide the services that increases their entitlement to future paid leaves therefore, at each reporting date the entity should recognize an expense and provision in respect of the unused non-vested accumulating compensated absences which are expected to be used in future with the relating expected amount payable.

b) Non-accumulating Absences

The compensated absences which are not allowed to be carried forward to the next years and expire if current year's entitlement is not utilized in full are termed as non-accumulating compensated absences. For these leaves the entity will recognize the expense when employee will actually take up the leave and no provision is required at reporting date as these does not increase employee's entitlement to the future compensated absences.



PROBLEM :1

An enterprise has 100 employees, who are each entitled to five working days of leave for each year. Unused leave may be carried forward for one calendar year. The leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X4, the average unused entitlement is two days per employee. The enterprise expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of leave in 20X5 and that the remaining eight employees will take an average of six and a half days each.

SOLUTION : 1

The enterprise expects that it will pay an additional 12 days of pay as a result of the unused entitlement that has accumulated at 31 December 20X4 (one and a half days each, for eight employees). Therefore, the enterprise recognises a liability, as at 31 December 20X4, equal to 12 days of pay.

PROBLEM :2

An entity has several employees, each of whom is entitled to 8 working days of paid sick leave for each year. Unused sick leave may not be carried forward to the next year. Employees are also not entitled to a cash payment for unused entitlement of sick leave on leaving the entity. Management is preparing the interim financial report for the 1st quarter of the year. Whether one quarter of the unused annual sick leave entitlement should be provided, because the sick leave may be used in the remaining 3 quarters?

SOLUTION : 2

Management should not recognize a provision for unused sick leave since the use of sick leave is determined by an unpredictable future event that is the illness of the employee and not through the employee's own wish. A low level of sickness in the 1st quarter odes not cause a higher level of sickness in future quarters.

Management should not recognize an expense in respect of non-accumulating sick leave until the time of absence, because employee service does not increase the amount of the benefit.

PROBLEM 3 :

ASF Ltd. has a headcount of 100 employees in 2010-11. As per the employee policy, the employees are entitled for 30 annual leaves out of which 10 may be carried forward to the next current year, 10 sick leaves out of which 2 may be carried forward as paid leave. At March 31, 2011, the average unused entitlement is 5 days per employee for privilege leave and 1 for sick leave. On an average, it is found that the number of such employees who would be claiming annual leaves would be 30 and 10 employees who would claim sick leaves. Compute the liability to be recognised as sick pay and privilege leave by the entity in 2010-11.

SOLUTION 3 :

The entity will recognise liability in the books equal to 150 (30 x 5) days of annual leave and 10 (10 x 1) days of sick leave.

PROBLEM : 4

A company has an informal understanding with its employees that unused leave may be taken as paid vacation in the following year. Would a provision be required for unused leave?

SOLUTION : 4

Yes, if an informal understanding casts a constructive obligation on the company such that it cannot go back on its agreement without causing a significant damage to its relationship with the employees.

10. PROFIT SHARING AND BONUS PLANS

The expected cost of profit sharing and bonus plans are recognized only when

- there is a present legal or constructive obligation as a result of past events and
- only when it is possible to make a reliable estimate.

The obligation exists when the entity has no choice but to make payment. Constructive obligation means that irrespective of the existence of a contract for payment of such sums, the obligation exists as a result of past practice of the entity.

PROBLEM : 5

Whimsical Employer Ltd (WEL) grants annual bonus to its employees on discretionary basis. WEL has a March 2016 year end and finalises accounts by April 2016, but bonus is announced and paid in late May 2016. Is a provision required to be made for bonus at March 2016 year end?

SOLUTION : 5

Since in the given case, there is no formula, nor is the amount finalized before the financial statements are approved, nor is there a reliable past practice, provision for bonus is not made in March 2016 accounts.

PROBLEM : 6

[Profit sharing bonus] ASF Ltd. pays 2% bonus on profit after tax to its employees distributed in proportion to annual basic pay.

Profit is determined only after the reporting period. Should the obligation to pay profit sharing bonus for the year 2014-15 be recognised in 2015-16 when the amount of bonus is determined and paid? There is no formal agreement or such bonus payment.

SOLUTION : 6

The liability for short-term profit sharing bonus has arisen out of rendering service by employee during 2014-15. It is recognised in 2014-15 in accordance with IAS 19 read with IAS 10. It is an adjusting event as per IAS 10 Events after the reporting period.

PROBLEM : 7

When employee participates in profit sharing plan, whether the profit share should be treated as an appropriation or charge to P & L A/c

SOLUTION : 7

An obligation under profit sharing plan and bonus plans results from employee service and not from a transaction with the enterprise's owners. Therefore, an enterprise recognises the cost of profit sharing and bonus plans as an expense and not as a distribution of profit.

PROBLEM 8 :

ASF Ltd is a profit making entity and has reported ` 200 crore in the financial year 20X1 - 20X2. According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation. As under these kinds of plans, an entity is

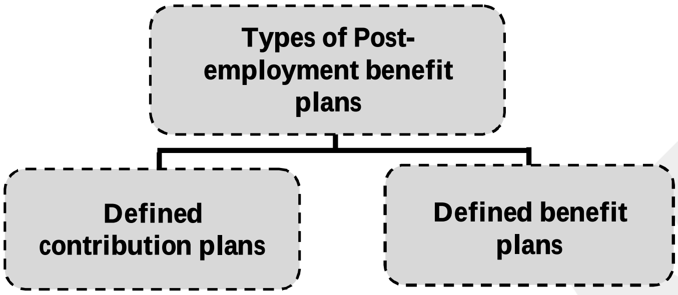
under an obligation to pay if the employees complete a specified period with the organisation. Laxmi mills has estimated that due to turnover in the organisation, the estimated pay-out would be around 4.5%. Compute the liability and expense of the company under this plan.

SOLUTION 8 :

The company shall make a provision for liability and recognise the same amount as an expense of the amount of ` 9 crores in 20X1-20X2 (4.5% of ` 200 crores).

11. POST-EMPLOYMENT BENEFITS

Recognition and measurement is based on the classification of the benefits. They are classified as under:



- **Defined Contribution Plans (DCP):** The entity pays fixed contributions to a fund and there are no further obligations that devolve on the entity on the event of any shortfall in the fund.
- **Defined Benefits Plans (DBP):** The benefits are determined by the length of service or other variable factors. The entity is under obligation to pay the benefits that accrue to the employee as a result of such variable factors. These may be funded or unfunded. Any shortfall in funding will result in additional obligation to the entity.

12. COMPARISON BETWEEN DEFINED CONTRIBUTION PLANS AND DEFINED BENEFIT PLANS

Point	Defined Contribution Plans	Defined Benefit Plans
1. Meaning	These are Post-Employment Benefit Plans under which an enterprise pays fixed contributions into a separate entity (a Fund), and will have no obligation to pay further contributions if the Fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.	These are Post-Employment Benefit Plans other than Defined Contribution Plans.
2. Obligation of enterprise	The Enterprise's obligation is limited to the amount that it agrees to contribute to the Fund. The amount of the Post-Employment Benefits received by the employee is determined by the amount of contributions paid by an enterprise (and also by the employee) to a Post-Employment Benefit Plan or to an Insurance Company, together with investment returns arising from the contributions.	The Enterprise's obligation is to provide the agreed benefits to current and former employees.
3. Bearing of Risks	Actuarial Risk (the benefits will be less than expected) and Investment Risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.	Actuarial Risk (that benefits will cost more than expected) and Investment Risk fall, on the enterprise. If actuarial or investment experience are worse than expected, the enterprise's obligation may be increased.
4. Accounting	Simple and Straightforward.	Comparatively complex due to use of actuarial assumptions, and discounting.

13. CONTRIBUTION PLANS AND BENEFIT PLANS

Contribution plans and benefit plans can function as:

- **State plans:** They are established by a legislation operated by a national or local government or autonomous body.
- **Multi-Employer plans:** Under this plan the contributions of various enterprises are pooled, invested and proceeds are used to provide benefits to employees of more than one entity.
- They are generally operated by third parties.
- When the information is available to treat the plan as a defined benefit plan under each of the above two cases, an entity should account for the proportionate share of the obligation, plan assets and cost in the same way as any other DBP.
- When sufficient information is not available, the benefit plan shall be treated as defined contribution plan disclosing the fact and reason for non-availability of information.
- **Insured benefits:** The contributions are made in the form of insurance premiumand the employees derive benefits in an assured manner.

The entity shall treat the plan as a defined contribution plan unless there is legal or constructive obligation on part of the entity to pay the employees or the insurer in case of any shortfall. Where the entity retains any legal or constructive obligation, the plan shall be treated as a defined benefit plan

If the risk remains with the plan operator or the insurer it is a defined contribution plan. If the risk is shifted to the employer, then it is a defined benefit plan.

Thus, the key in identifying the post-employment benefit as a 'contribution plan' or a 'benefit plan' depends on the absorption of the actuarial or investment risk associated with the plan. If the risk remains with the plan operator or the insurer it is a defined contribution plan. If the risk is shifted to the employer, then it is a defined benefit plan

14. DCP - RECOGNITION

These are the benefit plans under which employer commits a fixed amount of contribution for an employee that is (may be along with employee's equivalent contribution) paid into a fund (separate entity), which is then managed by the board of trustee (appointed persons) of the fund, to accumulate returns thereon, until the retirement date and later this will be available to employee at relevant retirement date. However, the amount of benefit which will be available to employee after the formal retirement depends upon how well the plan performs.

- The employer's obligation is limited to the fixed amount of contributions only, and employer does not retain any risk and rewards related to the contributions after these are contributed to the fund (separate entity). The fund (separate entity) is termed as 'Plan Asset'
- The employer is not liable for any shortfall in the plan asset, if at retirement date the fund (separate entity) does not hold adequate resources to pay all employee benefits in respect of employee services in the current and previous years.
- When the employee has provided the services, the employer will recognize the fixed amount of contributions at the end of accounting period as:
  a) An expense which reflects the consumption of employee services and alternatively it may be included in the cost of another asset if required by a particular standard, such as IAS 16 Property Plant and Equipment or IAS 2 Inventories
  b) A liability after deducting the amount which has been already paid to the plan asset, if the amount already paid is in excess of contribution payable then the excess will be treated as current asset (pre-paid expense)

- The contribution fund (separate entity) which is also known as plan asset is not treated as the asset of employer in case of defined contribution plans as employer does not retain the related risk and rewards
- When the contributions do not fall due within 12 months then present value concept is to be adopted.

Disclosures

This standard requires the entity to disclose the amounts which are recognized as an expense in respect of defined contribution plans.

PROBLEM 9 :

ASF Ltd. has a headcount of around 1,000 employees in the organisation in 2010-11. As per the company policy, the employees are given 35 days of privilege leave (PL), 15 days of sick leave (SL) and 10 days of casual leave. Out of the total PL and sick leave, 10 and 5 can be carried forward to next year. On the basis of past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 as PL and 5 as SL. Also the company has been incurring profits since 2009. It has decided in 2010-11 to distribute profits to its employees @ 4% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the ASF Ltd. is expected to be around 3.5%. The profits earned during 2010-11 is ` 2,000 crores.

ASF Ltd. has a post-employment benefit plan also available which is the nature of defined contribution plan where contribution to this fund amounts to ` 100 crores which will fall due within 12 months from the end of accounting period.

The company has paid ` 20 crores to its employees in 2010-11.

What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by ASF Ltd?

SOLUTION : 9

(i) **ASF** Ltd. will recognise a liability in its books to the extent of 5 days of PL for 200 employees and 10 days of PL for remaining 800 employees and 2 days of SL for 200 employees and 5 days of SL for remaining 800 employees in its books as an unused entitlement that has accumulated in 2010-11.

(ii) **ASF** Ltd. will recognise ` 70 crores (2,000 x 3.5%) as a liability and expense it books of account.

(iii) When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) Under IAS 19, the amount of ` 80 crores may be recognised as a liability (accrued expense), after deducting any contribution already paid (100-20). However, if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense); and

(b) Also, ` 80 crores will be recognised as an expense in this case study which will be disclosed as an expense in the statement of profit or loss.

It can also be seen that the contributions are payable within 12 months from the end of the year in which the employees render the related service, they will not be discounted. However, where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate.

15. DEFINED BENEFIT PLANS(DBP) — RECOGNITION

The plans under which an employer commits a 'certain benefit' which will be available to employee after the formal retirement are termed as defined benefit plans e.g. (pension equal to certain percentage of final year salary multiple of year of services with employer) or (post employment medical care facility)

- These may be funded i.e. a fund (separate entity) is maintained by employer in which periodic contributions are made by employer which are then managed by the board of trustees (appointed persons) of the fund, to accumulate returns thereon, and later these accumulated funds will be used to pay employee retirements. The fund (separate entity) is known as plan asset. However, if plan funds asset does not have adequate resources to pay employee retirements then employer will make up the shortfall.

In case of defined benefit plans, although the benefit will be paid to employee after the formal retirement in future however, the entity will recognize the expense in respect of future retirement benefit over the period of services to the retirement date on matching basis.

Accounting for defined benefit plans will involve the following s**teps:**

a) The entity will determine the estimated cost of future benefits resulting from employee services in the current year. This is determined using Projected Unit Credit Method and involves some actuarial assumptions

b) The actuarial assumptions include demographic and financial assumptions

c) Demographic assumptions take into account the effect of:
   - Mortality rates
   - Employee turnover rates
   - Plan expected amendments

d) Financial assumptions take into account the effects of:
   - Salary Increments
   - Inflation Rates
   - Statutory Increments
   - Interest Rates

e) The estimated cost of future benefit determined by the entity is then discounted using the appropriate discount rate to arrive at the present value of defined benefit liability in respect of employee services in the current year, which is known as 'current service cost'

f) The entity will incorporate interest expense on the present value of defined benefit liability outstanding at the start of the accounting period

g) The entity will recognize return on plan asset resources held at the start of the accounting period

h) The discount rate used should be the rate of return of high quality corporate bonds, if this is not available then the rate of return of the government securities

i) The entity will determine the re-measurement gains and losses on defined benefit liability and plan asset, as the difference between the amount of defined benefit liability and plan asset recognized by the entity and there fresh valuation determined at the end of reporting period, the resulting re-measurement gains and losses on the defined benefit liability and plan asset will be recognized in other comprehensive income which will include the following:
   - Actuarial gains and losses relating to defined benefit liability
   - Return on the plan asset
   - Effect of asset ceiling adjustment

j) The net defined benefit liability (asset) is determined as the difference between the amount of the defined benefit liability and related plan asset at the end of reporting period

k) If there is net defined benefit asset, it will be restricted to the effect of asset ceiling adjustment

PROBLEM : 10 The projected unit credit method.

A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is 15,000 and is assumed to increase at 9% (compound) each year. The discount rate used is 10% per annum. Show how the obligation builds up for an employee who is expected to leave at the end of year 7, assuming that there are no changes in actuarial assumption. Determine the present value of the benefit obligation and show how this builds up over the years?

SOLUTION : 10

Step 1 : Determine the salary at the time of retirement as follows:

Salary at the time of retirement

= Salary of first year x (1 + rate of salary increase) $^{(\text{No. of years of service left} - 1)}$

= Final salary at year 7 (15,000 compounded at 9%)

= 15,000x $(1 + 0.09)^6$

= 25,157

Step 2 : Determine the expected pension as follows:

1% of final salary attributed to each year (25,157 x 1%) = 251.572

Expected final benefit = 7 years x 25.157 = 1,761

Step 3 : Calculate the present value of the current service cost for each year of service:

Current service cost = 252 (rounded off)

Current service cost, being present value of 252 discounted at 10%: e.g.

Year 1	142
Year 2	156
Year 3	172
Year 5	189
Year 6	208
Year 7	229
	$252

Step 4 : Determine the benefits attributed to current period and prior period as given above

Step 5 : Determine the obligation for each period as given above

Year	1	2	3	4	5	6	7
Benefit attributed to:							
Prior year	0	252	504	756	1,008	1 ,260	1,512
Current year (1% of final salary) (see step 1 and 2)	252	252	252	252	252	252	252
Current and prior years	**252**	**504**	**756**	**1,008**	**1 ,260**	**1,512**	**1,764***
Opening Obligation	142	142	312	515	755	1 ,039	1,372
Interest at 10%(see step 6)		14	31	51	76	104	137
Current service cost (see step 2)		156	172	189	208	229	252
Closing obligation	**142**	**312**	**515**	**755**	**1,039**	**1 ,372**	**1,761***

Step 6 : Interest is to be determined on the opening obligation x Rate of interest

*** rounding off**

NOTES :

- The opening obligation is the present value of benefit attributed to prior years.
- The current service cost is the present value of benefit attributed to the current year.
- The closing obligation is the present value of benefit attributed to current and prior years.

PROBLEM : 11 **Projected Unit Credit Method**

A lump sum benefit, equal to 3% of final salary for each year of service, is payable on termination of service.

The salary in year 1 is Rs.1,00,000 and is assumed to increase at 13% (compound) each year. The discount rate used is 10% per annum. Calculate current service cost and interest cost, using Projected Unit Credit Method. The employee is expected to leave at the end of year 5.

PROBLEM : 12

An employee Roshan has joined a company XYZ Ltd. in the year 2013. The annual emoluments of Roshan as decided is Rs.14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%. (P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

SOLUTION : 12

Calculation of Defined Benefit Obligation

Expected last drawn salary = Rs.14,90,210 x 110% x 110% x 110% x 110% x 110%

= Rs.24,00,000

Defined Benefit Obligation (DBO) = Rs.24,00,000 x 25% x 5 = Rs. 30,00,000

Amount of Rs.6,00,000 will be charged to Profit and Loss Account of the company everyyear as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. Rs. 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

PROBLEM : 13

A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in the first year is 20,000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10% per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of the fifth year, assuming that there are no changes in actuarial assumption.Determine the present value of the benefit obligation and show how this builds up over the years?

SOLUTION : 13

Step 1 : Determine the salary at the time of retirement as follows:

Salary at the time of retirement = Salary of first year x (1 + Rate of salary increase)$^{(\text{No. of years of service left}-1)}$

= Final salary at year 5 (20,000 compounded at 7%) = 20,000 x $(1 + 0.07)^4$ = 26,215

Step 2 : Determine the expected pension as follows:

1% of final salary attributed to each year = 262

Expected final benefit = 5 year x 1% x 26,215 = 1,311

Step 3 : Calculate the present value of the current service cost for each year of service:

Current service cost = 262 (as calculated above)

Current service cost, being present value of 262 discounted at 10%: e.g.

Year 1	262 x $(1 + 0.1)^{-4}$ = 179
Year 2	262 x $(1 + 0.1)^{-3}$ = 197
Year 3	262 x $(1 + 0.1)^{-2}$ = 217
Year 4	262 x $(1 + 0\ 1)^{-1}$ = 238
Year 5	262

Step 4 : Determine the benefits attributed to current period and prior period as given above

Step 5 : Determine the obligation for each period as given above

Step 6 : Interest is to be determined on the opening obligation x Rate of interest

Benefit attributed to:	Year 1	Year 2	Year 3	Year 4	Year 5
Prior year	0	262	524	786	1 ,048
Current year (1% of final salary)					
(see step 1)	262	262	262	262	262
Current and prior years		524	786	1,048	1,310*
Opening Obligation	262	178	392	649	952
Interest at 10%		18	39	65	95
Current service cost (see step 2)	178	197	217	238	262
Closing obligation	**178**	**393**	**649**	**952**	**1,309***

*rounding off error

Notes

- The opening obligation is the present value of benefit attributed to prior years.
- The current service cost is the present value of benefit attributed to the current year.
- The closing obligation is the present value of benefit attributed to current and prior years.

PROBLEMS : 14

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay

last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct.

SOLUTION : 14

The present case falls under the category of defined benefit scheme as per IAS 19 "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by IAS 19.

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

16. PLAN ASSET

It contains the resources which will be used to settle the employee benefits in respect of current and previous services of employees and may be in the form of following:

- Assets or resources held in a long term fund (separate entity)
- A qualifying insurance policy

However, plan asset does not include the unpaid contributions.

17. REIMBURSEMENT

If an entity will get reimbursement for all or part of the employee defined benefit liability by another party, the entity will recognize the right to reimbursement as a separate asset only if it is virtually certain to be received, such as qualifying insurance policy under which insurance proceeds will be used to settle employee defined benefit liability.

- However, if at maturity date the insurance proceeds are not adequate to pay employee retirements then employer will make up the shortfall.
- The entity will recognize the right to reimbursement at fair value and it will be accounted for same as the plan asset

18. ASSET CEILING

It is applicable when there is net defined benefit asset in the statement of financial position i.e. the present value of defined benefit liability is less than the fair value of plan asset at the reporting date.

- The entity recognizes that net defined benefit asset because entity controls such asset and owns the related risks and rewards
- It is applied to rationalize the net defined benefit asset in the statement of financial position
- It states that net defined benefit asset in the statement of financial position should be recognized at lower of:

a) Value in the statement of financial position

b) Present value of refund available from plan asset (asset ceiling value)

The difference between (a) and (b) will be recognized in other comprehensive income as part of re-measurements.

19. STATEMENT OF PROFIT AND LOSS

The entity will recognize the following elements in respect of defined benefit plan in the statement of profit or loss:

- Determining current service cost
- Determining the past service cost where a plan has been introduced or changed.
- Determining the resultant gain or loss in case of curtailment or settlement. Curtailments are reduction of benefits for future service as a result of plan amendments.
- Determining net interest on the net defined benefit liability / (asset)

20. STATEMENT OF FINANCIAL POSITION

The entity will recognize the following elements in respect of defined benefit plan in the statement of financial position:

- The net defined benefit liability (asset) is determined as the difference between the amount of the defined benefit liability and related plan asset at the end of reporting period
- If there is net defined benefit asset it will be restricted to the effect of asset ceiling adjustment

21. OTHER COMPREHENSIVE INCOME (OCI)

- The actuarial gains or losses to be recognized.
- Return on plan assets excluding amounts included in net interest on the net defined benefit liability / (asset)
- Any change in effect of asset ceiling.

The OCI items put together are referred as remeasurement of net defined benefit liability / (asset).

The entity should not only account for its legal obligation but also for any constructive obligation that arises out of entity's informal practices.

22. ACTUARIAL GAINS OR LOSSES

Actuarial gains or losses are the results of change in the defined benefit obligation on account of change in actuarial assumptions. The assumptions are two-fold.

- **Demographic assumptions** are— mortality, rate of employee turnover, disability and retirement, proportion of plan members who will be eligible for benefits, claim rates.
- **Financial assumptions are** — discount rate, benefit levels, future salary, future medical costs and taxes payable.

23. PAST SERVICE COSTS AND CURTAILMENTS:

These are costs that arise in the measurement of defined benefit obligation due to changes in the existing plan or introduction of new plan. These costs relate to the services already rendered by the employees. Past service costs are recognized as expense in the period in which they are incurred.

It is the change in the present value of defined benefit liability in respect of the previous year services of the employee resulting from amendment into plan or curtailment.

- It may be positive or negative.
- Past service cost is classified into vested past service cost (related to the employees which have already rendered the services) and non-vested past service cost (related to the employees for which services are to be rendered).

- However, it is irrelevant whether the past service cost is vested or non-vested, it will be recognized immediately in the profit or loss as an expense when the entity makes announcement and becomes liable for it
- Past service cost do not include:
  - differences between actual and assumed salary obligation,
  - changes in estimates of constructive obligation
  - changes due to actuarial assumptions and
  - where vesting is complete

24. CURTAILMENT

It is reduction in future earnable benefit of employees; it arises when the entity amends the plan in such a way that future services of employees will earn no benefit or low benefit such as:

- Significant reduction in number of employees
- Discontinuation of a business segment
- Sale of a business line

Curtailment may take place with the following arrangement:

Curtailment with Settlement

It is when future benefit of employee is curtailed and vested benefit will be paid off immediately, in such a case the difference between present value of defined benefit liability settled and settlement value will be charged to the statement of profit or loss.

Curtailment without Settlement

It is when future benefit of employee is curtailed but vested benefit of employees will be paid at original maturity date, in such a case the difference between (a) and (b) will be charged to the statement of profit or loss:

a. Present value of defined benefit liability and fair value of plan asset before curtailment, and
b. Present value of defined benefit liability and fair value of plan asset considering curtailment

PROBLEM :15

A pension plan of a company provides a pension of 1.5% of final salary for each year of service. The benefits are vested after four years of service. However, on 1 January the company changes the pension to 1.25% of final salary for each year of service starting from 1 January2019. The present value of the differential benefits for service from 1 January 2019 to 1 January at the date of the changes as follows:

	Rs'000
Employees with more than four service on	**125**
Employees with less than four years' service on	
(Average period until vesting - four years)	**121**
Total	**246**

REQUIRED : Determine the amounts recognised in respect of past service costs.

SOLUTION : 15

The enterprise recognises the whole amount of past service costs of Rs 246,000 immediately, since IAS 19 - states that past service costs are to be recognised immediately.

PROBLEM : 16

An enterprise discontinues a business segment and the employee of this segment will earn no further benefits. This is a curtailment without settlement. The curtailment reduces the obligation to Rs 900. Suggest the accounting treatment. Immediately before the curtailment, the details were :

PV of obligation	**Rs. 1000**
FV of plan assets	**Rs. 820**

PROBLEM : 17

Rock star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. In this, if the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Assuming the following:

Immediately before the curtailment, based on current actuarial assumption, the gross obligation was estimated at Rs. 6,000.

The fair value of plan assets on the date was estimated at Rs. 5,100.

Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation.

Calculate the gain from curtailment and liability after curtailment to be recognised in the SOFP.

25. NET INTEREST ON THE NET DEFINED BENEFIT LIABILITY/(ASSET):

This is obtained by multiplying discount rate to the opening balance of net defined benefit liability / (asset) and adjusting the interest for contributions and payments made during the period.

PROBLEM : 18

Opening balance of net defined liability/(asset) is Rs. 10 Lakhs liability, discount rate is 8% and two contributions of Rs. 1 lakh each was made on 30th September and 31st December of the year and 2 payments of Rs. 2 Lakhs on 30th June and Rs. 1 lakh on 31st March was made.

SOLUTION : 18

Net interest = (10 lakhs x 8% - (1 lakh x 8%x 6/12) - (1 lakh x 8% x 3/12)+ (2 lakh x 8% x 9 /12)) =

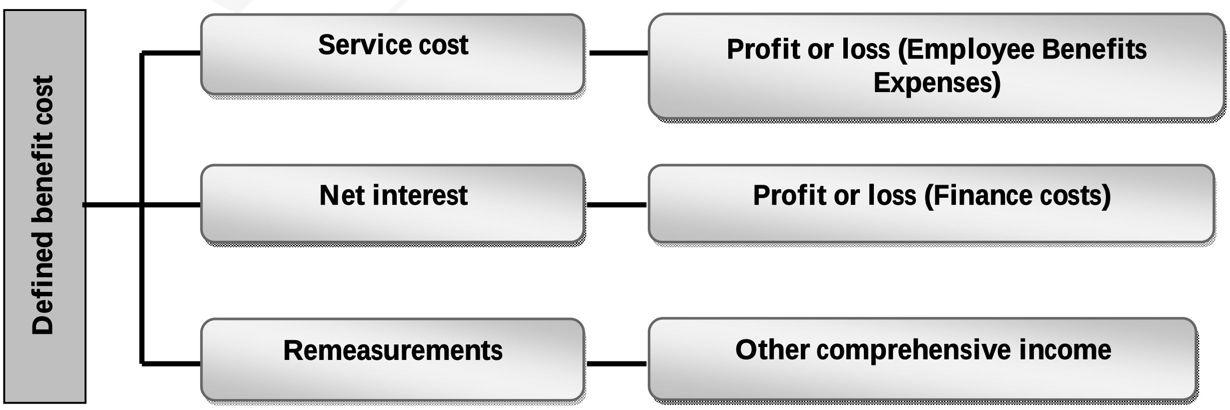
This could also be viewed as three separate components. Interest costs on obligation, interest income on assets and interest on asset ceiling all determined based on the above logic individually.

The interest income determined as above will be recognized in profit and loss account and will be reduced from return on plan asset, which will be recognized in OCI.

26. PRESENTATION

There is no requirement to distinguish current and non-current portion of the assets and liabilities arising from post-employment benefit plans.

Daigram : Summary of provisions under revised IAS 19



Cause of movement in net defined benefit liability (asset)	Provisions under IAS 19
Service cost	Profit or loss**(Employee Benefits Expenses)**
Interest cost on obligation and expected return on plan assets	Net interest income or expense on the net liability (asset) recognised in profit or loss **(Finance costs)**
Past service cost	Profit or loss (including unvested past service cost), as part of service cost **(Employee Benefits Expenses)**
Actuarial gains and losses / remeasurements	Immediate recognition in OCI

PROBLEM : 19

A defined benefit plan has the following characteristics for the year 2019 :

	Rs000
Fair value of plan assets — 1 January 2019	**21,000**
Fair value of plan assets — 31 December 2019	**22,380**
Defined benefit obligation - 1 January 2019 (based on actuarial valuation)	**22,500**
Defined benefit obligation - 31 December 2019 (based on actuarial valuation)	**26,115**
Contributions for the period	**1,575**
Benefits paid during the year	**1,500**
Current service costs	**800**

The discount rate used is 6%.

Prepare extracts of SOFP and statement of profit or loss and other comprehensive income after accounting for the defined benefit obligation.

SOLUTION : 19

Plan assets	**Rs000**
Fair value of plan assets — 1 January 2019	21,000
Return on plan assets (6% of 21,000)	1,260
Contributions for the period	1,575
Benefits paid during the year	(1,500)
Expected fair value of plan assets - 31 December 2019	**22,335**
Fair value of plan assets - 31 December 2019	
Remeasurements recognised in OCI in respect of plan assets	22,380
	45

Defined benefit obligation	**Rs000**
Defined benefit obligation - 1 January 2019 (based on actuarial valuation)	22,500
Interest cost (6% of 22,500)	1 ,350
Current service costs	800
Benefits paid during the year	(1 ,500)
Expected obligations on 31 December 2019	**23,150**
	26,115

Defined benefit obligation - 31 December 2019 (based on actuarial valuation) **Remeasurement recognised in OCI in respect of defined benefit obligation**	**2,965**
Statement of Profit and Los and OCI extracts	**Rs000**
Finance costs [Net interest cost (1,260 - 1 ,350)] Employee Benefits Expenses- Current service cost **Other comprehensive income** Remeasurement loss on net obligations (2965 – 45)	90 800 2,920

SOFP (extracts)	**Rs000**
Equity and liability	
Other components of equity – Remeasurement on DBO	2,920
Non-current liabilities	
Net defined benefit obligation (26,115 – 22,380)	3,735

PROBLEM : 20

Plan assets as at 1 January 2019	**142,500**
Defined benefit obligation as at 1 January 2019	**150,000**
Current Service cost for 2019	**13,500**
Discount rate as at 1 January 2019	**6%**
Expected return on plan assets as at 1 January 2019	**10,000**
Remeasurement loss arising in 2019	**2,250**
Past service cost arising on 1 January 2019	**4,500**
Vesting period for past service cost	**5 years**

The following information relates to a defined benefit plan of Crown Ltd

SOLUTION : 20

(a) The following amounts will be recognised in the statement of profit or loss and other comprehensive income:

	Rs
Current service cost	13,500
Net interest cost (6% of (150,000 - 142,500))	450
Past service cost	4,500
Net cost for the year recognised in profit or loss	**18,450**
Other comprehensive income	
Remeasurements recognised in OCI	2,250
Net cost for the year recognised in total comprehensive income	**20,700**

Worked Example

AB Ltd is a private limited company and it has established a post employment funded defined benefit plan for its employees. In accordance with the terms of the plan, the employees will receive a pension equal to 2% of the final year salary of employee multiple of year of services with the entity. AB Ltd determines the cost for the year using the projected unit credit method which also takes into account some actuarial assumptions regarding employee turnover, mortality rates, inflation rates and discount rates, which are based on the rate of return of high quality corporate bonds.

Following information is available related to the defined benefit plan for the year end of 31 December 2010

- The present value of pension benefit in respect of employee services for the year end of 31 December 2010 is $80,000.
- AB Ltd paid pension benefits of $84,000 to former employees in the current year
- The entity has contributed an amount of $40,000 into plan asset in the year end of 31 December 2010.
- The present value of defined benefit liability was $6million at year ended 31 December 2009 and it was $6.7 million at 31 December 2010.
- The plan asset had a fair value of $5.8 million at 31 December 2009 and the fair value of plan asset was $6.15 million at 31 December 2010

AB Ltd had amended the plan on 31 December 2010 and as a result employees are now entitled to an increased pension benefit. The estimated present value of these benefits is $250,000 at 31 December 2010. The interest rate on high quality corporate bonds was 6% per annum 31 December 2009.

AB Ltd recognizes re-measurement gains and losses in 'other comprehensive income (items that will not be reclassified to profit or loss)' in accordance with IAS 19, revised 2011.

Required

Prepare the extracts of financial statements in respect of defined benefit plan of AB Ltd for the year end of 31 December 2010, along with the movement in Define benefit liability and plan asset. (Assume that the pension benefits and the contributions paid were settled at 31 December 2010).

SOLUTION

Step 1:

Statement of Profit or Loss		**31.12.2010**
		$
Current Service Cost		(80)
Past Service Cost		(250)
Net Interest:		
Interest Expense ($6,000 × 6%)	(360)	
Interest Income ($5,800 × 6%)	348	(12)
Curtailment Gain / Loss		-
Total Charge		(342)
Other Comprehensive Income		
Re-measurements:		
Loss on Define benefit Liability		(94)
Gain on Plan Asset		46
		(48)

Step 2:

Statement of Financial Position	**31.12.2010**
	$
Present Value of Defined Benefit Liability at Reporting Date	6,700
Fair Value of Plan Asset at Reporting Date	(6,150)
Net Liability	550

Step 3:

Define Benefit Liability a/c	31.12.2010
	$
Balance b/f at 31.12.2009	6,000
Current Service Cost	80
Past Service Cost	250
Interest Expense ($6,000 × 6%)	360
Benefit Paid Out	(84)
Re-measurement Loss (Balancing Figure)	**94***
Present Value of Defined Benefit Liability at 31.12.2010	6,700

Step 4 -

Plan Asset a/c	31.12.2010
	$
Balance b/ f at 31.12.2009	5,800
Contribution into Plan Asset during the year	40
Interest Income ($5,800 × 6%)	348
Benefit Paid Out	(84)
Re-measurement Gain (Balancing Figure)	**46***
Fair Value of Plan Asset at 31.12.2010	6,150

27. OTHER LONG-TERM EMPLOYEE BENEFITS

The benefits (other than the termination benefits) which are payable after 12 months from the end of year in which employee has provided the services are termed as post employment benefits such as:

- Sabbatical leave
- Jubilee leaves
- Long term service awards
- Long term bonuses

These may be in the form of defined contribution plans or defined benefit plans. The entity will classify the other long term employee benefit plans as defined contribution plans or defined benefit plans in accordance with the terms of the plan and will account for such plans as follows:

The other long term employee benefit plan is a defined contribution plan, it will be accounted for as per the accounting treatment of defined contribution plans as prescribed in this standard

If the other long term employee benefit plan is a defined benefit plan, it will be accounted for as per the accounting treatment of defined benefit plans as prescribed in this standard. **However, when other long term employee benefit plan is a treated as defined benefit plan, the re-measurement gain or losses on defined benefit liability and plan asset will be recognized in the statement of profit or loss.**

28. TERMINATION BENEFITS

The benefits which are payable as a result of termination of employee's employment either because of:

- Entity's decision to terminate the employee or
- Employee's own decision to accept termination in return for certain benefits

The entity will recognize an expense and a liability in respect of expected amount of termination payments to settle the obligation in the year of termination

However, the expense and liability will be recognized at discounted value if the amount is expected to be settled after one year from the year of termination. The discount rate should be based on the market yields of high quality corporate bonds, in the absence of deep market for such bonds, then market yields of government bonds shall be used for discounting.

Enterprise is to recognise the liability as an expense only when;

- Present Obligation arises on account of past events (Services rendered by employees).
- A reliable estimate can be made of the amount of obligation.
- Probable outflow of economic benefits would be required to settle the obligation.

A provision is to be created for the obligation (IAS 37).

29. DISCLOSURES

There are no specific disclosure requirements for short-term, other long-term and termination benefits.

Defined Contribution Plan

- Amount recognized as expense for DCP in P&L
- DCP for key managerial personnel as per IAS 24.

Defined Benefit Plan

- General description of the type of plan — nature of benefits provided by the plan, regulatory framework in which the plan operates and any other responsibilities for the entity in governance of the plan
- Net defined benefit liability/(asset) showing separate reconciliation between opening and closing balances of PV of obligation and FV of Plan assets. Reconciliation should comprise
  - current service cost
  - interest income or expense
  - return on plan assets
  - actuarial gains and losses arising from demographic assumptions
  - actuarial gains and losses arising from changes in financial assumptions
  - past service costs
  - gains and losses from settlements
  - effects of changes in foreign exchange rates
  - contribution to the plan
  - payments from the plan
  - effects of business combinations and disposals
- Principal actuarial assumptions
- a sensitivity analysis for each significant actuarial assumptions, showing how defined benefit obligation would have been affected
- methods and assumptions used in sensitivity analysis and changes from previous period

The limit on a defined benefit asset, minimum funding requirements, and their interaction

When there is no minimum funding requirement Right to refund - Existence and Measurement

An entity has right to refund only when it is unconditional. It may be entitled to refund either during the life of the plan (either with or without regard of timing of payment of liabilities) or only at the winding up of the plan. The right to refund shall be measured as the excess of the fair value of the plan assets over the present value of the Defined benefit obligation (termed as surplus in the plan).

Future Contribution Reduction

The economic benefit available to the entity in the form of reduction in future contribution shall be measured at lower of surplus in the plan and present value of future service cost. The assumptions used to determine the defined benefit obligation shall be used for determining future service cost (e.g.: same work force).

When there is minimum funding requirement

The minimum funding requirement for future accrual of benefits shall be reduced from the future service costs determined asabove. The entity measures the future reduction in contribution as future service cost less minimum funding requirement for future accrual of benefits.

The entity shall consider whether Minimum funding requirement for past services will be available as a refund or future reductions in contribution. If no, the entity shall create a liability for the same.

30. MAJOR CHANGES IN IND AS 19 VIS-À-VIS IAS 19 NOT RESULTING IN CARVE OUTS

1. ***Discount Rate*****:** According to Ind AS 19, the rate to be used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to the market yields on government bonds. The subsidiaries, associates, joint ventures and branches domiciled outside India shall discount post-employment benefit obligations by reference to market yields on high quality corporate bonds. In case, such subsidiaries, associates, joint ventures and branches are domiciled in countries where there is no deep market in such bonds, the market yields on government bonds of that country shall be used, whereas under IAS 19, the government bonds can be used only where there is no deep market of high quality corporate bonds.
2. ***Example on Gratuity:*** To illustrate treatment of gratuity subject to ceiling under Indian Gratuity Rules, an example has been added in Ind AS 19.

IAS 12 — INCOME TAXES

1. INTRODUCTION

The Standard prescribes accounting treatment for the current and future tax consequences arising from the

- Future recovery of carrying amount of assets
- Future settlement of carrying amount of liabilities
- Current period transactions or events that are recognized

2. PRINCIPLE OF ACCOUNTING FOR DEFERRED TAX

Recognition of deferred tax is based on the principal that when an asset or liability is recognized, it is obvious that entity will recover or settle the carrying amount of that asset or liability. If as a result of such recovery or settlement of carrying amount, future tax payments is affected, **IAS 12** requires that in order to ensure the matching principle, the entity should recognize a deferred tax liability / deferred tax assets when the related assets or liabilities are recognized.

Deferred tax is a matching accounting tool.

Example – 1

ASF Ltd has a building worth Rs 2,00,000. The current tax rate is 20%. ASF Ltd decides to revalue the building at a fair value of Rs 5,00,000. By doing so, the entity is recognizing that in the future it is likely to be able to sell the asset for Rs 5,00,000. It is also likely to have to pay tax later on, then it should account for itin some manner. Therefore, deferred tax on Rs 3,00,000 (i.e Rs 5,00,000 – 2,00,000) should be recognized in the current year.

3. DEFINITIONS

Accounting profit is profit or loss for a period before deducting tax expense.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which the income taxes are payable (recoverable).

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current Tax + Deferred Tax Liability
OR
= Current Tax - Deferred Tax Asset

Current tax is the amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for a period.

4. RECOGNITION OF CURRENT TAX LIABILITIES AND CURRENT TAX ASSETS

Taxes on income payable for the current period is generally called Current tax. Current tax and any tax in respect of previous years, to the extent unpaid are to be recognized as a liability. If the amount already paid by way of advance tax, etc., in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognized as an asset.

The Standard envisages a situation where some tax-laws include provisions that would allow entity to adjust the tax loss incurred in the current period against taxable income (tax payable) in the previous periods.

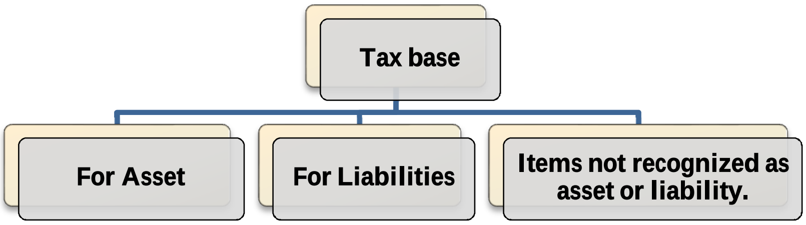
The benefit relating to a tax loss that can be carried back to recover current tax of previous period, shall be recognized as an asset. The asset stands recognized in the period in which the tax loss occurs because it is probable thatthe benefit will flow to the entity and the benefit can be reliably measured.

5. ACCOUNTING ENTRIES FOR CURRENT TAX:

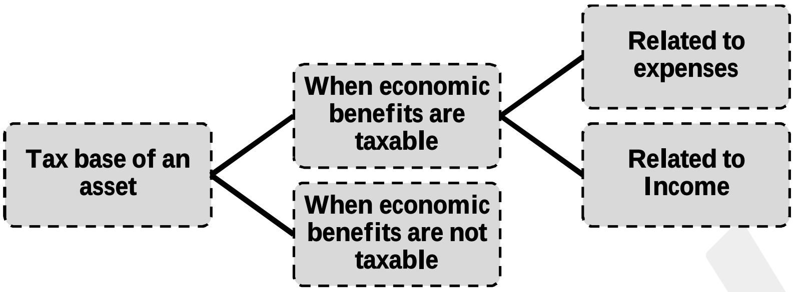
1. <u>**WHEN ADVANCE TAX IS PAID :**</u>
   Advance Tax A/C (Balance Sheet)……….Dr.
   To Bank A/C
2. <u>**WHEN EXPENSE IS RECOGNIZED :**</u>
   Current Tax Expense A/c (Profit and Loss A/c) ……Dr.
   To Current Tax Liability (Balance Sheet)
3. <u>**WHEN CURRENT TAX ASSET AND LIABILITY ARE ADJUSTED AGAINST EACH OTHER :**</u>
   Current Tax Liability A/c……….Dr.
   To Advance Tax A/C
   To Bank A/C (If tax liability is more than advance tax)

6. TAX BASE OF AN ASSET OR LIABILITY

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



7. TAX BASE OF AN ASSET



The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those benefits arising from the asset will not be taxable, the tax base of the asset is equal to its carrying amount.

a. WHEN ECONOMIC BENEFITS ARE TAXABLE

(i) IN THE CASE OF EXPENSES –

Tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

PROBLEM : 1

The cost of an asset is Rs 1,00,000. Tax depreciation is Rs 25,000. What is tax base of asset?

SOLUTION : 1

PROBLEM : 2

In the books of ASF Ltd., an amount of Rs 25,000 is recorded as rent paid in advance. For income tax purpose, the amount is deductible on accrual basis. Determine the tax base of asset.

SOLUTION : 2 Tax base of asset =

(ii) IN THE CASE OF INCOME –

Tax base of an asset is the amount <u>that will not be taxable</u> when it recovers the carrying amount of the asset.

PROBLEM : 3

Assume that interest receivable is Rs.100, and such interest is taxed on cash basis. When benefits flow to the entity (interest realised in cash), it will be subjected to tax. Determine the tax base of asset.

SOLUTION : 3

Any uncollected income, like interest receivable, if taxed on cash basis has a ____ tax base as it is to be added in full to future taxable income.**In this case, the tax base of interest receivable**

PROBLEM : 4

Assume that interest receivable is Rs.10,000. Rs 6,500 will be claimed as non-taxable and balance is taxable. Calculate Tax base.

SOLUTION : 4

b. WHEN ECONOMIC BENEFITS ARE NOT TAXABLE

If those benefits arising from the asset will not be taxable, the tax base of the asset is equal to its carrying amount.

PROBLEM : 5

ASF Ltd. recorded dividends of Rs 25,000 receivable from its subsidiary. The dividend is exempt from tax. Determine the tax base of asset.

SOLUTION : 5 **Tax base of asset =**

PROBLEM : 6

When a trade receivable of Rs.120 (being an asset in SOFP) is realised in full, the economic benefits receivable from the said asset is already included in the taxable profits when sales occurred. On realization of the amount, the benefits (cash inflow) are not taxable. Determine the tax base of asset

SOLUTION : 6

Any asset, which has no tax consequence has the carrying amount as its tax base**.Tax base of asset =**

PROBLEM : 7

What is the Tax base of inventory?

SOLUTION : 7

Tax base of inventory is its carrying amount. By definition the tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

In this case, recovery of the asset implies consumption or sale. The carrying amount of the inventory is charged against revenue when consumed or sold in full so its tax base is the carrying amount. There is no temporary difference.

PROBLEM : 8

What is the Tax Base of an Asset carried at fair value ?

SOLUTION : 8

Assets carried at fair value	
(i) Depreciable asset carried at fair value but fair value is not allowed for charging depreciation for tax purpose.	(i) Carrying amount is fair value and original cost allowed as per tax law less tax depreciation is the tax base.
(ii) Depreciable asset carried at fair value but fair value is allowed for charging depreciation for tax purpose. For the purpose of this example depreciation includes amortisation.	(ii) Carrying amount is the tax base.
(iii) Financial assets carried at fair value when fair value gain is not taxed and fair value loss is disallowed for tax purpose.	(iii) Carrying amount is fair value but tax base is original cost. In case indexation is allowed, indexed original cost becomes the tax base.

PROBLEM : 9

A Ltd has a bank balance of Rs 10,000. Determine the tax base .

SOLUTION : 9

PROBLEM : 10

A ltd has stock at Fair Value in its Balance Sheet at Rs 1,000 whose cost is Rs 800. What is the tax base of asset?

SOLUTION : 10

PROBLEM : 11

An entity has an investment in listed equity shares. There is no tax on gains that arise on sale of these listed equity shares. What is the tax base of asset?

SOLUTION : 11

8. TAX BASE OF A LIABILITY

TAX BASE OF A LIABILITY

- **Expenses**
- **Income received in Advance**

a. TAX BASE OF A LIABILITYFOR EXPENSES –

The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liabilityin future periods.

PROBLEM : 12

Consider the case of provision of Rs.200,000 towards bonus. Such expenditure towards bonus is tax deductible only on payment of that liability (when the bonus payment is actually paid, being subject to Section 43B of theIncome tax Act). Determine tax base of liability.

SOLUTION : 12 The tax base is

PROBLEM : 13

A company has made provision for warranty costs of Rs 10,000 in its accounts. The tax laws do not permit deduction until the company actually pays the claim. Determine tax base of liability.

SOLUTION : 13 **Tax base =**

b. TAX BASE OF A LIABILITY - FOR INCOME RECEIVED IN ADVANCE -

(i) The tax base of a liability is its carrying amount, LESS any amount of revenue that will not be taxable against that item in future.

PROBLEM : 14

Rent received in advance Rs 10,000 already taxed on receipt basis. This amount will not be taxed again in future. Determine tax base of liability.

SOLUTION : 14 **Tax base =**

(ii) In the case of future revenue which is received in advance but will be taxed in future on accrual basis the tax base is the carrying amount.

EXAMPLE : Advance received for supply of goods and services has tax base equal to carrying amount as those advances are taxed on accrual basis.

(iii) An outstanding expenses that is not deductible in computing tax profit has a tax base to the extent it is not deductible for tax purpose.

EXAMPLE - Current liabilities include accrued fines and penalties with a carrying amount of Rs. 10,000. Fines and penalties are not deductible for tax purposes. The tax base of the accrued fines and penalties is Rs. 10,000. **There is no temporary difference.**

(iv) If a liability represents an outstanding expenses that is taxed on cash basis then its tax base is nil.

EXAMPLE –

Outstanding contribution to employees provident fund of Rs. 1 million	
Carrying amount of the liability	= Rs. 1 million
- Amount to be deducted from future tax income	= Rs. 1 million
Tax base	Nil

(v) A liability having no tax consequence has the carrying amount as its tax base.

EXAMPLE : A company has outstanding Loan liability of Rs. 10 million. Its Tax base is Rs. 10 million.

Carrying amount of the liability	= Rs. 10 million
- Amount to be deducted From future tax income	= 0
Tax base	Rs. 10 million

PROBLEM : 15

Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense will be deducted for tax purposes on a cash basis. what is the tax base ?

SOLUTION : 15

PROBLEM : 16

Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense has already been deducted for tax purposes. What is the tax base ?

SOLUTION : 16

PROBLEM : 17

Current liabilities include interest revenue received in advance, with a carrying amount of Rs. 100. The related interest revenue was taxed on a cash basis. What is the tax base ?

SOLUTION : 17

9. ITEMS NOT RECOGNIZED AS ASSET OR LIABILITY.

Some items may not recognized as assets or liabilities but still may have tax base.

PROBLEM : 18

ASF Ltd incurred research costs of Rs 5,000. The amount is charged to Profit and Loss Account.

For tax purpose the deduction is permitted only after satisfying certain conditions. The carrying amount is nil as no asset is recognized. What is the tax base?

SOLUTION : 18

PROBLEM : 19

A Limited has been incorporated recently. It incurred Rs. 1,00,000 on its incorporation. It has been charged to revenue in the very first accounting period. The taxation laws allow deduction over a period of 5 years. The carrying amount at the end of year 1 in Rs. Nil. What is the tax base ?

SOLUTION : 19

10. TEMPORARY DIFFERENCES

Temporary differences

The carrying amount of an asset and a liability in the Balance Sheet of the entity may be equal to or different from the amount determined as the tax base.

No difference is said to arise when the carrying amount is equal to the tax base.

Differences nevertheless will arise, when the carrying amount is either greater than or less than the tax base.

These differences represent amounts that may or may not affect the level of future taxable income of the enterprise. In this backdrop, following three parameters are relevant.

1. In situations where the level of future taxable income is likely to increase, these differences are called taxable temporary differences.

2. In situations where the level of future taxable income is likely to decrease, these are called deductible temporary differences.
3. Despite there being a difference between carrying amount and tax base, there can be situations where the level of future taxable income is NOT AFFECTED.

The Standard lays down accounting prescriptions for items (1) and (2), and implies that no accounting treatment is required in situations covered under item (3).

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

a) Taxable temporary differences

b) **Deductible temporary differences**

11. TAXABLE TEMPORARY DIFFERENCES

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

These result in higher taxable profits in future. **(Save now, pay later)**

Taxable temporary differences can arise when:

Assets side: When the carrying amount of an asset is greater than its tax base.

Liabilities side: When the tax base of a liability exceeds its carrying amount.

12. DEFERRED TAX LIABILITIES

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

In such situations, the difference that presently exists gives rise to an increase in taxable income at a future date. It follows therefore that, as on the reporting date, the entity carries an obligation to pay tax at future date. When the obligation exists, and the amount can be reliably measured, a provision requires to be made. In a limited sense, a provision is regarded as a Liability. The standard prescribes that wherever the temporary differences give rise to a tax liability at a future date, a liability should be created. In accounting jargon, such a 'future' tax liability is called deferred tax liability.

EXAMPLE. : 2

The original cost of an asset is Rs.100000 and its carrying amount is Rs.50000. The cumulative depreciation for tax purposes works out to be Rs.60000. The tax rate is 30%.

In this situation, the Tax base of the asset is Rs.40000 (Rs.100000 - Rs.60000).

The carrying amount of the asset is Rs.50000. To recover the carrying amount the entity has to earn a taxable income of Rs.50000 but it will have the benefit of tax depreciation only to the extent of Rs.40000.

In this case, the entity will pay income taxes of Rs.3000 (being 30% of Rs.10000) when it recovers the carrying amount of the asset.The entity will therefore recognise a deferred tax liability of Rs.3000, being the tax payable when it recovers the carrying amount of the asset.

PROBLEM : 20

The cost of an asset is Rs 1,00,000. The accounting depreciation is Rs 16,000 while tax depreciation is Rs 25,000. Tax rate is 30%. Calculate DTL.

SOLUTION : 20

- **Carrying amount of asset =**
- **Tax base of asset =**
- **The taxable temporary difference =**
- **This will give rise to DTL of 30% x**

PROBLEM : 21

Interest receivable has a carrying amount of Rs 100. The related revenue will be taxed on cash basis. Tax rate is 30%. Calculate DTL.

SOLUTION : 21

- **Carrying amount of asset =**
- **Tax base of asset =**
- **The taxable temporary difference =**
- **This will give rise to DTL of 30% x**

PROBLEM : 22

Land was acquired for Rs 100. It is revalued at Rs 150. The cost of land for Balance sheet purpose was Rs 120 due to indexation of cost for tax purpose. Calculate DTL.

SOLUTION : 22

- **Carrying amount of asset =**
- **Tax base of asset =**

- **The taxable temporary difference =**
- **This will give rise to DTL of 30% x**

PROBLEM : 23

Carrying amount of financial asset = Rs 12 lacs. As per tax laws deductions will be allowed on indexed basis. Current year Index is 282. Index was 246 when asset was acquired. Cost of asset was Rs 10 lacs. corporate tax rate is 30%. Long term Capital gain tax rate = 20%. Pass journal entry assuming

- A. FVTPL 2. FVTOCI

SOLUTION : 23

13. DEDUCTIBLE TEMPORARY DIFFERENCES

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

These result in lower taxable profits in future. (Pay now, save later)

There are two possible situations when a deductible temporary difference can arise:

- **Asset side: When the carrying amount of an asset is less than its tax base**
- **Liabilities side: When the carrying amount of a liability is greater than its tax base**

14. DEFERRED TAX ASSETS

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of

a) deductible temporary differences;

b) carry forward of unused tax losses and

c) the carry forward of unused tax credits.

Consider the following situations

- **Downward revaluation** of assets without a corresponding adjustment to its tax base results in temporary differences. The carrying amount in books would be less than its tax base. Therefore, future taxable income will be less than the income level thrown up in accounts. This gives rise to tax savings in future. The Standard accordingly prescribes that a deferred tax asset may be recognized.
- **Retirement benefits** are allowed by tax authorities as tax- deductible expenses only on payment to employees. But, these are considered for accounting purposes on accrual basis. In this case, the tax base of the liability is equal to zero. Hence there arises a deductible temporary difference for which a deferred tax asset is created.

PROBLEM : 24

A company has made provision for warranty costs of Rs 10,000 in its accounts. The tax laws do not permit deduction until the company actually pays the claim. Tax rate = 30%. Calculate DTA.

SOLUTION : 24

- **Carrying amount of liability =**
- **Tax base =**
- **Therefore, Deductible Temporary Difference =**
- **DTA = 30 % x**

15. STEPS TO CALCULATE DEFERRED TAX

Step 1 - Find out carrying amount of assets and liabilities

Step 2 – determine tax base of assets and liabilities

Step 3 – Find out temporary difference (step 1- step 2)

Step 4 – determine whether temporary difference is a TTD or DTD

Step 5 – Calculate DTA / DTL using tax rates that have been enacted or substantively enacted by the end of reporting period.

16. RECOGNITION OF DEFERRED TAX LIABILITIES AND DEFERRED TAX ASSETS

Determination of DTA and DTL

PROBLEM : 25

A ltd has following liabilities in SOFP. Tax rate = 30%. Calculate tax base and DTA / DTL.

	Particulars	Carrying Amount	Tax base Formula	Answer	DTD	DTA@ 30%
A	Loan payable	10,000				
B	Advance income – non taxable in future	500,000				
C	Advance income – taxable in future	300,000				
D	Creditors	400,000				
E	Bonus payable	100,000				
F	Outstanding interest payment to nationalized bank	50,000				
G	Rent Payable	60,000				
H	Printing expenses payable	1,60,000				
I	Gratuity Provision	20,00,000				

PROBLEM : 26

A Ltd has debtors of Rs 10,000. Loss Allowance (Provision for Bad Debts) = Rs 1500. Calculate deferred tax assuming tax laws does not allow Loss Allowance . Tax rate is 30%.

SOLUTION : 26

17. ASSETS CARRIED AT FAIR VALUE

Prescriptions in certain other Standards (e.g., IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets etc.) permit entities to carry assets by adopting either Cost Model or Revaluation Model. Where entities adopt Revaluation Model, assets are carried at fair value. The taxability status can differ between different tax jurisdictions.

Tax Jurisdictions permitting fair valuation: On fair valuation, if the tax base is also affected correspondingly, there arises no taxable temporary difference and consequently there would be no future tax liability.

Tax Jurisdictions not permitting fair valuation for tax purposes: When the tax base is not adjusted on fair valuation of the assets, if the fair valued asset amount is more than the unaltered tax base, there arises taxable temporary difference.

This gives rise to the need for creating a Deferred Tax Liability.

PROBLEM : 27

A Ltd has debtors of Rs 10,000. Loss Allowance (Provision for Bad Debts) = Rs 1500. Calculate deferred tax assuming tax laws does not allow Loss Allowance . Tax rate is 30%.

SOLUTION : 27

PROBLEM : 28

A Ltd purchased a plant on 01.04.16 for Rs 10 lacs. Depreciation rate = 12% p.a. (WDV). On 31.3.18, the recoverable amount of plant is Rs 4 lacs. Tax depreciation is 18% p.a. (WDV). Calculate DTA/DTL.

SOLUTION : 28

PROBLEM : 29

Whether following items will give rise to DTA or DTL?

SOLUTION : 29

a. Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis.

SOLUTION : a.

b. Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected.

SOLUTION : b.

c. Development costs have been capitalised and will be amortised to the statement of profit and loss but were deducted in determining taxable profit in the period in which they were incurred.

SOLUTION : c.

d. Financial assets are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

SOLUTION : d.

e. An entity revalues property, plant and equipment (under the revaluation model treatment in IAS 16, Property, Plant and Equipment) but no equivalent adjustment is made for tax purposes

SOLUTION : e.

f. The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes.

SOLUTION : f.

g. Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the end of the reporting period for tax purposes.

SOLUTION : 6.

h. The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

SOLUTION : h.

i. A government grant which is included in the SOFP as deferred income will not be taxable in future periods.

SOLUTION : i.

j. Financial assets are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

SOLUTION : j.

k. Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

SOLUTION : k.

PROBLEM : 30

A Ltd purchased a machine for Rs 10,00,000. Depreciation rate is 25% SLM. As per tax laws, depreciation rate is 40% SLM. PBDT is Rs 30,00,000 each year. Prepare Statement of Profit and Loss for four years.

SOLUTION : 30

PROBLEM : 31

Following information is given for 3 years:

1. Purchase of Fixed Assets on 1.4.16 : Rs 10,00,000. 50 % of these were sold on 1.4.17 for Rs 7,00,000.

2. Purchase of Fixed Assets on 1.4.17 : Rs 12,00,000. 100% of these were sold on 1.4.18 for Rs 29,00,000.

3. Purchase of Fixed Assets on 1.4.18 : Rs 15,00,000

Accounts depreciation rate is 10 % WDV. Tax depreciation rate is 25% WDV. Tax rate is 30%. Profit before depreciation, tax and profit/loss on sale of fixed assets is Rs 40 lacs each year. Prepare statement of Profit and Loss.

SOLUTION : 31

PROBLEM : 32

A company had purchased an asset at ` 1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20% . (Depreciation rate for Tax purposes is 25% . The operating profit is ` 1,00,000 for all the 5 years. Tax rate is 30% for the nex t 5 years. Calculate the Book Value as per financial and tax purposes and then DTL.

SOLUTION : 32

Let us first of all calculate the Book Value as per financial and tax purposes.

Financial Accounting: **Rs 000's**

Year	1	2	3	4	5
Gross Block	100	100	100	100	100
Accumulated					
Depreciation	20	40	60	80	100
Carrying Amount	80	60	40	20	0

Tax Accounting: **Rs 000's**

Year	1	2	3	4	5
Gross Block	100	100	100	100	100
Accumulated					
Depreciation	25	50	75	100	100
Carrying Amount	75	50	25	0	0

Calculation of DTL: **Rs 000's**

Year	1	2	3	4	5
Carrying Amount Tax Base	80 75	60 50	40 25	20 0	0 0
Difference	5	10	15	20	0
Deferred Tax Liability (Difference x 30%)	1.5	3	4.5	6	0

18. UNUSED TAX LOSSES AND UNUSED TAX CREDITS

A deferred tax asset may be recognized for carry forward tax losses and unused tax credits to the extent there are taxable temporary differences or when it is probable that future taxable profit will be available against which the unused tax losses or tax credits can be utilized.

PROBLEM 33 :

B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of ` 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of ` 4,000 relating to preliminary expenses expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 20X1.

SOLUTION 33 :

The year-wise anticipated reversal of temporary differences is as under:

Particulars	Year ending on March 31, 20X2	Year ending on March 31, 20X3	Year ending on March 31, 20X4	Year ending on March 31, 20X5
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (9,000 / 3)	3,000	3,000	3,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (4,000 / 4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of 2,700 on taxable temporary difference relating to accelerated depreciation of 9,000 @ 30%.

However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending March 31, 20X4 amounting to ` 900 (` 3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 20X5 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on March 31, 20X5 deferred tax asset on the remainder of ` 1,000 (` 4,000 – ` 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

19. CRITERIA FOR ASSESSING THE PROBABILITY OF AVAILABILITY OF TAXABLE PROFITS

While assessing the probability of the future taxable profit, the entity may consider the following criteria:

- Whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity.

  Whether the entity will have sufficient taxable profits before the unused tax losses or the unused tax credits expire. E.g.: If the tax laws are allowed to be carried forward for three years, DTA should not be recognized if the entity expects to earn taxable profits only from Year four.
- Whether unused tax losses arise from identifiable causes that are unlikely to recur.
- Whether tax planning opportunities are available to the entity that will create taxable profits in the period in which unused tax losses or unused tax credits can be utilized.

20. RE-ASSESSMENT OF UNRECOGNIZED DTA

An entity can reassess unrecognized deferred tax assets and recognise it to the extent that it has become probable that future taxable profit is available to recover the DTA. This review may be taken up in two stages:

- At the end of each reporting period.
- At the time of events that makes the availability of future taxable profit probable such as Business Combinations.

21. MEASUREMENT

Measurement of current tax

Current tax liabilities (or assets representing tax recoveries) for the current and prior periods shall be measured at the amount expected to be paid to or recovered from Tax-authorities. For this purpose, **tax-laws and tax-rates that have been enacted or substantively enacted by the end of the reporting period shall be adopted.**

22. MEASUREMENT OF DEFERRED TAX

Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Although, the usual practice is to measure current and deferred taxes using tax rates that have been enacted, in some jurisdictions, announcement by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In such cases tax assets and liabilities are measured using such announced rates.

23. DIFFERING TAX RATES FOR DIFFERENT ELEMENTS OF TAXABLE INCOME

In many countries, differing tax rates are applied to different components that constitute the taxable income. For examples some components deemed as income in the nature of capital gains are taxed at a rate different from the rate levied on normal business income. In some cases, some elements of income may be deemed to be speculative income and taxed at a higher rate.

For example, an asset has a carrying amount of Rs.1,00,000 and the tax base is Rs.80,000. If the applicable tax rate on sale of an asset is 20% and that on other income is 30%, then, the entity will recognise a DTL of Rs.4,000 (i.e. 20% of Rs.20,000) if it expects to sell the asset and a DTL of Rs.6,000 (i.e. 30% of Rs.30000) if it expects to retain the asset and recover its carrying amount through continued use.

PROBLEM 34 :

Cost of machine on 1.04.2016 is Rs 10,00,000. Depreciation rate is 10% WDV.

Tax depreciation rate is 20% WDV.

Upward revaluation on 01.04.18 = Rs 1,00,000

Applicable tax rate on sale of an asset is 20% and that on other income is 30%.

Calculate deferred tax as on 31.3.19 assuming –

(a) entity intends to sell the asset

(b) entity intends to use the asset

PROBLEM 35 :

Details of a depreciable asset that has been classified as held for sale by X Ltd. as on 31.3.2017 are as follows (Amount Rs. thousand):

As on	31.3.2016	31.3.2017
Carrying amount	90.00	80.00
Tax base	60.00	55.00
Taxable temporary difference	30.00	25.00
Deferred tax liability	9.00	
Fair value less costs to sale		75.00

The company recognises a deferred tax liability of Rs. 9,000 at 30%. It has considered that the asset will be recovered through use and therefore, it has applied the tax rate applicable to business profit. During 2016-17, it has decided to sell the asset. Assume that the applicable capital gain tax rate is 20%. The company shall bring down the carrying amount of the asset to its fair value less costs to sale as per Ind AS 105 by writing off Rs. 5,000.

How should the company re-measure the deferred tax liability and how shall it account for any change?

SOLUTION 35 :

Assumption : Tax law disallows write down			(Amount in Rs. thousand)	
	Carrying amount	Tax base	Temporary Difference	Deferred tax liability
As on 31.3.2014	75.00	55.00(a)	20.00	4.00
Assumption : Tax law allows write down				
As on 31.3.2014	75.00	50.00(b)	25.00	5.00

(a) Tax base is the amount that will be allowed to be charged against the expected sale proceeds i.e. tax base of Rs. 55 million.

When an entity expects to recover the carrying amount by selling the asset, the capital gain = Sale proceeds - Allowed cost i.e. Rs. 20 million and expected capital gain tax is Rs. 4 million.

Deferred tax liability of Rs. 5 million is reversed through Profit and loss i.e. adjusted to tax expense.

(b) Tax base is adjusted for write down already allowed.

24. DEFERRED TAX ASSETS AND LIABILITIES SHALL NOT BE DISCOUNTED

The Standard prescribes that the amounts of DTL or DTA, should be determined in absolute terms as a tax-percentage of temporary taxable or deductible differences — even though obligations towards these tax liabilities or rights by way tax recoveries will result in cash outflow only at a future date. In brief, the amount of DTA / DTL shall not be recognized on a discounted basis, **since the computation calls for detailed scheduling of timing of reversal of each temporary difference.**

25. RECOGNITION OF DEFERRED TAX

The tax-effects in respect of transactions and other events recognized in profit or loss are recognized as income or expense in profit or loss, with the exception of the following:

- Where the transactions and other events stand recognized either in other comprehensive income or directly in equity,the related tax effects are also recognized under the same component and not through P&L.
- In a business combination (explained in the next paragraph)

26. RECOGNITION OF DEFERRED TAX IN A BUSINESS COMBINATION

In accordance with Ind AS 103, deferred tax assets or liabilities are recognized as identifiable assets and liabilities at the acquisition date. These deferred tax assets and liabilities affect the amount of goodwill or capital reserve, that the entity recognises. It is however to be noted that the entity, however does not recognise DTL arising from initial recognition of goodwill

27. TEMPORARY DIFFERENCES IN A BUSINESS COMBINATION

Differences may arise when tax base of the assets and liabilities acquired in a business combination differ from the carrying amount. Morespecifically, the identifiable assets and liabilities acquired are measured at fair value for initial recognition, while the tax-laws may permit recognition of an amount equal to the cost to the previous owner.

The difference attributable to carrying amount of fair valued asset being more than its tax base, gives rise to taxable temporary difference.

The resulting deferred tax liability affects the goodwill on business combination.

28. GOODWILL ARISING IN A BUSINESS COMBINATION

The tax base of the Goodwill, which arises on account of business combination, is the decisive factor for recognizing or not recognizing any deferred tax liabilities.

The tax laws can differ from country to country. Many taxation authorities, however do not allow reductions in carrying amount of goodwill as a deductible expense in determining taxable profit. The tax base of goodwill in such cases is NIL. This gives rise to a taxable temporary difference.

It is assumed that in certain tax-jurisdictions, tax authorities may permit recognition of goodwill, and allow certain deductions in computing taxable income. In these cases, the carrying amount of Goodwill may differ from its tax base.

Based on this assumption the Standard provides that a deferred tax asset may be recognized if the carrying amount of goodwill arising in a business combination is less than its tax base. This deferred tax asset arising from initial recognition of goodwill in a business combination will be accounted as part of business combination considering the availability of probable taxable profit.

It is clarified that the difference in carrying amount of Goodwill and its tax base may give rise to recognition of Deferred tax asset (goodwill amount will stand reduced to the extent DTA is recognized).

The standard does not permit recognition of deferred tax liability on goodwill because goodwill is measured as a residual and recognition of deferred tax liability would only lead to increase in carrying amount of goodwill(because Goodwill should not be increased merely on account of this contra-item of DTL).

EXAMPLE – 3

An entity acquires a subsidiary and pays Rs. 1,00,000. The fair value of net identifiable assets is Rs. 65,000. The following entry shall be made in the books:

Entry 1:

Goodwill	**Dr.**	**35,000**	
Net Assets	**Dr.**	**65,000**	
To Consideration			**1,00,000**

The tax base of goodwill is Rs. Nil. Hence the taxable temporary difference is Rs. 35,000. Assuming tax rate to be 30%, deferred tax liability of Rs. 10,500 needs to be created. Now because of recognition of this deferred tax liability, the following entry needs to be passed instead of the above entry:

Goodwill	**Dr.**	**45,500**	
Net assets	**Dr.**	**65,000**	
To Consideration			**1,00,000**
To Deferred tax liability			**10,500**

The temporary difference now is Rs. 45,500 and not Rs. 35,000 and the resultant deferred tax liability should be Rs. 13,650 (45,500 x 30%) and not Rs. 10,500.

Thus, deferred tax liability in entry 2 should be increased by Rs. 3,150 which in turn will increase goodwill by a similar amount with consequent impact on taxable temporary difference and deferred tax liability.

Therefore, no deferred tax liability is to be recognised in the case of taxable temporary difference arising on the initial recognition of goodwill in a business combination in tax jurisdiction where such goodwill is not tax deductible.

Subsequent decrease in unrecognized deferred tax liability (for e.g., resulting from reduction in amount of goodwill as a result of recognition of impairment loss on the same) is considered to be relating to the initial recognition of goodwill and the same is not to be recognized.

Deferred tax liability is however recognized for taxable temporary differences to the extent they do not relate to initial recognition of goodwill. E.g. Where the carrying amount of goodwill is deductible for tax purposes.

29. PRE-ACQUISITION DTA OF THE ACQUIRER

A prospective acquirer may have deductible temporary differences, in respect of which a DTA (prior to business combination) may or may not have been recognized. A business combination arrangement will affect the status of recognition of a DTA, in as much as such an arrangement may either increase or at times even decrease the level of future taxable income. Consequently, it is expected of the acquirer to undertake a review of the status of recognition of DTA, soon after business combination.

- Where a DTA stands already recognized, and if on account of lack of income-generating capacity of acquiree, the acquirer may need to de-recognise and reverse the DTA.
- Where a DTA had not been recognized, and if the business combination, strengthens the possibility of generation of future taxable income, the acquirer can consider recognising the item at that stage.
- There can be situations where, the acquiree does have tax-loss carry forward. The deferred tax benefits acquired in a business combination can be recognized either during the measurement period (one-year fair valuation period), or later, giving rise to two different situations:
  - If the Deferred Tax Benefits are recognized within the measurement period, it would affect the Goodwill if anyrecognized. **In case where the goodwill is less than the amount of deferred taxes, difference is recognized in profit or loss.**
  - If the acquired tax benefits are recognized after measurement period, the recognition shall be made ONLY in profit or loss.

30. CURRENT AND DEFERRED TAX ARISING FROM SHARE BASED PAYMENT TRANSACTIONS

In case of transactions relating to remuneration paid in shares, share options or other equity instruments, the timing of permitted deduction of the recognized expenses by tax laws of the concerned jurisdiction will be the factor that determines whether or not deferred taxes will arise.

EXAMPLE

it is possible that the tax authorities may allow deduction of recognized expenses only when the employees exercise the share options which results in recognition of deferred tax assets until the period in which employees will exercise the option (or shares are issued).

It is possible in such transactions, for the amount of tax deduction to differ from the amount of related remuneration expense. If the amount of tax deduction (future tax deduction) exceeds the related cumulative remuneration expense, this indicates that tax deduction relates not only to the remuneration expense but also to equity. In this case, the excess of the associated current / deferred tax should be directlyrecognized in equity.

31. PRESENTATION: OFFSETTING

As regards current tax, the off-setting requirement stipulated in the Standard, lays greater stress and emphasis on the compliance of two conditions (a) and (b) below, if an entity were to off-set current tax assets against current tax liabilities.

a) If and if only the entity has a legally enforceable right to set off the recognized amounts; and

b) If and if only the entity intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

A similar requirement as to the existence of legally enforceable right has been prescribed for off-setting deferred tax assets and deferred tax liabilities. The other condition is that the entity should ensure that the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

- The same taxable entity; or
- Different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

32. DISCLOSURES

In the financial statements

- Major components of tax expense or income such as current tax, prior period tax, deferred tax, reversals of deferred tax, previously unrecognized current tax or deferred tax now recognized etc.
- Aggregate amount of current and deferred tax on items that are credited or charged to equity
- Amount of income tax relating to each component of other comprehensive incomeIn the notes to accounts
- Amount and date of expiry if any for deferred tax assets
- Unused tax losses and tax credits for which no deferred tax asset is recognized
- Deferred taxes relating to business combinations
- Deferred taxes associated with investment in subsidiaries, branches and associates and interests in joint ventures not recognized
- Income tax in respect of dividend distribution to shareholders
- Supporting evidences for recognizing deferred tax assets on the basis of future taxable profit
- An additional disclosure requirement relates to a numerical Reconciliation Statement being presented to explain income tax (expense) and accounting profit in either or both of the following forms:
  - Reconciliation of **amounts** commencing with accounting profit multiplied by applicable tax rate and ending with the **amount** of income tax expense (this reconciliation will not arise in situations where there is an accounting loss juxtaposed to taxable income).
  - Reconciliation of average effective tax rate and applicable tax rate.

Income taxes - Changes in the tax status of an entity or its shareholders

Any income tax consequences from the change of tax status of an entity or its shareholders shall be included in "profit or loss" for the period or included in other comprehensive income if the related transactions were included in "profit or loss" or other comprehensive income respectively.

EXAMPLE - 4

As per the tax laws of some countries, the tax consequence of a partner stepping down from a partnership is such that, his proportionate loss, if any, of the firm cannot be carried forward except for his share in unabsorbed depreciation. Consequently any previously recognized temporary difference shall be reversed accordingly.

33. MAJOR CHANGES IN IND AS 12 VIS-À-VIS IAS 12 NOT RESULTING IN CARVE OUTS

(i) ***Presentation of Tax Expense:*** IAS 12 requires presentation of tax expense (income) in the separate income statement, where separate income statement is presented. Ind AS 12 does not require such presentation since in Ind AS 1 option regarding the two statement approach has been removed.

(ii) ***Deferred Tax Benefits Related to* Business Combinations:** IAS 12 provides that acquired deferred tax benefits recognised within the measurement period that results from new information about facts and circumstances existed at the acquisition date shall be applied to reduce the carrying amount of goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits shall be recognised in profit and loss. As a consequence of different accounting treatment of bargain purchase gain prescribed in Ind AS 103, in comparison to IFRS 3, Ind AS 12 provides that if the carrying amount of such goodwill is zero, any remaining deferred tax benefits shall be recognised in other comprehensive income and accumulated in equity as capital reserve or recognised directly in capital reserve.

(iii) ***Specified Grant Related to Asset (Para 33):*** As against IAS 12, Ind AS 12 does not allow the option of deducting specified grant from the cost of the related asset as this option is not permitted in Ind AS 20 *'Accounting for Government Grants and Disclosure of Government Assistance'.*

PROBLEMS FOR SELF-PRACTICE

PROBLEM 36 :

X Ltd. acquired the business of Y Ltd. at purchase consideration of Rs. 10 lacs. Following net assets were taken over: (Rs in lacs)

Assets	Fair value	Tax base	Taxable Temporary difference	DTL
Machinery	5	4		
Equipment	6	5		
Liabilities	3	3		

Tax rate = 30%. Pass journal entries for business combination.

PROBLEM 37 :

Problem same as above, except that purchase consideration is Rs 7 lacs

PROBLEM 38 :

X Ltd. acquired the business of Y Ltd. at purchase consideration of Rs. 10 lacs. Following net assets were taken over: (Rs in lacs)

Assets	Fair value	Tax base	Deductible Temporary difference	DTA
Machinery	5	6		
Equipment	6	7		
Liabilities	3	3		

Tax rate = 30%. Pass journal entries for business combination.

PROBLEM 39 :

A Ltd. Acquired B Ltd. The following assets and liabilities are acquired in a business combination: ` 000's

	Fair Value	Carrying amount	Temporary Difference
Plant and Equipment	250	260	-10
Inventory	120	125	-5
Debtors	200	210	-10
	570	595	-25
9% Debentures	100	100	
	470	495	
Consideration paid	500	500	
Goodwill	30	5	-25

Calculate Deferred Tax Asset.

SOLUTION 39 :

In this case, tere is a DTA as the tax base of assets qcquired is higher by Rs. 25,000 DTA would be Rs. 7,500 (30% x 25,000)

Journal entry: Plant and equipment ______________________Dr 250

Inventory ____Dr 120

Debtors ____Dr 200

Good will ____Dr 22.5 (30- 7 .5)

DTA ____Dr 7.5

PROBLEM 40 :

X Ltd. acquired the business of Y Ltd. at purchase consideration of Rs. 135 million for net assets value measured at fair value of Rs. 115 million. Accordingly, there is goodwill of Rs. 20 million. However, deferred tax liability arises out of taxable temporary difference of machinery Rs. 9 million, and deferred tax assets amounting to Rs. 4.5 million arises out of deductible temporary difference of equipment and trade receivables. Assume tax rate of 30% for measuring deferred tax. (Amount in in Rs. Million)

Assets	Carrying amount of the acquiree	Fair value	Tax base	Taxable Temporary difference	Deductible temporary difference
Machinery	100.0	110	80	30	
Equipment	30.0	20	25		5
Inventory	20.0	15	15		
Trade receivables	40.0	30	40		10
	190.0	175		30	15
Liabilities					
Payables	60.0	60	60		
Deferred tax liability	7.5				
Net assets value acquired		115			
Fair value of purchase consideration		135			
Goodwill		20			

Initial recognition of deferred tax asset and liability by adjusting goodwill is explained in this example. Assume that amortisation of goodwill over 5 years on straight line basis is allowed as per tax law.

SOLUTION 40 :

	Rs. in million
Goodwill	20.0
Deferred Tax on initial recognition of assets and liabilities:	
Deferred tax liability	+9.0
Deferred tax	- 4.5
Adjusted Goodwill	24.5

Accounting entry:

Amount in Rs. million		**Dr.**	**Cr.**
Goodwill	Dr.	24.5	
Machinery A/c	Dr.	110.0	
Equipment A/c	Dr.	20.0	
Inventory A/c	Dr.	15.0	
Trade Receivables A/c	Dr.	30.0	
Deferred Tax Asset A/c	Dr.	4.5	
Payables A/c	Cr.		60.0
Deferred Tax Liability A/c	Cr.		9.0
Purchase consideration A/c	Cr.		135
		204.0	204.0

Deferred tax liability is created when goodwill is amortised as per Tax Law and the accumulated deferred tax liability is reversed when the goodwill is impaired.

Year	Carrying amount	Amortisation as per Tax Law	Tax Base	Taxable Temporary Difference	Deferred Tax Liability	Deferred Tax Expense
0	24.5		24.5			
1	24.5	4.9	19.6	4.9	1.47	1.47
2	24.5	4.9	14.7	9.8	2.94	1.47
3	24.5	4.9	9.8	14.7	4.41	2.94
4	24.5	4.9	4.9	19.6	5.88	2.94
5	24.5	4.9	0	24.5	7.35	4.41

In the same manner if goodwill is valued at Rs. 22.5 million and amortised over 10 years for tax purpose, deferred tax impact will be as discussed below.

Deferred tax analysis on amortisation of Goodwill: (Amount in Million)

Year	Carrying amount	Amortisation for tax purpose	Tax base	Taxable Temporary difference	Deferred tax liability	Deferred tax expense
0	22.5					
1	22.5	2.25	20.25	2.25	0.68	0.68
2	22.5	2.25	18.00	4.50	1.35	0.68
3	22.5	2.25	15.75	6.75	2.03	0.68
4	22.5	2.25	13.50	9.00	2.70	0.68
5	22.5	2.25	11.25	11.25	3.38	0.68
6	22.5	2.25	9.00	13.50	4.05	0.68
7	22.5	2.25	6.75	15.75	4.73	0.68
8	22.5	2.25	4.50	18.00	5.40	0.68
9	22.5	2.25	2.25	20.25	6.08	0.68
10	22.5	2.25	0.00	22.50	6.75	0.68

Deferred tax liability on goodwill is reversed when goodwill is impaired.

IFRS 10 CONSOLIDATED FINANCIAL STATEMENTS

1. INTRODUCTION

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements (CFS) when an entity controls one or more other entities.

This standard defines control for all entities that could be consolidated.

This IFRS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination.

2. STANDARDS PROVIDING GUIDANCE ON PREPARATION OF CFS

1. The following standards provides guidance on preparation of consolidated financial statements:
   a. IFRS 10 : Consolidated Financial Statements
   b. IFRS 11 : Joint Arrangements
   c. IFRS 12 : Disclosure of Interests in Other Entities
   d. IAS 27 : Separate Financial Statements
   e. IAS 28 : Investments in Associates and Joint Ventures
2. The focus in IFRS is on substance over form. It is the de-facto evaluation rather than the de-jure evaluation that determines the relationship of subsidiary, joint arrangement or associate.
3. The objective of IFRS 10, is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities.
4. The objective of IFRS 11, Joint Arrangements, is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (Joint arrangements).
5. The objective of IFRS 12, Disclosure of Interests in Other Entities, is to require an entity to disclose information that enables users of its financial statements to evaluate.
6. The objective of IAS 27, Separate Financial Statements, is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

The objective of IAS 28, Investments in Associates & Joint Ventures, is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates & joint ventures.

3. SCOPE

A parent who controls one or more entities is required to present consolidated financial statements.

However, a parent is not required to present consolidated financial statements if it meets all of the following four conditions

Condition 1:

The parent is either a wholly owned subsidiary or a partially owned subsidiary of another entity. Further its other owners (including those not entitled to vote) have been informed and do not object, to the parent not presenting the consolidated financial statements.

Condition 2

The equity instruments or the debt instruments of the parent are not traded in a public market. The public market could be a domestic or foreign stock exchange or an over the counter market including local and regional markets

Condition 3:

The parent has neither filed nor is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

Condition 4:

The ultimate or any intermediate parent, of the parent (that is required to present consolidated financial statements), produces financial statements that are available for public use and comply with IFRS, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10.

Further, a parent who fulfills the following two conditions is also not required to present consolidated financial statements:

Condition 1:

The parent is an investment entity

Condition 2:

The parent is required to measure all its subsidiaries at fair value through statement of profit or loss.

Also, IFRS 10 does not apply to post – employment benefit plans or other long term employee benefit plans to which IAS 19 'Employee Benefits', applies

CASE STUDY : Exemption from preparing consolidated financial statements.

Entity X owns the following other entities:

1. 100% interest in entity Y. Entity Y owns 60% interest in entity Z.

2. 80% interest in entity M. Entity M owns 60% interest in entity N.

The structure is illustrated as follows:

Entity X is a listed company and prepares IFRS compliant consolidated financial statements. Entities Y & M do not have their securities publically traded and they are not in the process of issuing securities in public markets. Entity X does not require its subsidiary M to prepare consolidated financial s tatements. Entity Y is a wholly - owned subsidiary of entity X. Entity Y is not required to prepare consolidated financial statements.

Entity M is not required to prepare consolidated financial statements provided, the non-controlling interest holders have been informed about, and do not object to Entity M presenting consolidated financial statements.

Example: Where local regulations govern the participation of consolidate financial statements.

At times local regulations dictate when, and for what periods, an entity must present consolidated or separate financial statements. Local regulations might allow or require an intermediate parent to produce separate financial statements prepared in accordance with IAS 27, instead of consolidated financial statements.

Where local regulations permit an entity not to prepare consolidated financial statements, the entity should still consider the exemptions as per IFRS 10 and determine whether it is exempt from preparing consolidated financial statements

4. WHAT IS CONSOLIDATED FINANCIAL STATEMENTS

The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

5. COMPONENTS OF CONSOLIDATED FINANCIAL STATEMENTS

'Consolidated Financial Statements' includes:

i Consolidated SOFP;
ii Consolidated Statement of Profit and Loss;
iii Consolidated Statement of Changes in Equity;
iv Consolidated Cash Flow Statement;
v Consolidated Notes to the Financial Statements.

6. WHAT IS CONTROL OF AN INVESTEE:

An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

- **Example of Variable returns**: Dividend

7. WHO IS A DECISION MAKER:

An entity with decision-making rights that is either a principal or an agent for other parties.

8. DEFINITIONS

Group: A parent and its subsidiaries

Non-controlling interest: Equity in a subsidiary not attributable, directly or indirectly, to a parent.

Parent: An entity that controls one or more entities

Power: Existing rights that give the current ability to direct the relevant activities

Protective rights: Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate

Relevant activities: relevant activities are activities of the investee that significantly affect the investee's returns

Relevant activities and decision about relevant activities

Operating and financing activitiesthat significantly affect the returns are relevant activities.They include,

- Selling and purchasing of goods or services
- Managing financial assets during their life
- Selecting, acquiring or disposing of assets
- Researching and developing new products or processes
- Determining a funding structure or obtaining funding

Decisions about relevant activities include :

- Establishing operating and capital decision of the investee
- Appointing and remunerating entity's key managementpersonnel or service providers and terminating their services or employment

Removal rights: Rights to deprive the decision maker of its decision-making authority.

9. CONTROL

An investor determines whether it is a parent by assessing whether it controls one or more investees.

An investor controls an investee if and only if the investor has all of the following elements:

- power over the investee, i.e. the investor has existing rights that give it the ability to direct the relevant activities (the activities that significantly affect the investee's returns)
- exposure, or rights, to variable returns from its involvement with the investee
- the ability to use its power over the investee to affect the amount of the investor's returns.

An investor considers all relevant facts and circumstances when assessing whether it controls an investee. The following are relevant factors to be considered:

10. PURPOSE AND DESIGN OF THE INVESTEE

The design can be as simple as proportionate voting rights represented by means of equity instrument. But there may be complex arrangements where the voting rights are not dominant factor in deciding control over investee, such as when the relevant activities are directed by means of a contractual arrangement. In such cases, consideration to the below factors is relevant for determining control.

11. RIGHTS THAT GIVE POWER (CURRENT ABILITY) TO DIRECT RELEVANT ACTIVITIES

Power arises from rights. Such rights can be straight forward (e.g. through voting rights) or be complex (e.g. embedded in contractual arrangements).

The current ability can flow either from contractual rights or voting rights.

Such rights should further be assessed as to whether those rights are substantive rights or protective rights.

Protective rights do not result in power over investee, while investor with substantive rights has power over investee.

12. EXAMPLE OF SUBSTANTIVE RIGHTS

- Right to appoint or remove Board of Directors or Key managerial personnel.
- Right to direct investee to enter into transactions for the benefit of the investor.

13. EXAMPLE OF PROTECTIVE RIGHTS

- A lender's rights to restrict a borrower from undertaking activities that could change the credit risk of borrower to the detrimental of the lender.
- Right to seize the assets of borrower if borrower fails to repay the loan.

14. FACTORS TO BE CONSIDERED WHEN IT IS DIFFICULT DETERMINE WHETHER AN INVESTOR'S RIGHT ARE SUFFICIENT TO GIVE POWER OVER AN INVESTEE

- o Whether the investor can appoint or approve the appointment of the key management personnel
- o Whether the investor can direct the investee to enter into transaction for the benefit of the investor
- o Whether the investor can dominate the nomination process for electing members of the investee's governing body
- o Whether the investee's key management personnel are related parties of the investor
- o Whether majority of governing body of the investee are related parties of the investor

15. EXPOSURE OR RIGHTS TO VARIABLE RETURNS

An investor must be exposed, or have rights, to variable returns from its involvement with an investee to control the investee.

Such returns must have the potential to vary as a result of the investee's performance and can be positive, negative, or both.

Examples of variable returns :

- ☑ **dividends**
- ☑ remuneration for servicing assets and liabilities,
- ☑ residual interests in the investee and access to future liquidity and returns that are not available to other holders like cost savings,
- ☑ access to "proprietary information".

Variabilityof returns should be assessed with reference to substance of the arrangement rather than mere form. For example, a fixed rate instrument may be considered variable due to significant default risk on such instrument.

16. LINK BETWEEN POWER AND RETURNS

A parent must not only have power over an investee and exposure or rights to variable returns from its involvement with the investee, a parent must also have the ability to use its power over the investee to affect its returns from its involvement with the investee.

17. CONSOLIDATION PROCEDURES

PROCESS

1. Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
2. Consolidated financial statements:
   - ☑ combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
   - ☑ offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 'Business Combination' explains how to account for any related goodwill).
   - ☑ eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).
3. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.
4. IAS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.
5. Share of non-controlling interests in the profit and loss and in the net assets of the consolidated subsidiariesis identified and disclosed separately.

18. NON-CONTROLLING INTEREST

When a subsidiary is not wholly owned, (i.e. owned 100% by the parent), a part of the net assets belong to the minority shareholders. This is called non-controlling interest (NCI).

- Measure NCI either at:
- (a) either at fair value
- (b) or at an amount that represents the proportionate share of non-controlling interests, in the net-assets of acquiree.

Option 1: Measuring non-controlling interest at fair value

= Number of the equity shares not held by the acquirer x market price prevailing on the date of acquisition.

Option 2: Measuring non-controlling interest by calculating the share of the fair value of net assets acquired

= Proportionate NCI holding X acquisition date FV of net assets

Where, FV of net assets = FV of all identified assets – FV of all identified liabilities

OR

Share capital + all reserves on acquisition date + FV adjustment on acquisition

Non-controlling interest in the consolidated subsidiaries comprises of three elements;

- On the date of acquisition the non-controlling interest is measured as per IFRS 3 - Business Combinations.
- The non-controlling interest's share on consolidated subsidiaries profit or loss for the period and
- The non-controlling interest's share on each component of the consolidated subsidiary's equity.

The non-controlling interest is disclosed within equity separately from owner's equity, since it represents the residual interest in the assets and liabilities of subsidiary and also it is not a presentobligation to the entity.

Example : 1 Fair value Method

A Limited acquires 80% of B Limited at a valuation of 150.00 crores by payment in cash of 120.00 crores. The value of non–controlling interest is 30 crores.

As per method 2 : 'Proportionate Share method'

Example : 2 Proportionate NCI holding Method

Continuing with the above example in method 1

Assume that the value of recognized amount of subsidiary's identifiable net assets is 130.00 crores, as determined in accordance with IFRS 3. The value of non–controlling interest is 26.00 crores (i.e. 130 crores x 20%).

19. COMPUTATION OF GOODWILL

On the acquisition date the goodwill is determined as per IFRS 3- Business Combinations and thereafter tested for impairment annually. The result may be either goodwill or a gain on bargain purchase.

Goodwill is measured as the excess of (a) over (b) explained below:

a) The aggregate of:

- Amount of consideration transferred, measured on the basis of acquisition-date fair value,
- Amount of any non-controlling interest measured either at fair value or by any other permitted basis; and
- In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

b) The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

- **Excess of (a) over (b) results in goodwill. This is recognised as an asset.**
- **However, the excess of (b) over (a) results in a gain on bargain purchase.**

In the aforesaid example, as per method 1, goodwill is determined at 20.00 crore whereas as per method 2, the amount of goodwill is 16.00 crore

Method 1 – Fair Value Method	(All figures in crores)		
		Dr.	Cr.

Method 2 – Proportionate Share Method	(All figures in crores)		
		Dr.	Cr.

EXAMPLE : 3

In the aforesaid example, if the consideration is 90 instead of 120.00 crore, then the amount of bargain purchase is determined at 10.00 crore whereas as per method 2, the amount of bargain purchase is 14.00 crore.

Method 1 – Fair Value Method	(All figures in crores)		
		Dr.	Cr.

Method 2 – Proportionate Share Method	(All figures in crores)		
		Dr.	Cr.

PROBLEM 1 : MEASUREMENT OF GOODWILL WHEN THERE IS NON-CONTROLLING INTEREST

Raja Ltd. purchased 60% shares of Ram Ltd. paying 525 lakh. Number of issued capital of B Ltd. is 1 lakh. Fair value of identifiable assets of B Ltd. is 640 lakh and that of liabilities is 50 lakh.

As on the date of acquisition, market price per share of Ram Ltd. is 775. Find out the value of goodwill.

SOLUTION : 1

	(Rs in lakh)
(i) Fair value of consideration paid	
(ii) Fair value of non-controlling interest (40% x 1 lakh x 775)	
(A)	
Fair value of identified assets	
Less: Fair value of liabilities	
Fair value of Net Identified Assets (B)	
Goodwill [(A) – (B)]	

Note: When goodwill is measured taking non-controlling interest at fair value, it is often termed as full goodwill.

On the other hand, it is possible to measure non-controlling at the proportionate value of net assets.

	Amount in lakhs
(i) Fair value of consideration paid	
(ii) Proportionate value of non-controlling interest (40% x 590 lakh)	
(A)	
Fair value of identified assets	
Minus fair value of liabilities	
Fair value of Net assets (B)	
Goodwill [(A)-(B)]	

When non-controlling interest is measured at proportionate share of net asset, the goodwill is popularly termed as partial goodwill.

20 MEASUREMENT

PROFIT OR LOSS OF SUBSIDIARY COMPANIES

An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date.

An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests.

The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

PROBLEM : 2

A Ltd. acquired 70% of equity shares of B Ltd. on 1.04.20X1 at cost of 10,00,000 when B Ltd. had an equity share capital of 10,00,000 and other equity of 80,000. In the four consecutive years B Ltd. fared badly and suffered losses of 2,50,000, 4,00,000, 5,00,000 and 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. experienced turnaround and registered an annual profit of 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. recorded annual profits of 1,00,000 and 1,50,000 respectively. Show the non- controlling interests and goodwill at the end of each year for the purpose of consolidation.

Assume that the assets are at fair value.

SOLUTION : 2

Calculation of Non-controlling interest on the date of acquisition:	Rs
Share Capital	10,00,000
Other equity	80,000
Total	10,80,000
NCI (30% X 10,80,000)	3,24,000

NCI is measured at NCI's proportionate share of the acquiree's identifiable net assets.

(Considering the carrying amount of share capital & other equity to be fair value).

Calculation of Goodwill:	Rs
Consideration	10,00,000
Non-controlling interest [30% x (10,00,000 + 80,000)]	3,24,000
Less: Net Assets	10,80,000
Goodwill	2,44,000

Statement showing non- controlling interests at the end of each year

Year	Profit/loss	NCI Share (30%)	NCI Balance
At the time of acquisition in 20X1			3,24,000
20X1-20X2	(2,50,000)	(75,000)	2,49,000
20X2-20X3	(4,00,000)	(120,000)	1,29,000
20X3-20X4	(5,00,000)	(150,000)	(21,000)
20X4-20X5	(1,20,000)	(36,000)	(57,000)
20X5-20X6	50,000	15,000	(42,000)
20X6-20X7	1,00,000	30,000	(12,000)
20X7-20X8	1,50,000	45,000	33,000

21. WILL ANY FURTHER CHANGE IN THE PARENT'S INVESTMENT PORTION IN SUBSIDIARY NOT RESULTING IN LOSS OF CONTROL AFFECT GOODWILL ?

Any further change in the parent's investment portion in subsidiary not resulting in loss of control does not affect goodwill (eg: from 73% holding to either 65% or 85%).

WHY?

The reason behind this is, when control is obtained on the acquisition date, the parent is able to control the entire economic resources of the entity. On further investments, the parent is not obtaining control of any new asset, instead is only obtaining a higher share in the income generated using the same resource. Hence, goodwill is not affected.

22. PREPARATION OF CONSOLIDATED SOFP

- When preparing the consolidated SOFP, assets and outside liabilities of the subsidiary company are merged with those of the holding company.
- Equity share capital and other equity of the subsidiary company are apportioned between parent company and non–controlling interests.
- These items, along with investments of parent company in shares of subsidiary company are not separately shown in consolidated SOFP.
- The net amounts resulting from various computations on these items, shown as
  - (a) non - controlling interest
  - (b) Goodwill or gain on bargain purchase
  - (c) holding company's share in post-acquisition profits of the subsidiary company (added to appropriate concerned account of the holding company) are entered in consolidated SOFP.
- As per IFRS 10, if an entity makes two or more investments in another enterprise at different dates and eventually obtain control of the other enterprise the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence.

PROBLEM : 3

Black Co acquired 100% shares in White Co on 31 December 2015. SOFP of Black and White On that date were

		Black Co		White Co
Non-current assets				
Tangible assets		**60,000**		**35,000**
Investments: Shares of White Co (100% shares in white)		**30,000**		
Loan stock of White Co		**5,000**		
Current assets				

Inventories	10,000		8,000	
Receivables	8,000		9,000	
Cash at bank	4,000	22 ,000	-	17,000
Total assets		117,000		52,000
EQUITY AND LIABILITIES				
Equity				
Ordinary shares	73,000		16,000	
Retained earnings	30,000	103,000	12,500	28,500
Non-current liabilities				
Loan stock	-			10,000
Current liabilities				
Bank overdraft	-		3,000	
Payables	14,000	14,000	10,500	13,500
Total liabilities		117,000		52,000

Prepare Consolidated SOFP.

PROBLEM : 4

Preparation of Consolidated Financial Statements

Given below are SOFP of P Ltd and Q Ltd as on 31.3.20X1: ***(` in lakhs)***

SOFPs	P Ltd.	Q Ltd.
Assets		
Non-current Assets		
Property Plant Equipment	1,07,000	44,000
Financial Assets:		
Non-Current Investments	5,000	1,000
Loans	10,000	
Current Assets		
Inventories	20,000	10,000
Financial Assets:		
Trade Receivables	8,000	10,000
Cash and Cash Equivalents	38,000	1,000
Total Assets	1,88,000	66,000
Equity and Liabilities		
Shareholders Fund		
Share Capital	20,000	10,000
Other equity	1,20,000	40,000
Non-current Liabilities		
Financial liabilities:		
Long term liabilities	30,000	10,000
Deferred tax liabilities	5,000	1,000
Long term provisions	5,000	1,000
Current Liabilities		
Financial liabilities:		
Trade Payables	6,000	2,000
Short term Provisions	2,000	2,000
Total Equity & Liabilities	1,88,000	66,000
Notes to Financial Statements	P ltd	Q ltd
Reserve & Surplus		
General Reserve	1,00,000	30,000
Retained earnings	20,000	10,000
	1,20,000	40,000

Inventories		
Raw Material	**10,000**	**5,000**
Finished Goods	**10,000**	**5,000**
	20,000	**10,000**

On 1.4.20X1, P Ltd acquired 70% of equity shares (700 lakhs out of 1000 lakhs shares) of Q Ltd. at ` 36,000 lakhs. The company has adopted an accounting policy to measure Non-controlling interest at fair value (quoted market price) applying IFRS 3. Accordingly, the company computed full goodwill on the date of acquisition. Shares of both the companies are of face value Rs 10 each. Market price per share of Q Ltd. as on 1.4.20X1 is Rs 55. Entire long term borrowings of Q Ltd. is from P Ltd. The fair value of net identifiable assets is at Rs 50,000 lakhs.

Prepare consolidated SOFP as on 1.4.20X1.

23. ACCOUNTING POLICIES

The consolidated financial statement shall be prepared using uniform accounting policies. Accordingly if a component of the group applies different accounting policy other than groups accounting policy for like transactions and other events, then adjustments are made to reflect uniformity.

PROBLEM : 5

PQR Ltd. is the subsidiary company of MNC Ltd. In the standalone financial statements prepared in accordance with IFRS, PQR Ltd. has adopted Straight-line method (SLM) of depreciation and MNC Ltd. has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per IFRS 10, Consolidated Financial Statements, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd.?

SOLUTION : 5

As per IAS 16, 'Property, Plant and Equipment', a change in the method of depreciation shall be accounted for as a change in an accounting estimate as per IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

Therefore, the selection of the method of depreciation is an accounting estimate and not an accounting policy.

The entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the standalone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

24. DIFFERNECE IN REPORTING DATES

The consolidated financial statement shall be prepared on same reporting dates.

If the subsidiary's reporting period is different from that of parent, then adjustments for significant events and transaction between the two dates shall be made.

In any case the difference between the reporting periods shall not exceed three months.

25. INTRAGROUP TRANSACTIONS

In order to present financial statements for the group in a consolidated format, the effect of transactions between group enterprises should be eliminated.

Intra - group balances and intra - group transactions and resulting unrealized profits should be eliminated in full.

Unrealized losses resulting from intra - group transactions should also be eliminated unless cost cannot be recovered**.**

Liabilities due to one group enterprise by another will be set off against the corresponding asset in the other group enterprise's financial statements.

Sales made by one group enterprise to another should be excluded both from turnover and from cost of sales or the appropriate expense heading in the consolidated statement of profit and loss.

To the extent that the buying enterprise has further sold the goods in question to a third party, the eliminations to sales and cost of sales are all that is required, and no adjustments to consolidated profit or loss for the period, or to net assets, are needed.

However, to the extent that the goods in question are still on hand at year end, they may be carried at an amount that is in excess of cost to the group and the amount of the intra-group profit must be eliminated, and assets are reduced to cost to the group.

For transactions between group enterprises, unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and tangible fixed assets, are eliminated in full. The requirement to eliminate such profits in full applies to the transactions of all subsidiaries that are consolidated – even those in which the group's interest is less than 100%.

26. UNREALISED PROFIT IN INVENTORIES:

Where a group enterprise sells goods to another, the selling enterprise, as a separate legal enterprise, records profits made on those sales. If these goods are still held in inventory by the buying enterprise at the year end, however, the profit recorded by the selling enterprise, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group. On consolidation, the unrealized profit on closing inventories will be eliminated from the group's profit, and the closing inventories of the group will be recorded at cost to the group.

Here, the point to be noted is that one has to see whether the intragroup transaction is "upstream" or "down-stream".

1. **Upstream transaction** is a transaction in which the subsidiary company sells goods to holding company.

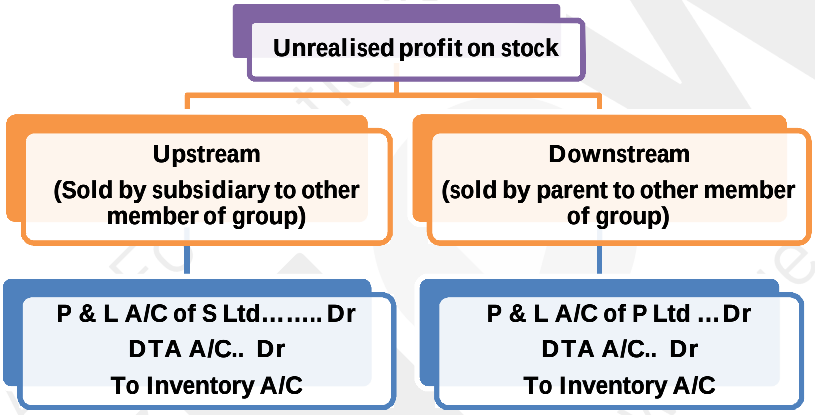
   In the case of upstream transaction, goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the NCI. In such a transaction, if some goods remain unsold at the reporting date, the unrealized profit on such goods should be eliminated from NCI as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold Inventory.

2. While in the **downstream transaction** holding company is the seller and subsidiary company is the buyer.

   In the case of downstream transaction, the whole profit is earned by the holding company, therefore whole unrealized profit should be adjusted from unsold inventory account and consolidated profit and loss account, irrespective of the percentage of the shares held by the parent

   Unrealised losses:

   Unrealised losses resulting from intra-group transactions that are deducted in arriving at the carrying amount of assets are also eliminated **unless cost cannot be recovered.**



• IMPORTANT POINTS

- **P & L A/c of parent will be adjusted in Retained earnings of the group.**
- **If statement of Profit is also prepared then unrealized profit will be adjusted in cost of sales (change in stock).**
- **Elimination of sale and purchase transaction will be done as usual in CPL. Elimination for sale and purchase will be done even if there is no closing stock held on date of consolidation.**
- **Unrealised profit will be adjusted only for transaction made in post-acquisition period.**
- **Deferred tax calculation on unrealized profit should also be made.**

PROBLEM : 6 **Elimination of intra-group profit on sale of assets by a subsidiary to its parent**

A parent owns 60% of a subsidiary. The subsidiary sells some inventory to the parent for Rs 35,000 and makes a profit of Rs 15,000 on the sale. The inventory is in the parent's SOFP at the year end.

SOLUTION : 6

The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's SOFP at Rs 20,000 (35,000 - 15,000). The consolidated income statement will show a corresponding reduction in profit of Rs 15,000.

The double entry on consolidation is as follows:

		`'000	`'000
Revenue A/c	Dr		
To Cost of sales A/c			
To Inventory A/c			

The reduction of group profit of Rs15, 000 is allocated between the parent company and non-controlling interest in the ratio of their interests – 60% and 40%.

PROBLEM : 7 **Elimination of intra-group profit on sale of assets by a parent to its subsidiary**

In the above illustration, assume that it is the parent that makes the sale. The parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for Rs 35,000 and makes a profit of Rs 15,000 on the sale. The inventory is in the subsidiary's SOFP at the year end.

SOLUTION : 7

The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's SOFP at Rs 20,000. (35,000 – 15,000). The consolidated income statement will show a corresponding reduction in profit of Rs 15,000.

The double entry on consolidation is follows:

		`'000	`'000
Revenue A / c	Dr		
To Cost of sales A / c			
To Inventory A / c			

In this case, since it is the parent that has made the sale, the reduction in profit of Rs 15,000 is allocated entirely to the parent company.

PROBLEM : 8 Inventories of subsidiary out of purchases from the parent

A Ltd, a parent company sold goods costing Rs 200 lakh to its 80% subsidiary B Ltd. at Rs 240 lakh.

50% of these goods are lying at its stock. B Ltd. has measured this inventory at cost i.e. at Rs 120 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

SOLUTION : 8

PROBLEM : 9 Inventories of the parent out of purchase from subsidiary

Ram Ltd., a parent company purchased goods costing Rs 100 lakh from its 80% subsidiary Shyam Ltd. at Rs 120 lakh. 50% of these goods are lying at the godown. Ram Ltd. has measured this inventory at cost i.e. at Rs 60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

SOLUTION : 9

27. UNREALISED PROFIT ON TRANSFER OF NON-CURRENT ASSET:

Similar to the treatment described above for unrealized profits in inventories, unrealized intercompany profits arising from intra-group transfers of fixed assets are also eliminated from the consolidated financial statements.

Case 1 – Sale by parent to subsidiary

Step 1 – Eliminate unrealised rofit from fixed assets.

Group Total Retained Earnings A / C ……..Dr
To Group Fixed Assets A / C

Step 2 – Eliminate Additional Depreciation

Group Fixed Assets A / C …….Dr
To Group Total Retained Earnings A / C
To Non-Controliing Interest (NCI's Share)

Note – If fixed assets are sold at a loss, the entries will be reverse of the above.

Case 2 – Sale by subsidiary to Parent

Step 1 – Eliminate unrealised profit from fixed assets.

Group Total Retained Earnings A / C …….. Dr
Non-Controlling Interest A / C (NCI Share)….Dr
To Group Fixed Assets A / C

Step 2 – Eliminate Additional Depreciation

Group Fixed Assets A / C …….Dr
To Group Total Retained Earnings A / C

Note – If fixed assets are sold at a loss, the entries will be reverse of the above.

If Subsidiary is fully owned, there will be no non-controlling interest.

28. ACCOUNTING FOR TEMPORARY DIFFERENCE DUE TO ADJUSTMENT FOR UNREALIZED PROFIT ON INTRA-GROUP SALE OF FIXED ASSETS

The tax effect on elimination of profit on intra group sale of asset must also be considered.

A temporary deductible difference has arisen because the tax base of asset is higher than its carrying amount.

The future taxable profit are lower than the consolidated accounting profit because the unrealized profit has already been recognized for tax purpose.

A DTA is recognized by passing following entry.

Deferred Tax Asset A/c .....Dr

To Group Total Retained Earnings A/C (Adjust in the profit of seller)

In the subsequent years, the entity depreciates its Fixed assets and deducts the depreciation from the taxable income. Following entry is made to unwind the DTA

Group Total Retained Earnings A/C..........Dr (Adjust in profit of buyer)

To Deferred Tax Asset A/c

29. DIVIDEND RECEIVED FROM SUBSIDIARY COMPANIES

As per IFRS 9, dividends are recognized by an investor entity only when:

- The entity's right to receive payment of the dividend is established;
- It is probable that the economic benefits associated with the dividend will flow to the entity; and
- the amount of the dividend can be measured reliably.

As per IAS 27, an entity shall recognize a dividend from a subsidiary in its separate financial statements when its right to receive the dividend is established.

The entity's right to receive the dividend is established when it is declared by the shareholders in the annual general meeting of the Company.

PROBLEM : 10

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for Rs 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was Rs 1,00,000 and the balance in the statement of Profit & Loss was Rs 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of 20,000 and at the same time, declared and paid a dividend of 30,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

SOLUTION : 10

XYZ Ltd.'s share of dividend = 30,000 x 80% = 24,000

		Rs.	Rs.
Bank A/c	Dr.	24,000	
To Profit & Loss A/c			24,000

Note: Dividend will be recognized only when approval by the shareholder is received in the annual general meeting.

30. TREATMENT OF DIVIDEND IN CFS

1. Addback dividend and dividend distribution tax in statement of Net Assets since it is an uneven item.
2. Apply time adjustment, if any.
3. Deduct dividend from parent's profit and loss account and NCI in SOCIE.
4. Deduct dividend distribution tax from parent's retained earnings and NCI in SOCIE.
5. Dividend should be deducted to the extent of parent and NCI share.

31. REVALUATION / CHANGE IN FAIR VALUE OF IDENTIFIED NET ASSETS (INA)

Whenever fair value of INA is different from book values of such assets, then

- effect of revaluation on date of acquisition should be considered.
- Effect of deferred tax arising on such deferred tax should also be considered on date of acquisition.
- Post acquisition profits and net assets should be adjusted with any consequential effects of revaluation, e.g.,
  - ☑ if PPE is revalued, then, additional depreciation or saving in depreciation (net of tax) should be considered.
  - ☑ If inventory is revalued, the COGS should be adjusted (net of tax), if such inventory has been sold suring the post-acquisition period.

Consolidated SOFP should reflect above effects.

32. PREPARATION OF CONSOLIDATED PROFIT & LOSS

All the revenue items are to be added on line by line basis and from the consolidated revenue items inter-company transactions should be eliminated.

For example, a holding company may sell goods or services to its subsidiary, receives consultancy fees, commission, royalty etc. These items are included in sales and other income of the holding company and in the expense items of the subsidiary. Alternatively, the subsidiary may also sell goods or services to the holding company. These inter-company transactions are to be eliminated in full.

If there remains any unrealized profit in the inventory of good, of any of the group company, such unrealized profit is to be eliminated from the value of inventory to arrive at the consolidated profit.

IMPORTANT POINTS

P & L Account will be consolidated from the date of acquisition till date of consolidation.

Contra sales and purchase cancellation will be required even if there is no unrealized profit on stock.

Tax expense should be adjusted for any tax effect of unrealized profit.

Dividend received within the group will be cancelled.

Consolidated Profit and Loss A/c will include effects of impairment of goodwill, additional savings in depreciation due to revaluation and tax effects.

NCI should be calculated based on subsidiary's profit after adjusting .

- **unrealized profit in case of upstream transaction.**
- **Additional depreciation on revaluation.**
- **Impairment of goodwill when full goodwill has been calculated (i.e., NCI is based on fair value method).**

33. PREPARATION OF CONSOLIDATED CASH FLOWS

All the items of cash flow from operating activities and financing activities are to be added on line by line basis and from the consolidated items, inter – company transactions should be eliminated.

34. LOSS OF CONTROL

A parent can lose control on subsidiary with or without change in the ownership interest.

For example, the existence of potential voting rights exercisable by another investor which transfers the ability to govern the financial and operating policies of the subsidiary.

However changes in ownership interests that do not result in loss of control shall be accounted for as equity transactions.

35. ACCOUNTING FOR LOSS OF CONTROL

- On loss of control, since the entity does not any more control the economic resources of the former subsidiary, it shall derecognize the assets and liabilities of the former subsidiaryat its carrying amount on the date of loss of control.
- The non-controlling interests which were presented in equity shall be derecognized at their carrying amount on the date of loss of control including their share on the components of equity attributable from the date of acquisition.
- Any consideration received in the transaction resulting in loss of control shall be accounted at fair value.
- During this entire process of accounting for loss of control, the resulting difference shall be recognised as gain or loss inprofit or loss.

Any investments of former subsidiary retained after loss of control shall be stated at fair values. This fair value shall be the cost of the investment when the loss of control results in either interest in associate or joint venture.

36. DETERMINING WHETHER AN ENTITY IS AN INVESTMENT ENTITY

A parent shall determine whether it is an investment entity. An investment entity is an entity that:

- Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services
- Commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both
- Measures and evaluates the performance of substantially all of its investments on a fair value basis

37. INVESTMENT ENTITIES: EXCEPTION TO CONSOLIDATION

Investment entities are exempted from consolidation requirements of this standard. Such entities shall measure investments in subsidiaries at fair value through profit or loss in accordance with IFRS 9.

38. MAJOR CHANGE IN IND AS 10 VIS-A-VIS IFRS 10 NOT RESULTING IN CARVE OUT

Investment Properties:IFRS 10 requires all investments to be measured at fair value to qualify for the exemption from consolidation available to an investment entity. Ind AS 40 'Investment Properties' requires all investment properties to be measured at cost initially and cost less depreciation subsequently. Accordingly, the relevant paragraph of IFRS 10 has been deleted in IFRS 10 as investment property measured at fair value is not relevant in the Indian context.

CONSOLIDATED FINANCIAL STATEMENTS - QUESTIONS

PROBLEM : 11

On 1 April 2016 Police Co acquired 60% share in Soldier Co. On 1 July 2016 Soldier Co sold non-current assets worth Rs. 40,000 to Police Co for Rs. 60,000. Police Co charges depreciation at 20% p.a. The unrealised profit on the sale of non-current assets creates temporary differences. The tax rate applicable to both entities is 20%. The fair value of the non-controlling interest at the date of acquisition is Rs. 40,000.

SOPL of Police Co and Soldier Co for the year to 31 December 2016 are

	Police Co Rs.	Soldier Co Rs.
Turnover	240,000	115,000
Cost of sales	120,000	55 000
Gross profit	120,000	60,000
Other income		20,000
	120,000	80,000
Administrative expenses (including depreciation)	35,000	22,500
Profit before taxation	85,000	57,500
Taxation	12 000	9,000
Profit after taxation	73,000	48,500
Brought forward reserves	25,000	14,000
Carried Forward reserves	**98 000**	**62,500**

The SOFP of Police Co and Soldier Co as at 31 December 2016 are

	Police Co.		Soldier Co	
	Rs.	Rs.	Rs.	Rs.
Assets				
Non-current assets				
Tangible assets		1,23,000		75,000
Investments Shares in soldier Co.		60,000		
Current assets				
Inventories	29,000		39,000	
Receivables	25,000		20,000	
Others	7,500		18,500	
		61,500		77,500
Total assets		2,44,500		1,52,500
Equity and liabilities				
Capital and reserves				
Ordinary shares	1,25,000		75,000	
Retained earnings	98,000		62,500	
		223,000		1,37,500
Current liabilities				
Payables	21,500		15,000	
		21,500		15,000
Total liabilities		**244,500**		**1,52,500**

Required:

Prepare consolidated financial statements for the group as at 31 December 2016

PROBLEM : 12

1 January 2016 Precocious Ltd. acquired 75% share in Sugary Ltd.

On 1 January 2016 Precocious Ltd. also advanced a loan of Rs. 30,000 to Sugary Ltd. The loans payable of Sugary Ltd. is Rs. 25,000.

The interest received by Precocious from Sugary Ltd. is Rs. 2,500 while the interest paid by Sugary Ltd. is Rs. 3,000 The fair value of the non-controlling interest at the date of acquisition is Rs.10,000.

SOPL of Precocious Inc and Sugary Ltd. for the year to 31 December 2016

	Precocious Rs.	Sugary Rs.
Turnover	250,000	95,000
Cost of sales	120,000	52,500
Gross profit	**130,000**	**42,500**
Other income (interest received)	2,500	
	132,500	**42,500**
Administrative expenses (including interest paid) **Profit before taxation**	45,000	(22,000
	87,500	**20,500**
Taxation	15,000	9,000)

Profit after taxation	**72,500**	**11,500**
Brought forward reserves	2,500	
Carried forward reserves	**75,000**	**11,500**

The SOFP of Precocious Inc and Sugary Ltd. as at 31 December 2016 are

	Precocious		Sugary	
	Rs.	**Rs.**	**Rs.**	**Rs.**
Assets				
Non-current assets				
Tangible assets		1,64,000		65,000
Investments: Shares in Sugary Ltd.		30,000		
Current assets				
Inventories	20,000		10,000	
Receivables	12,000		12,000	
Loans given	30,000		-	
		62,000		22,000
Total assets		256,000		87,000
Equity and liabilities				
Capital and reserves				
Ordinary shares	1,50,000		40,000	
Retained earnings	75,000		11,500	
		2,25,000		51,000
Current liabilities				
Payables	31,000		10,500	
Loans payable	-		25,000	
		31,000		35,000
Total liabilities		256,000		87,000

Required :

Prepare consolidated financial statements of Precocious group as at 31 December 2016

PROBLEM : 13

Patient Ltd acquired 55% shares in Smart Ltd on 1st January 2016. The retained earnings on the date of acquisition were nil. The fair value of the non-controlling interest on the date of acquisition was Rs. 21,500.

The SOFP of Patient Ltd and Smart Ltd as on 31st December 2016 are

	Patient Inc		Smart Co	
	Rs.	**Rs.**	**Rs.**	**Rs.**
Assets				
Non-current assets				
Tangible assets				
Land			10,000	
Property, plant and equipment	33,000	33,000	15,000	25,000
Investments: Shares in Smart Co		27,000		
Current assets				
Inventories	10,000		9,000	
Others	4,500	14,500	13,000	22,000
Total assets		**74500**		**47,000**
Equity and liabilities				
Equity				
Ordinary shares	42,000		25,000	
Retained earnings	18,500	60,500	17,000	42,000
Current liabilities				
Payables	14,000	14,000	5,000	5,000
Total equity and liabilities		**74,500**		**47,000**

The directors of Patient Inc carried out a fair value exercise on the net assets of Smart Co on the date of acquisition. The following matters arose from the exercise:

1. On the date of acquisition, the fair value of Smart Co's land was Rs. 5,000 more than its carrying amount and that of its plant was Rs.10,000 more than its carrying amount of Rs. 5,000. Smart Co charges depreciation at 10% (straight line method).
2. On 1st January 2016, Smart Ltd had a brand name that was protected legally but was not included in the SOFP because it did not meet recognition criteria. The directors of Patient Ltd considered that the brand had a market value of Rs 4,000 on 1st January 2016 and that it would give competitive advantage for 5 years from that date.

Required:

Prepare the consolidated financial statements for the group.

PROBLEM : 14 Sale of a 20% interest in a wholly- owned subsidiary

Entity P sells a 20% interest in a wholly- owned subsidiary to outside investors for Rs 100 lakh in cash. The carrying value of the subsidiary's net assets is Rs300 lakh, including goodwill of Rs 65 lakh from the subsidiary's initial acquisition.

Pass journal entries to record the transaction.

PROBLEM : 15

Entity A acquired 60% of entity B two years ago for 6,000. At the time entity B's fair value was Rs 10,000. It had net assets with a fair value of Rs 6,000 (which for the purposes of this example was the same as book value). Goodwill of Rs 2,400 was recorded (being 6,000 – (60% * 6,000).

On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is Rs20,000 and entity A pays Rs4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is Rs 12,000 and the carrying amount of the non- controlling interest is Rs4,000.

Pass journal entries to record the transaction.

PROBLEM : 16

A Ltd. acquired 10% additional **shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of SOFP finalized as on 1.4. 20X0:**

	Rs in thousand
Separate financial statements	**As on 31.3.20X0**
Investment in subsidiary (70% interest) – at cost	**14,000**
Purchase price for additional 10% interest	**2,600**
Consolidated financial statements	
Non-controlling interest (30%)	**6,600**
Consolidated profit & loss account balance	**2,000**
Goodwill	**600**

The reporting date of the subsidiary and the parent is 31 March, 20X0. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

PROBLEM : 17

A Ltd. acquired 70% of shares of B ltd. On 1.4.20X0 when fair value of net assets of B Ltd. was Rs 200 lakh. During 2010-2011, B ltd. made profit of Rs100 lakhs. Stand-alone and consolidated SOFPs as on 31.3. 2011 are as follows:

(Rs in lakhs)

	A	**B**	**Group**
Assets			
Goodwill			10
PPE	627	200	827
Financial Assets:			
Investments	150		
Cash	200	30	230
Other Current Assets	23	70	93
	1,000	**300**	**1,160**
Equity and Liabilities			
Share Capital	200	100	200
Other Equity	800	200	870
Non-controlling interest			90
	1,000	**300**	**1,160**
Notes:			
Profit for the year		100	

As on 1.4. 20X1			
Purchase Consideration	150		
30% Non-controlling Interest	60		
	210		
Fair Value of net assets	200		
Goodwill	10		
Now A ltd. purchases another 10% stake in B ltd which reduces non-controlling interest to 20%	32		
Proportionate carrying amount of non-controlling interest	30		

A ltd. acquired another 10% stake in B ltd on 1.4. 2010 at Rs 32 lakh. The proportionate carrying amount of the non-controlling interest is Rs 30 lakh. Show the stand alone and consolidated SOFP of the group immediately after the change in non-controlling interest.

PROBLEM : 18 REDUCE INTEREST IN SUBSIDIARY

Amla Ltd. purchase a 100% subsidiary for Rs 10,00,000 at the end of 2011 when the fair value of the subsidiary's net asset was Rs 8,00,000.

The parent sold 40% of its investment in the subsidiary in March 2014 to outside investors for Rs 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is Rs 18,00,000 (including net assets of Rs 16,00,000 & goodwill of Rs 2,00,000).

Calculate gain or loss on sale of interest in subsidiary as on 31st March 20X4.

PROBLEM 19 :

Subsidiary issues shares to a third party and parent loses control

In March 2011 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is Rs20,000 at March 2011 calculated using the partial goodwill method. On 31 March 2011, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at Rs 12 per share, raising Rs 3,00,000. The net assets of the subsidiary in the consolidated SOFP prior to the option's exercise were Rs 4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder.

PROBLEM 20 : Calculation of gain on outright sale of subsidiary

A parent purchased an 80% interest in a subsidiary for Rs1,60,000 on 1 April 2011 when the fair value of the subsidiary's net assets was Rs 1,75,000. Goodwill of Rs 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs 8,000 was charged in the consolidated financial statements to 31 March 2013. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 2014 for Rs 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was Rs 2,25,000 (not including goodwill of Rs12,000). When the subsidiary met the criteria to be classified as held for sale under IFRS 5, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary at cost, as permitted by IAS 27.

Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 2014.

PROBLEM 21 : Partial disposal where subsidiary becomes an associate

AT Ltd. purchased a 100% subsidiary for Rs 50,00,000 on 31st March 2011 when the fair value of the BT Ltd. whose net assets was Rs 40,00,000. Therefore, goodwill is Rs10,00,000. The AT Ltd. sold 60% of its investment in BT Ltd. on 31st March 2013 for Rs 67,50,000, leaving the AT Ltd. with 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd., excluding goodwill is Rs 80,00,000. Assume the fair value of the investment in associate BT Ltd. retained is proportionate to the fair value of the 60% sold, that is Rs45,00,000.

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd's separate and consolidated financial statements as on 31st March 20X3.

PROBLEM 22 : Partial disposal where 10% investment in former subsidiary is retained.

The facts of this example as same as example 25, except that the group AT Ltd. disposes of a 90% interest for Rs 85,50,000, leaving the AT Ltd. with a 10% investment. The fair value of the remaining interest is Rs 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold).

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 2011.

PROBLEM : 23

DEF Ltd. acquired 100% ordinary shares of Rs. 100 each of XYZ Ltd. on 1st October 2011. On March 31, March 2012 the summarised SOFPs of the two companies were as given below:

	DEF Ltd.	XYZ Ltd.
Assets		
Property Plant Equipment		
Land & Buildings	15,00,000	18,00,000
Plant & Machinery	24,00,000	13,50,000
Investment in XYZ Ltd.	34,00,000	-
Inventory	12,00,000	3,64,000
Financial Assets		
Trade Receivable	5,98,000	4,00,000
Cash	1,45,000	80,000
Total	**92,43,000**	**39,94,000**
Equities & Liabilities		
Equity Capital (Shares of Rs 100 each fully paid)	50,00,000	20,00,000
Other Equity		
Other reserves	24,00,000	10,00,000
Retained Earnings	5,72,000	8,20,000
Financial Liabilities		
Bank Overdraft	8,00,000	-
Trade Payable	4,71,000	1,74,000
Total	**92,43,000**	**39,94,000**

The retained earnings of XYZ Ltd. showed a credit balance of Rs 3,00,000 on 1st April 2011 out of which a dividend of 10% was paid on 1st November; DEF Ltd. has credited the dividend received to retained earnings account; Fair Value of P& M as on 1st October 2011 was Rs 20,00,000. The rate of depreciation on plant & machinery is 10%.

Following are the changes in Fair value as per respective IFRS from Book value as on 1st October 2011 which is to be considered while consolidating the SOFPs

Liabilities	Amount	Assets	Amount
Trade Payable	1,00,000	Land & Building	10,00,000
		Inventories	1,50,000

Prepare consolidated SOFP as on March 31, 2012.

PROBLEM : 24

On 31 March 2012, Blue Heavens Ltd. acquired 100% ordinary shares carrying voting rights of Orange County Ltd. for Rs. 6,000 lakh in cash and it controlled Orange County Ltd. from that date. The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. statement of financial position were:

	Blue Heavens Ltd	Orange County Ltd	
	Carrying Amount Rs (Lakh)	Carrying Amount Rs (Lakh)	Fair Value Rs (Lakh)
Assets			
Non-current Assets			
Building and other PPE	7,000	3,000	3,300
Investment in Orange County Ltd.	6,000		
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
Total assets	**15,500**	**4,450**	
Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
Current liabilities			
Trade payables	300	150	150
Total liabilities and equity	**15,500**	**4,450**	

Prepare the Consolidated SOFP as on March 31,2012 of group of entities Blue Heavens Ltd. and Orange County Ltd.

PROBLEM : 25

The facts are the same as in Question above. However, Blue Heavens Ltd. acquires only 75% of the ordinary shares, to which voting rights are attached of Orange County Ltd. Blue Heavens Ltd. pays Rs 4,500 lakhs for the shares. Prepare the Consolidated SOFP as on March 31, 2012 of group of entities Blue Heavens Ltd. and Orange County Ltd.

PROBLEM : 26

Facts are same as in Question above, Blue Heavens Ltd. acquires 75% of Orange County Ltd. Blue Heavens Ltd. pays Rs 4,500 lakhs for the shares. At 31 March 2013 i.e one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd Carrying Amount Rs (Lakh)	Orange County Ltd Carrying Amount Rs (Lakh)
Assets		
Non-current Assets		
Building and other PPE	6,500	2,750
Investment in Orange County Ltd.	4,500	
	11,000	2,750
Current assets		
Inventories	800	550
Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
Current liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of comprehensive income for the year ended 31 March 2013 :

	Blue Heavens Ltd Carrying Amount Rs (Lakh)	Orange County Ltd Carrying Amount Rs (Lakh)
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Gross profit	**1,200**	**900**
Administrative expenses	(400)	(350)
Profit for the year	**800**	**550**

Note: Blue Heavens Ltd. is unable to make a reliable estimate of the useful life of goodwill and consequently, the useful life is presumed to be ten years. Blue Heavens Ltd. uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31st March 2012 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31st March was sold during 2013.

Prepare the Consolidated SOFP as on March 31st, 2003 of group of entities Blue Heavens Ltd. and Orange County Ltd.

PROBLEM : 27

P Ltd acquired 80% of the share capital of S Ltd two years ago, when the reserves of S Ltd stood at Rs 125,000. P Ltd paid initial cash consideration of Rs 1 million. Additionally P Ltd issued 200,000 shares with a nominal value of Rs 1 and a current market value of Rs 1.80. It was also agreed that P Ltd would pay a further Rs. 5,00,000 in three years' time. Current interest rates are 10% pa. The appropriate discount factor for Rs.1 receivable three years from now is 0.751. The shares and deferred consideration have not yet been recorded.

Below are the SOFP of P Ltd and S Ltd as at 31st December 2014:

	P Ltd Rs 000	S Ltd Rs 000
Non-current Assets		
Property, plant & equipment	5,500	1,500
Investment in S Ltd at cost	1,000	
Current assets		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Equity		
Share capital	2,000	500
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

Further information:

(i) At acquisition the fair values of S Ltd plant exceeded its book value by Rs 200,000. The plant had a remaining useful life of five years at this date.

(ii) For many years S Ltd has been selling some of its products under the brand name of 'M Ltd'. At the date of acquisition the directors of P Ltd valued this brand at Rs 250,000 with a remaining life of 10 years. The brand is not included in S Ltd SOFP

(iii) The consolidated goodwill has been impaired by Rs. 280,000.

(iv) The P Ltd Group values the non-controlling interest using the fair value method. At the date of acquisition the fair value of the 20% non-controlling interest was Rs. 380,000.

Prepare the consolidated SOFP as at 31st December 2014.

PROBLEM : 28 **SOFP of P and S as at 30 June 2018 are given below:**

	P - Rs	S - Rs
Non-current assets:		
Land [Note – (iii)]	4,500	2,500
Plant & equipment [Note – (iii)]	2,400	1,750
Investments [Note – (i)]	8,000	0
	14,900	4,250
Current assets		
Inventory	3,200	900
Receivables [Note – (ii)]	1,400	650
Bank [Note – (ii)]	600	150
	5,200	1,700
	20,100	5,950
Ordinary share capital 50p	5,000	1,000
Retained earnings	8,300	3,150
Non-current liabilities:	13,300	4,150
8% loan Stock [Note – (i)]	4,000	500
Current liabilities [Note – (ii)]	2,800	1,300
	20,100	5,950

(i) P acquired 75% of S on 1 July 2015 when the balance on S retained earnings was Rs 1,150. P paid Rs 3,500 for its investment in the share capital of S. At the same time, P invested in 60% of S 8% loan stock.

(ii) At the reporting date P recorded a payáble to S of Rs 400. This did not agree to the corresponding amount in S financial statements of Rs 500. The difference is explained as cash in transit.

(iii) At the date of acquisition it was determined that S land, carried at cost of 2,500 of had a fair value, of Rs 3,750 S plant was determined to have a fair value of Rs 500 in excess of its carrying amount and had a remaining life of 5 years at this time. These values had not been recorded by S.

(iv) The P group uses the fair value method to value the non-controlling interest. For this purpose the subsidiary share price at the date of acquisition should be used. The subsidiary share price at acquisition was Rs 2.20 per share.

(v) Goodwill has impaired by Rs 100.

Required:

Prepare the consolidated SOFP of the P group as at 30 June 2018.

PROBLEM : 29 **SOFP of P Ltd and S Ltd as at 31.3.2018 is given below : (Rs. In Lacs)**

Particulars	P. Ltd	S. Ltd
PPE	10	8
Investment in S Ltd	9	-
Current Assets :		
Inventory	6	4
Other Current Assets	2	2
Total	**27**	**14**
Equity and Liabilities :		
Share Capital	15	5
Reserves	5	5
Non-Current Liabilities	3	2
Current Laibilities	4	2
Total	**27**	**14**

P Ltd. acquired 80% shares of S Ltd. on 31.3.2018. Prepare Consolidated SOFP..

PROBLEM : 30

On 1st May 2017 K bought 60% of S paying Rs 76,000 cash. The summarised SOFP for the two companies as at 30th November 2017 are:

	K Rs	S Rs
Non-current assets:		
Property, plant & equipment	138,000	115,000
Investment	98,000	-
Current assets		
Inventory	15,000	17,000
Receivables	19,000	20,000
Cash	2,000	-
	272,000	152,000
share capital	50,000	40,000
Retained earnings	189,000	69,000
Non-current liabilities:	239,000	109,000
8% loan Stock	-	20,000
Current liabilities	33,000	23,000
	272,000	**152,000**

The Following information is relevant:

(i) The inventory K includes Rs 8,000 of goods purchased for cash from S at cost plus 25%

(ii) On 1 June 2017 K transferred an item of plant to S for Rs.15,000. Its carrying amount at at date was Rs 10,000. The asset had a remaining useful economic life of 5 years.

(iii) The K Group values the non-controlling interest using the fair value method. At the date of acquisition the fair value of the 40% non-controlling interest was Rs. 50,000.

(iv) An impairment loss of Rs 1,000 is to be charged against goodwill at the year-end.

(v) S earned a profit of Rs 9,000 in the year ended 30 November 2017.

(vi) The loan note in S books represents monies borrowed from K on 30 November 2017.

(vii) Included in K receivables is Rs 4,000 relating to inventory sold to S during the year. S raised a cheque for Rs 2,500 and sent it to K on 29 November 2017. K did not receive this cheque until 4 December 2017.

Required:

Prepare the consolidated SOFP as at 30 November 2017.

PROBLEM : 31

Set out below are the draft statements of profit or loss of P and its subsidiary company S for the year ended 31 December 2017.

On 1 January 2016 P purchased 75,000 ordinary shares in S from an issued share capital of 100,000 Rs 1 ordinary shares.

Statements of profit or loss for the year ended 31 December 2017

	P Rs 000	S Rs 000
Revenue	600	300
Cost of sales	(360)	(140)
Gross profit	240	160
Operating expenses	(93)	(45)
Profit from operations	147	115
Finance costs		(3)
Profit before tax	147	112
Tax	(50)	(32)
Profit for the year	97	80

The following additional information is relevant:

(i) During the year S sold goods to P for Rs 20,000 making a mark-up of one third. Only 20% of these goods were sold before the end of the year, the rest were still in inventory.

(ii) Goodwill has been subject to an impairment review at the end of each year since acquisition and the review at the end of this year revealed another impairment of The current impairment is to be recognised as an operating cost.

(iii) At the date of acquisition a fair value adjustment was made and this has resulted in an additional depreciation charge for the current year of Rs 15,000. It is group policy that all depreciation is charged to cost of sales.

(iv) P values the non-controlling interests using the fair value method.

Prepare the consolidated statement of profit or loss for the year ended 31 December 2017.

PROBLEM : 32

P acquired 70% of S three years ago, when S retained earnings were Rs 430,000.

The Financial Statements of each company for the year ended 31 March 2017 are as follows:

SOFP as at 31 March 2017

	P Rs 000	S Rs 000
Non-current assets		
Property, plant and equipment	900	400
Investment in S at cost	700	-
Current assets	300	600
Total	**1,900**	**1,000**
Share capital (Re 1)	200	150
Share premium	50	-
Retained earnings	1,350	700
	1,600	850
Non-current liabilities	100	90
Current liabilities	200	60
Total	**1,900**	**1,000**

Statements of profit or loss for the year ended 31 March 2017

	P Rs 000	S Rs 000
Revenue	1,000	260
Cost of sales	(750)	(80)
Gross profit	250	180
Operating expenses	(60)	(35)
Profit from operations	190	145
Financial Costs	(25)	(15)
Investment income	20	-
Profit before tax	180	130
Tax	(100)	(30)
Profit for the year	85	100

You are provided with the following additional information:

(i) S had plant in its SOFP at the date of acquisition with a carrying amount of Rs 100,000 but a fair value of Rs 120,000. The plant had a remaining life of 10 years at acquisition. Depreciation is charged to cost of sales.

(ii) The P group values the non-controlling interests at fair value. The fair value of the noncontrolling interests at the date of acquisition was Rs 250,000 Goodwill has been impaired by a total of 30% of its value at the reporting date, of which one third related to the current year.

(iii) At the start of the year P transferred a machine to S for Rs 15,000. The asset had a remaining useful economic life of 3 years at the date of transfer. It had a carrying amount of Rs 12,000 in the books of P at the date of transfer.

(iv) During the year S sold some goods to P for Rs 60,000 at a mark-up of 20%. 40% of the goods remained unsold at the year-end. At the year-end, S books showed a receivables balance of Rs 6,000 as being due from P. This disagreed with the payables balance of Rs 1,000 in P books due to P having sent a cheque to S shortly before the year end which S had not yet received.

(v) S paid a dividend of 20,000 on 1 March 2017.

Required:

Prepare the consolidated SOFP and consolidated statement of profit or loss for the year ended 31 March 2017.

PROBLEM : 33

P Ltd acquired 30% shares of S. Ltd. on 1.4.2018 for Rs 1,00,000. P Ltd applied IFRS 9 on such investment on 31.3.2019, P Ltd revalued investments at ` 1,20,000 through Profit & Loss A/c. On 31.3.2020, P Ltd acquired another 40% shares in S Ltd for Rs 2 lacs. SOFP of two companies is as follows :

(Rs. In Lacs)

	P Ltd.	S Ltd.
Assets :		
Non-Current Assets :		
• PPE	15	10
• Investment in S Ltd.	1.20	-
Current Assets	8.80	2
	25	**12**
Equity and Laibilities		
• Share Capital	10	6
• Reserves & Surplus	10	5
• Non-Current Liabilities	5	1
	25	**12**

Fair value of shares of S Ltd (30% Lot) on 31.3.2020 was Rs 1,50,000. P Ltd has not journalised acquisition of 2nd Lot, which was cash Acquisition.

Prepare Consolidated SOFP.

PROBLEM : 34

P Ltd acquired 80% shares of S Ltd. On 1.7.2018. SOFP on 31.03.2019 are as follows : **(Rs. In Lacs)**

	P Ltd.	S Ltd.
Assets :		
Non-Current Assets :		
• PPE	6	2
• Investment in S Ltd.	10	-
Current Assets		
• Inventory	5	3
• Other Current Assets	2	7
	23	**12**
Equity and Laibilities		
• Share Capital	15	6
• Reserves & Surplus	5	4
• Current Liabilities	3	2
	23	**12**

S. Ltd declared and paid dividend @ 10% on 1.3.2019 out of Post-acquisition profit.

Profit and Loss Account of two companies for year ended 31.03.2019 **(Rs. In Lacs)**

	P Ltd.	S Ltd.
Income		
• Revenue	15	10
• Dividend from S Ltd	0.48	-
Expenses	(14)	(8)
Profit	1.48	2

SOCIE of P Ltd **(Rs. In Lacs)**

	Retained Earning	General Reserve	Total
Opening Balance	2	1.52	3.52
Add : Total Comprehensive Income	1.48	-	1.48
Total	**3.48**	**1.52**	**5.00**

SOCIE of S Ltd **(Rs. In Lacs)**

	Retained Earning	General Reserve	Total
Opening Balance	1	1.60	2.60
Add : Total Comprehensive Income	2	-	2.00
Less : Dividend Paid	(0.60)	-	(0.60)
Total	**2.90**	**1.60**	**4.00**

Prepare Consolidated SOFP.

PROBLEM : 35

P bought 70% of S on 1 July 2016. The following are the statements of profit or loss of P and S for the year ended 31 March 2017.

	P Rs 000	S Rs 000
Revenue	31.200	10,400
Cost of sales	(17,800)	(5,600)
Gross profit	13,400	4,800
Operating expenses	(8,500)	(3,200)
Profit from operations	4,900	1,600
Investment income	2,000	-
Profit before tax	6,900	1,600
Taxation	(2,100)	(500)
Profit for the year	4,800	1,100

The following information is available:

(i) On 1 July 2016, an item of plant in the books of S had a fair value of Rs 5,000 in excess of its carrying amount. At this time, the plant had a remaining life of 10 years. Depreciation is charged to cost of sales.

(ii) During the post-acquisition period S sold goods to P for Rs 4,400. Of this amount, Rs 500 was included in the inventory of P at the year-end. S earns a 35% margin on its sales.

(iii) Goodwill amounting to Rs 800 arose on the acquisition of S, which had been measured using the fair value method. Goodwill is to be impaired by 10% at the year-end. Impairment losses should be charged to operating expenses.

(iv) S paid a dividend of Rs 500 on 1 January 2017.

Required:

Prepare the consolidated statement of profit or loss for the year ended 31 March 2017.

PROBLEM : 36

P Pvt. Ltd. has a number of wholly-owned subsidiaries including S Pvt. Ltd. at 31st March 2012. P Pvt. Ltd. consolidated statement of financial position and the group carrying amount of S Pvt. Ltd. assets and liabilities (ie the amount included in that consolidated statement of financial position in respect of S Pvt. Ltd. assets and liabilities) at 31st March are as Follows:

Particulars	Consolidated (Rs In millions)	Group carrying amount of S Pvt. Ltd. asset and liabilities Ltd. (Rs.In millions)
Assets		
Non-Current Assets		
Goodwill	380	180
Building	3,240	1,340
Current Assets		
Inventories	140	40
Trade Receivables	1,700	900
Cash	3,100	1000
Total Assets	**8,560**	**3,460**
Equities & Liabilities		
Equity		
Share Capital	1600	
Other Equity		
Retained Earnings	4,260	
Current liabilities		
Trade Payables	2,700	900
Total Equity & Liabilities	**8,560**	**900**

Prepare consolidated SOFP after disposal as on 31st March, 2012 when P Pvt. Ltd. group sold 100% shares of S Pvt. Ltd. to independent party for Rs 3,000 millions.

PROBLEM FOR SELF PRACTICE

PROBLEM : 37 : ***STEP ACQUISITION WHEN CONTROL IS OBTAINED.***

Entity D has a 40% interest in entity E. The carrying value of the equity interest, which has been accounted for as an associate in accordance with IAS 28 is ` 40 lakh. Entity D purchases the remaining 60% interest in entity E for ` 600 lakh in cash. The fair value of the 40% previously held equity interest is determined to be ` 400 lakh., the net aggregate value of the identifiable assets and liabilities measured in accordance with IFRS 3 is determined to be identifiable ` 880 lakh. The tax consequences have been ignored. How does entity D account for the business combination?

SOLUTION : 37

Entity D recognizes at the acquisition date:

i. 100% of the identifiable net assets

ii. Goodwill as the excess of 1 over 2 below:

1. The aggregate of:
    - Consideration transferred
    - The amount of any non controlling interest (Not applicable in this example)
    - In a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquire.
2. The assets and the liabilities recognized in accordance with IFRS 3.

The journal entry recorded on the date of acquisition of the 60% controlling interest is as follows:

		Dr. (in lakh)	Cr. (in lakh)
Identifiable net assets	Dr.	880	
Goodwill	Dr.	120	
To Cash			600
To Associate interest			40
To Gain on equity interest (to be recognized in income statement)			360

Goodwill is calculated as follows:

	in lakh
Fair value of consideration transferred	600
Fair value of previously held equity interest	400
	1,000
Less: Recognised value of 100% of the identifiable net assets, measured in accordance with the standards	(880)
Goodwill recognised	120

The gain on the 40% previously held equity interest is recognized in the income statement. The fair value of the previously held equity interest less the carrying value of the previously held equity interest is ` 360 lakh (400 – 40).

PROBLEM : 38

Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 30 September 2013 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	320,000	235,000	220,000
Intangible assets (Notes 1 and 4)	55,000	60,000	Nil
Investments (Notes 1 and 2)	322,000	Nil	Nil
	697,000	295,000	220,000
Current assets:			
Inventories (Note 5)	88,000	61,000	42,000
Trade receivables (Note 6)	65,000	49,000	38,000
Cash and cash equivalents	12,000	10,000	9,000

	165,000	120,000	89,000
Total assets	862,000	415,000	309,000
EQUITY AND LIABILITIES Equity			
Share capital ($1 shares)	195,000	150,000	120,000
Retained earnings	185,000	115,000	75,000
Other components of equity (Notes 2 and 3)	192,000	11,000	Nil
Total equity	572,000	276,000	195,000
Non-current liabilities:			
Long-term borrowings (Note 8)	170,000	54,000	50,000
Deferred tax	50,000	35,000	20,000
Total non-current liabilities	220,000	89,000	70,000
Current liabilities:			
Trade and other payables (Note 6)	48,000	45,000	34,000
Short-term borrowings	22,000	5,000	10,000
Total current liabilities	70,000	50,000	44,000
Total equity and liabilities	862,000	415,000	309,000

Note 1 – Alpha's investment in Beta

On 1 July 2012, Alpha acquired 120 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

– Alpha issued five shares for every six shares acquired in Beta. On 1 July 2012, the market value of an Alpha share was $2·40. This share issue has been correctly reflected in the financial statements of Alpha.

– Alpha will make a further cash payment of $50 million to the former shareholders of Beta on 30 June 2015. Alpha has made no entry in its financial statements in respect of this additional payment. At 1 July 2012, Alpha's credit rating was such that it could have borrowed funds at an annual interest rate of 10%.

  It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 July 2012 was $1·70 and can be used for this purpose.

  On 1 July 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $98 million.

– Other components of equity $5 million (see Note 3 below).

  The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 July 2012. The following matters emerged:

– Plant and equipment having a carrying value of $120 million had an estimated market value of $130 million. The estimated future economic life of the plant and equipment at 1 July 2012 was four years and this estimate remains valid. Beta has disposed of 20% of this plant and equipment since 1 July 2012.

– Intangible assets with an estimated market value of $12 million had not been recognised in the individual financial statements of Beta. At 1 July 2012, the estimated future economic lives of these intangible assets was five years.

The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 July 2012.

Note 2 – Alpha's investment in Gamma

On 1 October 2012, Alpha acquired 48 million shares in Gamma for a total cash payment of $80 million. This share purchase followed an agreement with two other investors (who each purchased 36 million shares in Gamma on 1 October 2012) to exercise joint control over Gamma. All key operating and financial policies, including the distribution of profits, require the unanimous consent of the three investors. In its own financial statements Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income. On 30 September 2013, the fair value of Alpha's investment in Gamma was $82 million. Alpha did not recognise any deferred tax in respect of this restatement to fair value. Therefore on 30 September 2013 Alpha credited $2 million to other components of equity.

On 1 October 2012, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $66 million.

– Other components of equity $Nil

On 1 October 2012, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

You do not need to consider the deferred tax implications of Alpha's investment in Gamma when preparing the consolidated statement of financial position of the Alpha group.

Note 3 – Property, plant and equipment of Beta

Beta measures its land under the revaluation model. The other components of equity of Beta consist entirely of revaluation surpluses arising on the revaluation of its land. On 1 July 2012, the carrying value of Beta's land in Beta's own financial statements was the same as its fair value. On 30 September 2013, Beta revalued its land by $7·5 million. As a result of this revaluation, Beta recognised an additional deferred tax liability of $1·5 million and credited $6 million to other components of equity. The policy of Alpha and Gamma is to use the cost model to measure all property, plant and equipment. This is the policy to be adopted in the consolidated financial statements.

Note 4 – Intangible assets of Alpha and Beta

The intangible assets of Alpha comprise expenditure incurred during the year on a project to reduce wastage incurred during the group's production processes. The project began on 1 November 2012 and is expected to be complete by 31 May 2014. Expenditure to date has been $5 million each month. On 1 June 2013, the directors were able to assess the technical feasibility and commercial viability of the project with reasonable certainty. At this date they also received assurance that the economic benefits the project was likely to bring to the group were likely to exceed the total project costs.

The intangible assets in the individual financial statements of Beta represent goodwill which arose on acquisition of an unincorporated business in 2008. No impairment of this goodwill has been necessary since the date of acquisition of Beta by Alpha.

Note 5 – Inter-company sale of inventories

The inventories of Beta and Gamma at 30 September 2013 included components produced by Alpha. The selling price of the components included in the inventories of Beta was $14 million. The selling price of the components included in the inventories of Gamma was $12 million. Alpha applied a mark up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

Note 6 – Trade receivables and payables

The trade receivables of Alpha included $8 million receivable from Beta and $7 million receivable from Gamma in respect of the purchase of components (see Note 5). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 7 – Forward currency contract

During July and August 2013 Alpha conducted a large marketing effort in Country X. The currency in Country X is the Euro. Alpha made no sales to customers in Country X in the year ended 30 September 2013 but is very confident of making substantial sales to such customers in the year ended 30 September 2014. On 5 September 2013, Alpha entered into a contract to sell €20 million for $28 million on 31 October 2013. Currency fluctuations in September 2013 were such that on 30 September 2013 the fair value of this currency contract was $1·1 million (a financial asset). The draft financial statements of Alpha do not include any amounts in respect of this currency contract since it has a zero cost. Alpha wishes to use hedge accounting whenever permitted by International Financial Reporting Standards. Alpha expects sales to customers in Country X to be at least €22 million in October 2013.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha include a loan at a carrying amount of $60 million which was taken out on 1 October 2012. The loan does not carry any interest but $75·6 million is repayable on 30 September 2015. This represents an effective annual rate of return for the investors of 8%. As an alternative to repayment, the investors can exchange their loan asset for equity shares in Alpha on 30 September 2015. The annual rate of return required by such investors on a non-convertible loan would have been 10%. Alpha has not charged any finance cost in respect of this loan for the year ended 30 September 2013.

The present value of $1 payable / receivable in three years' time is as follows:

– 79·4 cents when the discount rate is 8% per annum.

– 75·1 cents when the discount rate is 10% per annum.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2013.

Note: You should show all workings to the nearest $'000.

PROBLEM: 39

Alpha holds investments in two other entities, Beta and Gamma. The statements of profit or loss and other comprehensive income of the three entities for the year ended 31 March 2014 were as follows: Statements of profit or loss and other comprehensive income

	Alpha $ '000	Beta $'000	Gamma $'000
Revenue (note 4)	420,000	335,000	292,000
Cost of sales (note 4)	(240,000)	(192,000)	(168,000)
Gross profit	180,000	143,000	124,000
Distribution costs	(20,000)	(16,000)	(14,000)
Administrative expenses	(40,000)	(32,000)	(28,000)
Contributions to retirement benefit plan (note 5)	(5,000)	Nil	Nil
Finance costs	(20,000)	(15,000)	(12,000)
Investment income (note 6)	33,000	Nil	Nil
Profit before tax	128,000	80,000	70,000
Income tax expense	(32,000)	(20,000)	(16,000)
Profit for the year Other comprehensive income: Items that will not be reclassified to profit or loss	96,000	60,000	54,000
Gain on property revaluation (note 7)	25,000	Nil	12,000
Total comprehensive income for the year	121,000	60,000	66,000

Notes to the statements

Note 1 – Acquisition of Beta

On 1 April 2005, Alpha purchased 80% of the equity shares of Beta and gained control of Beta. Goodwill arising on the acquisition of Beta totalled $80 million. At 1 April 2005, Beta had three cash-generating units and the goodwill on acquisition was allocated to the three units as follows:

– Unit 1 – 40%

– Unit 2 – 35%

– Unit 3 – 25%.

No impairment of this goodwill had occurred in the years ended 31 March 2006 to 2013 inclusive. However, in the year ended 31 March 2014, despite Beta making a profit overall, Beta suffered challenging trading conditions. Therefore the directors of Alpha carried out an impairment review on the goodwill at 31 March 2014 and obtained the following results:

Unit	Carrying value of net assets (excluding goodwill) at 31 March 2014	Recoverable amount at 31 March 2014
	$'000	$'000
1	215,000	255,000
2	185,000	220,000
3	130,000	140,000
Total	530,000	615,000

None of the assets or liabilities of Beta which Alpha identified on 1 April 2005 remained in the statement of financial position of Beta at 31 March 2013 or 2014. Any impairment of goodwill should be charged to cost of sales.

Alpha measures all non-controlling interests based on their fair values at the date of acquisition of the relevant subsidiary.

Note 2 – Acquisition of Gamma

On 1 July 2013, Alpha acquired 40% of the equity capital of Gamma. The purchase consideration comprised the following:

– An issue of equity shares.

– A cash payment of $65·34 million due on 30 June 2015. On 1 July 2013, Alpha's borrowing rate was 10% per annum. No entry has yet been made in Alpha's financial statements regarding this future cash payment.

The other 60% of Gamma's shares are held by a wide variety of investors, none of whom owns more than 0·5% individually. None of the other shareholders has any arrangements to consult any of the others or make collective decisions. Since 1 July 2013, Alpha has actively participated in establishing the operating and financial policies of Gamma.

When reviewing the net assets of Gamma as at 1 July 2013, the directors of Alpha ascertained the following:

– The properties of Gamma had been revalued at 31 March 2013 and there was no significant difference between their carrying values at 1 July 2013 and their fair values at 31 March 2013.

– The plant and equipment of Gamma had a carrying value at 1 July 2013 of $70 million and a fair value at that date of $78 million. The estimated future useful life of the property, plant and equipment at 1 July 2013 was four years, with zero residual value.

– On 1 July 2013, Gamma was in the process of completing the development of a new method of production which will significantly reduce wastage. As at 1 July 2013, Gamma had recognised an intangible asset of $10 million in its financial statements in respect of this development. The directors of Alpha believed that, as at 1 July 2013, the process had a fair value of $22 million and that the process will produce economic benefits evenly for ten years from 1 January 2014.

– On 1 July 2013, Gamma had a contingent liability which it did not recognise in its own financial statements. This contingent liability still existed, and was still unrecognised by Gamma, at 31 March 2014. As at 1 July 2013, the directors of Alpha believed that the contingent liability had a fair value of $16 million. On 31 March 2014, they reassessed its fair value at $12 million. The reassessment was due to a change in circumstances after 1 July 2013.

The directors of Alpha believe that the facts described in this note mean that Gamma has been a subsidiary of Alpha since 1 July 2013 and wish to consolidate it. Based on the assumption that Gamma is consolidated, no impairment of the goodwill on consolidation is required at 31 March 2014. The profit of Gamma for the year ended 31 March 2014 accrued evenly over the year. However, as noted above, all of the other comprehensive income of Gamma arose after 1 July 2013. Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation. The rate of corporate income tax in the jurisdiction in which all three entities are located is 25%.

Note 3 – Presentation of depreciation and amortisation

All depreciation and amortisation charges should be presented as part of cost of sales

Note 4 – Trading between Alpha and Beta

1. Alpha supplies a component to Beta which is used by Beta in its production process. Alpha marks up its cost of production by one-third in arriving at the selling price. In the year ended 31 March 2014, the revenues of Alpha included $30 million in respect of the sale of these components. On 31 March 2014, the inventories of Beta included $6 million. On 31 March 2013, the inventories of Beta included $4·4 million in respect of identical unsold components purchased from Alpha at the same mark up on cost.
2. During the year ended 31 March 2013, Alpha manufactured a machine which was to be used by Beta from 1 April 2013. The costs of manufacture totalled $12 million. On 1 April 2013, Alpha transferred the machine to Beta for an invoiced price of $16 million, including relevant amounts in revenue and cost of sales. Beta included the machine in its property, plant and equipment and depreciated the machine over its estimated useful life of four years, with no residual value.

Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation.

Note 5 – Defined benefit retirement benefits plan

Certain senior executives of Alpha belong to a defined benefit retirement benefits plan. In the financial statements of Alpha, the contributions paid into this plan have been shown as an expense in the statement of profit or loss and other comprehensive income. Relevant information regarding this plan is as follows:

– The pension liability was $60m at 31 March 2013. This liability increased to $68m by 31 March 2014. – The pension asset was $40m at 31 March 2013. This asset increased to $46m by 31 March 2014.

– The current service cost was $4·5m.

– Alpha's borrowing rate at 31 March 2014 was 9% per annum. On that date market yields on government bonds were 8% per annum.

The salary costs of the senior executives who belong to this plan are presented in administrative expenses. You should ignore any adjustment to deferred tax as a result of the information included in this note.

Note 6 – Payment of dividends

On 31 December 2013, Beta paid a dividend of $30 million and Gamma paid a dividend of $20 million. Alpha recognised its share of both dividends in its investment income.

Note 7 – Property revaluations

It is the policy of the Alpha group to measure freehold properties using the fair value model and all freehold properties were revalued on 31 March 2014. Beta leases all of its properties and all of Beta's property leases are operating leases. The gains shown in the financial statements of Alpha and Gamma do not take account of the deferred tax implications of the revaluations.

Note 8 – Hedge of future property purchase

On 1 February 2014, Alpha entered into a firm commitment to purchase a property on 31 May 2014 for €40 million. In order to eliminate the impact of currency fluctuations, on 1 February 2014 Alpha entered into a contract to purchase €40 million for $48 million on 31 May 2014. This contract had no cost and Alpha did not record it in the financial statements for the year ended 31 March 2014. On 31 March 2014, the contract had a fair value of $3·6 million (financial asset). Alpha uses hedge accounting whenever permitted by International Financial Reporting Standards. Where a choice of hedge accounting method exists, Alpha uses cash-flow hedge accounting.

You should ignore any adjustment to deferred tax as a result of the information included in this note.

Required:

(a) Discuss the appropriateness of the directors' view that Gamma became a subsidiary of Alpha on 1 July 2013.

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the yearended 31 March 2014. For this part you should assume that Gamma is a subsidiary of Alpha from 1 July 2013.

PROBLEM: 40

Alpha holds investments in two other entities, Beta and Gamma. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 30 September 2014 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha $'000	Beta $'000	Gamma $'000
Revenue (Note 3)	260,000	200,000	180,000
Cost of sales (Notes 1-3)	(130,000)	(110,000)	(90,000)
Gross profit	130,000	90,000	90,000
Distribution costs	(20,000)	(15,000)	(13,500)
Administrative expenses (Note 4)	(25,000)	(20,000)	(18,000)
Redundancy and reorganisation costs (Note 5)	(14,000)	Nil	Nil
Investment income (Note 6)	12,600	Nil	1,500
Finance costs (Note 7)	(26,000)	(15,000)	(12,000)
Profit before tax	57,600	40,000	48,000
Income tax expense	(14,000)	(10,000)	(12,000)
Profit for the year Other comprehensive income: Items that will not be reclassified to profit or loss Gains on financial assets designated at fair value	43,600	30,000	36,000
through other comprehensive income (Note 8)	9,000	Nil	1,400
Total comprehensive income	**52,600**	**30,000**	**37,400**
Summarised statements of changes in equity			
Balance on 1 October 2013	180,000	140,000	120,000
Comprehensive income for the year	52,600	30,000	37,400
Dividends paid on 31 December 2013	(30,000)	(10,000)	(14,000)
Balance on 30 September 2014	**202,600**	**160,000**	**143,400**

Note 1 – Alpha's investment in Beta

On 1 October 2001, Alpha acquired 75% of the equity shares of Beta. This gave Alpha control over Beta. On 1 October 2001, the net assets of Beta had a fair value of $80 million. None of the assets and liabilities of Beta which existed on 1 October 2001 were still assets or liabilities of Beta on 30 September 2013. On 1 October 2001, Alpha measured the non-controlling interest in Beta at its fair value of $22 million. Goodwill on consolidation of $18 million arose on the acquisition of Beta. No impairment of goodwill on the acquisition of Beta has been necessary up to and including 30 September 2013.

Beta has four operating segments which are also cash generating units (CGUs) for the purposes of impairment reviews. On 1 October 2001, the goodwill on acquisition of Beta was allocated between these units on the following basis:

Unit 1 – $8 million.

Unit 2 – $4 million.

Unit 3 – $3 million.

Unit 4 – $3 million.

On 30 September 2014, the carrying amounts of the net assets (excluding goodwill) and recoverable amounts of the four CGUs of Beta were as follows:

	Unit 1 $'000	Unit 2 $'000	Unit 3 $'000	Unit 4 $'000	Total $'000
Carrying amount	45,000	55,000	30,000	30,000	160,000
Recoverable amount	50,000	65,000	35,000	35,000	185,000

Any impairment of goodwill should be charged to cost of sales.

Note 2 – Alpha's investment in Gamma

On 1 February 2014, Alpha acquired 80% of the equity shares in Gamma and gained control of Gamma.

On 1 February 2014, the fair value of Gamma's property, plant and equipment exceeded the carrying amounts in the individual financial statements of Gamma as follows:

– Property excess $20 million (land element of excess $11 million). The estimated remaining useful life of the buildings element of the property at 1 February 2014 was 25 years.

– Plant and equipment excess $7·2 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 February 2014 was three years.

All depreciation of property, plant and equipment is charged to cost of sales.

Alpha measured the non-controlling interest in Gamma on 1 February 2014 at its fair value of $28 million. There was no impairment of the goodwill arising on the acquisition of Gamma in the year ended 30 September 2014. The profit of Gamma for the year ended 30 September 2014 accrued evenly over the year, but see note 8 regarding the other comprehensive income of Gamma.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha applies a mark-up of 25% to cost when computing the intra-group selling price. All of the sales of this component by Alpha to Gamma occurred after the acquisition of Gamma on 1 February 2014. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta $'000	Gamma $'000
Sales of the component	12,000	5,000
Inventory of component at 30 September 2014 (at cost to Beta/Gamma)	2,400	2,000
Inventory of component at 30 September 2013 (at cost to Beta/Gamma)	1,800	Nil

Note 4 – Post-employment benefits

The group makes contributions into both defined benefit and defined contribution retirement benefit plans. All the employees of Beta and Gamma are members of defined contribution plans but many of the employees of Alpha are members of a defined benefit plan. The following are relevant details regarding the defined benefit plan:

– Obligation at 30 September 2014: $40 million (30 September 2013: $32 million).

– Fair value of plan assets at 30 September 2014: $34 million (30 September 2013: $27 million).

– Current service cost for the year ended 30 September 2014: $6 million.

– Contributions paid into the plan by Alpha in the year ended 30 September 2014: $5·4 million.

– Benefits paid to retired members: $2 million.

– Relevant market yield: 5% per annum throughout the period.

Alpha has charged the contributions paid into the defined benefit plan in the year ended 30 September 2014 ($5·4 million) as an administrative expense. Alpha has made no other entries in respect of the plan in the statement of profit or loss and other comprehensive income. However, Alpha correctly accounted for the defined benefit plan in the financial statements for the year ended 30 September 2013.

Note 5 – Redundancy and reorganisation costs

Following the acquisition of Gamma on 1 February 2014, the directors of Alpha formulated a plan to reorganise the group. The plan involved some redundancies and some employees changing their roles within the group. As a result of the reorganisation, certain non-current assets of Alpha will no longer be required. The final version of the plan was agreed on 31 July 2014 and made public on 15 August 2014. The plan was implemented from 1 November 2014. The total cost of the plan will be borne by Alpha. The directors of Alpha made a provision, with a corresponding charge to profit or loss, in respect of the plan as follows:

	$'000
Redundancy costs	10,000
Costs of training staff in new roles	5,500
Expected profit on the sale of surplus non-current assets	(1,500)
	14,000

Note 6 – Investment income

All of the investment income of Alpha, including dividends received from subsidiaries, has been correctly recognised in the individual financial statements of Alpha.

Note 7 – Bond issue

On 1 October 2013, Alpha issued 300 million $1 bonds at par. The interest payable on the bonds is 5% per annum, payable on 30 September in arrears. The bonds are repayable at par on 30 September 2023. Alternatively, the investors have the option to convert the bonds into equity shares in Alpha on 30 September 2023.

On 1 October 2013, Alpha recognised a financial liability of $300 million in its statement of financial position. On 30 September 2014, Alpha recognised the interest paid on that date as a finance cost in its statement of profit or loss.

On 1 October 2013, investors would have expected an annual return of 8% on non-convertible bonds. At a discount rate of 8% per annum, the present value of $1 receivable at the end of year 10 is 46·3 cents and the present value of $1 receivable at the end of each of years 1 to 10 is $6·71.

Note 8 – Other comprehensive income

Both Alpha and Gamma have financial assets which are appropriately classified as fair value through other comprehensive income. On 1 February 2014, the fair value of the financial assets of Gamma had not changed from 30 September 2013.

Note 9 – Forward currency contract

On 15 August 2014, Alpha entered into a commitment to supply a large consignment of components to a foreign customer whose currency is the Kroner. The agreed value of the order was 25 million Kroner and this amount is expected to be paid by the customer on 30 November 2014. On 15 August 2014, Alpha entered into a contract to sell 25 million Kroner for $13 million on 30 November 2014. Currency fluctuations in August and September 2014 were such that on 30 September 2014 the fair value of this currency contract was $1·1 million (a financial liability). The draft financial statements of Alpha do not include any amounts in respect of this currency contract since it has a zero cost. Alpha wishes to use cash-flow hedge accounting whenever permitted by International Financial Reporting Standards. The directors of Alpha have estimated that the currency contract is a perfectly effective hedge of the commitment to supply the components.

Required:

(a) **Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the yearended at 30 September 2014. You do not need to consider the deferred tax effects of any adjustments you make.**

(b) **Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 30 September 2014, including a column for the non-controlling interest.**

Note: You should show all workings to the nearest $'000.

PROBLEM: 41

Alpha holds investments in two other entities, Beta and Gamma. The draft statements of financial position of the three entities at 31 March 2015 were as follows:

	Alpha $'000	**Beta $'000**	**Gamma $'000**
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 6)	300,000	240,000	180,000
Investments (Notes 1, 2 and 3)	267,000	40,000	10,000
	567,000	280,000	190,000
Current assets:			

Inventories (Note 4)	90,000	60,000	45,000
Trade receivables (Note 5)	72,000	46,000	40,000
Cash and cash equivalents	15,000	10,000	8,000
	177,000	116,000	93,000
Total assets	744,000	396,000	283,000
Equity and liabilities			
Equity			
Share capital ($1 shares)	200,000	150,000	120,000
Retained earnings (Notes 1 and 2)	367,500	115,000	51,000
Other components of equity (Notes 1, 2 and 3)	5,000	4,000	2,000
Total equity	572,500	269,000	173,000
Non-current liabilities:			
Provision (Note 6)	12,500	Nil	Nil
Long-term borrowings (Note 7)	60,000	45,000	50,000
Deferred tax	32,000	30,000	20,000
Total non-current liabilities	104,500	75,000	70,000
Current liabilities:			
Trade and other payables (Note 5)	45,000	42,000	33,000
Short term borrowings	22,000	10,000	7,000
Total current liabilities	67,000	52,000	40,000
Total equity and liabilities	744,000	396,000	283,000

Note 1 – Alpha's investment in Beta

On 1 April 2010, Alpha acquired 120 million shares in Beta by means of a cash payment of $234·5 million. Alpha also incurred directly attributable costs of $2·5 million associated with the acquisition of Beta and recognised the investment in its individual statement of financial position at $237 million. There has been no change to the carrying value of this investment in Alpha's own statement of financial position since 1 April 2010.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 2010 can be used for this purpose. On 1 April 2010, the market value of a Beta share was $1·80.

On 1 April 2010, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $75 million.

– Other components of equity $1 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2010. The following matters emerged:

– Property having a carrying value of $150 million at 1 April 2010 (depreciable component $80 million) had an estimated market value of $180 million at that date (depreciable component $90 million). The estimated future economic life of the depreciable component at 1 April 2010 was 20 years. This property is included in Beta's statement of financial position at 31 March 2015.

– Plant and equipment having a carrying value of $110 million at 1 April 2010 had an estimated market value of $123 million at that date. Beta has disposed of all of this plant and equipment since 1 April 2010.

The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. No impairment of the goodwill on acquisition of Beta has occurred since 1 April 2010.

Note 2 – Alpha's investment in Gamma

On 1 July 2014, Alpha acquired 90 million shares in Gamma by means of a share exchange. Alpha issued two shares for every three shares acquired in Gamma. On 1 July 2014, the market value of an Alpha share was $2·90 and the market value of a Gamma share was $1·50. The share exchange has not been recorded in the draft financial statements of Alpha presented above.

Alpha also incurred directly attributable costs of $1·5 million associated with this acquisition and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 31 March 2015.

On 1 April 2014, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $45 million. The profits of Gamma for the year ended 31 March 2015 accrued evenly over the year.

– Other components of equity $2 million. See also the information provided in note 3 regarding other components of equity.

Gamma leases all of its properties on operating leases and its plant and equipment comprises assets with relatively short useful economic lives. Therefore on 1 July 2014, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

No impairment of the goodwill on acquisition of Gamma has occurred since 1 July 2014.

Note 3 – Other investments

Apart from its investment in Beta, the investments of Alpha included in the statement of financial position at 31 March 2015 are all financial assets which Alpha has elected to measure at fair value through other comprehensive income. All of the investments held by Beta and Gamma are also financial assets which Beta and Gamma have elected to measure at fair value through other comprehensive income. None of these investments have been bought or sold in the year ended 31 March 2015. The fair values which are included in the draft statements of financial position above are the fair values at 31 March 2014 for Beta and 1 July 2014 for Gamma. Relevant fair values as at 31 March 2015 were as follows:

– Alpha – $33 million.

– Beta – $43 million.

– Gamma – $11·6 million. The change in the fair value of Gamma's investments during the year ended 31 March 2015 was caused by events occurring AFTER 1 July 2014.

You do NOT need to consider the deferred tax implications of any gains arising on the remeasurement of these investments.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 2015 included components purchased from Alpha in the last three months of the financial year at a cost of $15 million to Beta and $10 million to Gamma. Alpha normally earns a profit margin of 30% on the sale of these components but supplies of these components to group companies are routinely made at a reduced margin of 20%.

In the consolidated financial statements, any adjustments required as a result of this note will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. You can assume that sufficient taxable profits exist in each entity to allow the deferred tax implications of deductible temporary differences.

Note 5 – Trade receivables and payables

The trade receivables of Alpha included $9 million receivable from Beta and $6 million receivable from Gamma in respect of the purchase of components (see Note 4). On 30 March 2015, Beta and Gamma paid $9 million and $6 million respectively to Alpha and so eliminated their trade payables balance in respect of the purchase of components. Alpha recorded these receipts on 3 April 2015.

Note 6 – Provision

On 1 March 2015, the board of directors of Alpha finalised a plan to re-organise and reconstruct the group. The plan was publicly announced on 15 March 2015. The plan involved closing down one of Alpha's operating units – unit X (not a separate legal entity). The business of unit X will not be discontinued – the other operating units of Alpha will be able to supply the unit's existing customers. However, all of the property, plant and equipment being used in unit X will be disposed of. Some of the employees working in unit X will be made redundant, and others will be transferred to other operating units of Alpha.

The provision made by Alpha in its draft financial statements comprised the best estimate of the following:

	$ million
Redundancy costs	8
Costs of relocating employees to new locations	2.5
Costs of retraining existing employees for work at new locations	2.0
	12.5

On 15 March 2015, the property, plant and equipment of unit X, which is included in the above statement of financial position, had a total carrying value of $15 million. $12 million of this amount relates to property, and $3 million to plant and equipment. On 15 March 2015, all of the property, plant and equipment was offered for sale. The property was offered for sale at a price of $16·5 million, and the plant and equipment at $1·05 million. Both of these amounts are considered to be reasonable prices which are achievable within six months of the year end. The estimated costs of disposal of the property are $500,000 and the costs of

disposal of the plant $50,000. However, none of the property, plant and equipment of unit X which was being offered for sale had actually been sold by 31 March 2015. You can assume that any change in carrying value of this property, plant and equipment between 15 and 31 March 2015 is immaterial.

Note 7 – Long-term borrowings

On 31 March 2015, Alpha issued 30 million $1 convertible loan notes. The loan notes carry a coupon rate of 6% per annum payable annually in arrears and are redeemable at par on 31 March 2020. As an alternative to redemption, the loan note holders can elect to exchange their loan notes for equity shares in Alpha on 31 March 2020. If the option to exchange were not available, the investors in the loan notes would have required a return on their investment of 10% per annum.

Discount factors which may be relevant are as follows: Discount rate

	6%	10%
	$	$
Present value of $1 receivable in 5 years	0·747	0·621
Cumulative present value of $1 receivable at the end of years 1–5	4·212	3·790

On 31 March 2015, Alpha debited cash and credited long-term borrowings with $30 million in respect of this loan.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2015.

PROBLEM: 42

Alpha's investments include two subsidiaries, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 2015 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	380,000	355,000	152,000
Intangible assets (Note 1)	80,000	40,000	20,000
Investments (Notes 1, 3 and 4)	497,000	Nil	Nil
	957,000	395,000	172,000
Current assets:			
Inventories (Note 5)	100,000	70,000	65,000
Trade receivables (Note 6)	80,000	66,000	50,000
Cash and cash equivalents (Note 6)	10,000	15,000	10,000
	190,000	151,000	125,000
Total assets	1,147,000	546,000	297,000
Equity and liabilities			
Equity			
Share capital (50c shares)	150,000	200,000	120,000
Retained earnings (Notes 1 and 3)	498,000	186,000	60,000
Other components of equity (Notes 1, 3 and 4)	295,000	10,000	2,000
Total equity	943,000	396,000	182,000
Non-current liabilities:			
Provision (Note 7)	34,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	50,000	45,000
Deferred tax	35,000	30,000	25,000
Total non-current liabilities	129,000	80,000	70,000
Current liabilities:			
Trade and other payables (Note 6)	50,000	55,000	35,000
Short-term borrowings	25,000	15,000	10,000
Total current liabilities	75,000	70,000	45,000
Total equity and liabilities	1,147,000	546,000	297,000

Note 1 – Alpha's investment in Beta

On 1 October 2012, Alpha acquired 300 million shares in Beta by means of a share exchange of one share in Alpha for every two shares acquired in Beta. On 1 October 2012, the market value of an Alpha share was $2·40. Alpha incurred directly attributable costs of $2 million on acquisition of Beta. These costs comprised:

– $0·8 million – cost of issuing own shares, debited to Alpha's share premium account within other components of equity;

– $1·2 million due diligence costs – included in the carrying amount of the investment in Beta in Alpha's own statement of financial position.

There has been no change to the carrying amount of this investment in Alpha's own statement of financial position since 1 October 2012.

On 1 October 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $125 million.

– Other components of equity $10 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2012. The following matters emerged:

– Plant and equipment having a carrying amount of $295 million had an estimated market value of $340 million. The estimated remaining useful economic life of this plant at 1 October 2012 was five years. None of this plant and equipment had been disposed of between 1 October 2012 and 30 September 2015.

– An in-process research and development project existed at 1 October 2012 but did not meet the recognition criteria of IAS 38 – *Intangible Assets*. The fair value of the research and development project at 1 October 2012 was $20 million. The project started to generate economic benefits on 1 October 2013 over an estimated period of four years.

The above two fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, these fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Beta.

Note 2 – Impairment review of goodwill on acquisition of Beta

No impairment of the goodwill on acquisition of Beta was evident when reviews were carried out on 30 September 2013 and 2014. On 30 September 2015, the directors of Alpha concluded that the recoverable amount of the net assets (including the goodwill) of Beta at that date was $450 million. Beta is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Note 3 – Alpha's investment in Gamma

On 1 October 2014, Alpha acquired 144 million shares in Gamma by means of a cash payment of $125 million. Alpha incurred costs of $1 million associated with this purchase and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 30 September 2015. There has been no change in the carrying amount of this investment in the financial statements of Alpha since 1 October 2014.

On 1 October 2014, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $45 million.

– Other components of equity $2 million.

On 1 October 2014, the fair values of the net assets of Gamma were the same as their carrying amounts with the exception of some land which had a carrying amount of $100 million and a fair value of $130 million. This land continued to be an asset of Gamma at 30 September 2015. The fair value adjustment has not been reflected in the individual financial statements of Gamma. In the consolidated financial statements, the fair value adjustment will be regarded as a temporary difference for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

There was no impairment of the goodwill arising on acquisition of Gamma in the consolidated financial statements at 30 September 2015.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Gamma.

Note 4 – Other investments

Apart from its investments in Beta and Gamma, the investments of Alpha included in the statement of financial position at 30 September 2015 are all financial assets which Alpha measures at fair value though other comprehensive income. These other investments are correctly measured in accordance with IFRS 9 – *Financial Instruments*.

Note 5 – Intra-group sale of inventories

The inventories of Alpha and Gamma at 30 September 2015 included components purchased from Beta in the last three months of the financial year at a cost of $20 million to Alpha and $16 million to Gamma. Beta supplied these goods to both Alpha and Gamma at a mark-up of 25% on the cost to Beta. (No Def Tax)

Note 6 – Trade receivables and payables

Group policy is to clear intra-group balances on a given date prior to each year end. All group companies had complied with this policy at 30 September 2015, so at that date there were no outstanding intra-group balances.

Note 7 – Provision

On 30 September 2015, Alpha finalised the construction of an energy generating facility. The facility has an expected useful economic life of 25 years and Alpha has a legal requirement to decommission the facility at the end of its estimated useful life. The directors of Alpha estimated the costs of this decommissioning to be $34 million – based on prices prevailing at 30 September 2040. At an appropriate discount rate the present value of the cost of decommissioning the facility is $10 million. The directors of Alpha made a provision of $34 million and charged this amount as an operating cost in the financial statements of Alpha for the year ended 30 September 2015.

Note 8 – Long-term borrowings

On 1 October 2014, Alpha issued 40 million $1 bonds at par. The cost of issuing the bonds was $1 million and this cost was charged as a finance cost for the year ended 30 September 2015. No interest is payable on the bonds but they are redeemable at a large premium which makes their effective finance cost 8% per annum. The bonds are included at a carrying amount of $40 million in the statement of financial position of Alpha at 30 September 2015.

Required:

(a) **Prepare the consolidated statement of financial position of Alpha at 30 September 2015. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.**

(b) On 15 November 2015, Alpha purchased shares in Theta which gave Alpha a 45% shareholding in Theta. On the same date, Alpha purchased an option which gave Alpha the right to acquire an additional 10% of the shares in Theta from the existing shareholders. This option is exercisable at any time between 15 November 2015 and 30 September 2017 at a price which makes it highly likely the option will be exercised during that period. The directors of Alpha are unsure how to treat Theta in the consolidated financial statements for the year ended 30 September 2016.

Required:

Advise the directors of Alpha on the appropriate treatment of Theta in the consolidated financial statements for the year ended 30 September 2016 PRIOR to any exercising of the option.

PROBLEM: 43

Alpha's investments include subsidiaries, Beta and Gamma. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 31 March 2016 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha $'000	Beta $'000	Gamma $'000
Revenue (Notes 3 and 4)	360,000	210,000	190,000
Cost of sales (Notes 1–3)	(240,000)	(110,000)	(100,000)
Gross profit	120,000	100,000	90,000
Distribution costs	(20,000)	(16,000)	(15,000)
Administrative expenses	(30,000)	(19,000)	(18,000)
Investment income (Notes 5 and 6)	19,800	Nil	Nil
Finance costs (Note 7)	(12,000)	(17,000)	(13,000)
Profit before tax	77,800	48,000	44,000
Income tax expense	(15,000)	(12,000)	(11,000)
Profit for the year Other comprehensive income: Items that will not be reclassified to profit or loss Gains/(losses) on financial assets designated at fair	62,800	36,000	33,000
value through other comprehensive income (Note 5)	Nil	Nil	Nil

Total comprehensive income	**62,800**	**36,000**	**33,000**
Summarised statements of changes in equity			
Balance on 1 April 2015	200,000	150,000	130,000
Comprehensive income for the year	62,800	36,000	33,000
Dividends paid on **31 December 2015**	(30,000)	(12,000)	(11,000)
Balance on 31 March 2016	**232,800**	**174,000**	**152,000**

Note 1 – Alpha's investment in Beta

On 1 April 2004, Alpha acquired 80% of the equity shares of Beta and gained control of Beta. Alpha paid $64 million in cash for these shares.

On 1 April 2004, the net assets of Beta had a fair value of $70 million. None of the assets and liabilities of Beta which existed on 1 April 2004 were still assets or liabilities of Beta on 31 March 2015.

Alpha measured the non-controlling interest in Beta using the proportion of net assets method. The resulting goodwill on acquisition of Beta was correctly recognised in the consolidated financial statements of Alpha. No impairment of goodwill on acquisition of Beta has been necessary up to and including 31 March 2015.

On 31 March 2016, the annual impairment review of the goodwill on acquisition of Beta indicated that the recoverable amount of the total net assets of Beta (including the goodwill) at that date was $180 million. Beta is regarded as a single cash generating unit for impairment purposes. Any impairment of goodwill should be charged to cost of sales.

Note 2 – Alpha's investment in Gamma

On 1 October 2015, Alpha acquired 60% of the equity shares in Gamma and gained control of Gamma. Gamma had 50 million equity shares in issue on 1 October 2015 and has not issued any new shares since that date. The acquisition was financed as follows:

– Alpha issued two new shares to the former shareholders of Gamma for every three shares Alpha acquired in Gamma. On 1 October 2015, the fair value of an equity share in Alpha was $2·80 and the fair value of an equity share in Gamma was $3·70.

– Alpha agreed to pay a total of $24·2 million to the former shareholders of Gamma on 30 September 2017. Alpha's incremental borrowing rate at 1 October 2015 was 10% per annum.

– Alpha agreed to pay a further amount to the former shareholders of Gamma on 31 December 2019 if the cumulative profits of Gamma for the four-year period from 1 October 2015 to 30 September 2019 exceed $150 million. On 1 October 2015, the fair value of this obligation was measured at $40 million. On 31 March 2016, this fair value was remeasured at $42 million.

Alpha has resolved to use the fair value method for measuring the non-controlling interest when recognising the goodwill on acquisition of Gamma. The fair value of an equity share in Gamma on 1 October 2015 can be used for this purpose. No impairment of the goodwill on acquisition of Gamma is necessary in the consolidated financial statements of Alpha for the year ended 31 March 2016.

On 1 October 2015, the fair values of the net assets of Gamma were the same as their carrying amounts in the financial statements of Gamma with the exception of:

– Property – whose fair value exceeded the carrying amount by $25 million ($10 million of this excess relates to land). The estimated remaining useful life of the buildings element of the property at 1 October 2015 was 20 years.

– Plant and equipment – whose fair value exceeded the carrying amount by $8 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 October 2015 was four years.

All depreciation of property, plant and equipment is charged to cost of sales. You can assume that the profit of Gamma for the year ended 31 March 2016 accrued evenly over the year.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha earns a profit margin of 10% on these supplies. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta $'000	Gamma $'000
Sales of the component (for Gamma all sales since 1 October 2015)	15,000	8,000
Inventory of component at 31 March 2015 (at cost to Beta/Gamma	2,000	Nil
Inventory of component at 31 March 2016 (at cost to Beta/Gamma)	3,000	2,800

Note 4 – Revenue of Alpha

On 1 October 2015, Alpha sold a large machine to a customer for a total price of $51·2 million and credited $51·2 million to revenue. As part of the sales agreement, Alpha agreed to provide annual servicing of the machine for four years from 1 October

2015 for no additional payment. The normal selling price of this without any annual servicing would have been $60 million and Alpha would normally charge the customer an annual fee of $1 million to service the machine. You should ignore the time value of money in respect of this transaction.

Note 5 – Alpha's other investment

Apart from its investments in Beta and Gamma, Alpha has one other investment – in entity X. Alpha purchased this equity investment on 1 July 2015 for $40 million and designated the investment as fair value through other comprehensive income. In order to protect against a prolonged decline in the fair value of the investment in entity X, Alpha purchased a put option to sell this investment. The cost of the option was $6 million and the option was regarded as an effective hedge against a prolonged decline in the fair value of the investment in entity X. On 31 March 2016, the fair value of the equity investment in entity X was $37 million and the fair value of the put option was $8·7 million. Apart from recognising the investment in entity X and the put option at cost, Alpha has made no other entries in its draft financial statements. Alpha wishes to use hedge accounting whenever permitted by International Financial Reporting Standards.

Note 6 – Investment income

All of the investment income of Alpha has been correctly recognised in the individual financial statements of Alpha.

Note 7 – Bond issue

On 1 April 2015, Alpha issued a convertible zero-coupon bond to a single institutional investor. The bond was issued for total proceeds of $250 million and will be redeemed or converted into equity shares on 31 March 2020. If the investor chooses to redeem the bond on 31 March 2020, the investor will receive $362·32million. The incremental borrowing rate of Alpha on 1 April 2015 is 10% per annum. The present value of $1 received in five years at a discount rate of 10% per annum is 62·1 cents.

Required:

(a) Using the information in notes 1 and 2, compute the goodwill arising on the acquisitions of Beta at 1 April 2004 and Gamma at 1 October 2015.

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the yearended at 31 March 2016. You do not need to consider the deferred tax effects of any adjustments you make.

(c) Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 31 March 2016, including a column for the non-controlling interest.

Note: You should show all workings to the nearest $'000.

IAS 28	INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

IAS 28 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

1. INTRODUCTION

Investments in Associates and Joint ventures are accounted under Equity method of accounting. The aaplication of equity method provides more informative reporting of the investor's net assets and profit or loss. Because the investor has joint control of, or significant influence over, the investor has an interest in the performance of associate and joint venture.

2. DEFINITIONS

An associate is an entity over which the investor has significant influence.

Consolidated Financial Statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

The **equity method** is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income

Joint control is the contractually agreed sharing of control over an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A Joint Venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A Joint Venturer is a party to a joint venture that has joint control of that joint venture.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies

3. SIGNIFICANT INFLUENCE

It is a rebuttable presumption that where an entity holds 20% or more of the voting power (directly or through subsidiaries) on an investee, the investor has significant influence and vice versa.

PROBLEM : 1

S Ltd and P ltd hold 15% equity each in G Ltd. P Ltd is already a subsidiary of S Ltd. Is G Ltd an Associate of S Ltd?

SOLUTION : 1

PROBLEM : 2

S Ltd owns 60% shares of M Ltd. M Ltd owns 30 % shares of N Ltd. Is N Ltd an associate of S Ltd ?

SOLUTION : 2

PROBLEM : 3

X Ltd. holds 6% shares in Y ltd. Z ltd. holds 8% shares of Y Ltd. Z Ltd. is subsidiary of X Ltd. Z ltd. Virtually takes part in most of the operating and financial decisions of Y ltd.

SOLUTION : 3

The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

- representation on the board of directors or equivalent governing body of the investee;
- participation in the policy-making process, including participation in decisions about dividends or other distributions;
- material transactions between the entity and the investee;
- interchange of managerial personnel; or
- provision of essential technical information

4. POTENTIAL VOTING RIGHTS

Potential voting rights like share warrants and options also should be considered while assessing the significant influence.

Potential voting rights should be currently exercisable or convertible.

Potential voting rights held by other entities are also considered when assessing whether an entity has significant influence.

PROBLEM : 4

S Ltd hold 12% shares in M Ltd and S Ltd also holds debt instruments which have the potential to be converted into ordinary shares of M Ltd. If and when these are converted, S Ltd will acquire power over 10% of the voting rights of M Co. Is M Ltd an associate of S Ltd ?

SOLUTION : 4

5. ACCOUNTING FOR INVESTMENT IN ASSOCIATES AND JOINT VENTURES

An investor shall account for all investments made in associate and joint venture by applying the "equity method".

6. COMPUTATION OF GOODWILL

On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment.

Amortisation of that goodwill is not permitted.

Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is recognised directly in equity as capital reserve in the period in which the investment is acquired.

Goodwill		**Gain on bargain purchase**	
Cost of Investment	X (A)	Cost of Investment	X (A)
Less: Investor's share of net fair value of associates's		Less: Investor's share of net fair Value of associate's	
Identifiable Net Assets	X (B)	Identifiable Net Assets	X (B)
Goodwill (A – B)	X	Gain on bargain purchase (B – A)	X
Positive goodwill is already included in the cost of investment and so needs no further accounting treatment		The gain on bargain purchase will be recognised directly in profit or loss in the period in which the investment is acquired.	

7. EQUITY METHOD

The investment is recognized at cost initially. This carrying amount is decreased or increased by the following adjustments:

- Share of profit or loss of the investee after date of acquisition
- Share on components of the other comprehensive income.
- Distributions received from an investee reduce the carrying amount of the investment.
- Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income.
- Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences.
- The investor's share of those changes is recognised in the investor's other comprehensive income **(IAS 1, *Presentation of Financial Statements*).**

PROBLEM : 5

ABC Ltd. holds 25% shares in PQR Ltd. at a cost of Rs. 10,00,000. There was no goodwill or capital reserve at the time of acquisition. The total share capital of PQR Ltd. is Rs. 40,00,000 and for the current year, it has made profits of Rs. 6,00,000 out of which a dividend @10% of share capital has been paid. Find out the amount to be shown by ABC Ltd. in the consolidated financial statements, as investment in associates.

SOLUTION : 5

PROBLEM : 6

XYZ Ltd. acquired 30% Equity share capital of Dev. Ltd. at a cost of Rs. 6,00,000. On the date of acquisition, the SOFP of Dev Ltd. shows the following :

Equity share capital	**Rs. 10,00,000**
General Reserve	**3,00,000**
Securities Premium A/c	**2,00,000**

Since then, Dev Ltd. has made profits of Rs. 2,50,000 and has declared and paid a dividend on equity share capital @ 15%. Find out the amount at which the investment in associates will be shown by XYZ Ltd. in the consolidated financial statements.

SOLUTION : 6

8. EXEMPTIONS FROM APPLYING EQUITY METHOD

An entity is exempt from applying the equity method if the investment meets one of the following conditions:

The entity is a parent that is exempt from preparing consolidated financial statements under IFRS 10 Consolidated Financial Statements or if all of the following four conditions are met (in which case the entity need not apply the equity method):

- the entity is a wholly-owned subsidiary, or is a partially- owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method
- the entity's debt or equity instruments are not traded in a public market
- the entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, and
- the ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.
- When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss (FVTPL) in accordance with IFRS 9.
- When a portion of investment in an associate or joint venture is held indirectly through venture capital organization or mutual fund, unit trust, that portion alone can be measure under IFRS 9, while the other portion directly held should be accounted in accordance with equity method.

9. SHARE OF LOSSES IN ASSOCIATE

The investor's share of losses of an associate or joint venture is recognised until it exceeds or equals its interest in the associate or joint venture. Beyond that, no further losses are recognised, if any.

After the investor's interest is reduced to zero, additional losses are provided for and liability is recognised **only to the extent an investor has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.**

On subsequent reporting of profits by an associate or joint venture, the share of profits of the investor will first be used to absorb the earlier unrecognized losses and only after that the profits are to be recognised.

PROBLEM : 7

Big Ltd. has two subsidiaries, Mini Ltd. and Small Ltd.. In order to have significant influence over financial and operating policies, Big Ltd. acquired 22% control in Group Soft Ltd. (total share capital Rs. 20,00,000) at a cost of Rs. 6,00,000. There was no accumulated profits or losses of Group Soft Ltd. on the date of such acquisition.

During next two years of operations, Group Soft Ltd. incurred total operating losses of Rs. 30,00,000. Show the investment in associates in the consolidated financial statements of Big Ltd. (i) after acquisition in Group Soft Ltd. and (ii) after two years of operations.

SOLUTION : 7

10. UNIFORM ACCOUNTING POLICIES

The financial statement of the associate or joint venture shall be prepared using uniform accounting policies. Accordingly if different accounting policies are applied for like transactions and other events, then adjustments are made to reflect uniformity.

11. DIFERENCE IN REPORTING PERIOD

If the associate or joint venture's reporting period is different from that of investor's, then adjustments for significant events and transaction between the two dates shall be made. In any case the difference between the reporting periods shall not exceed **three months.**

12. TREATMENT OF UNREALISED INTRA-GROUP PROFITS RELATED TO ASSOCIATES

Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements **only to the extent of unrelated investors' interests in the associate or joint venture.**

'**Upstream' transactions**are, for example, sales of assets from an associate or a joint venture to the investor.

'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

The investor's share in the associates or joint venture's gains or losses resulting from these transactions is eliminated.

13. TREATMENT OF ELIMINATION OF UNREALISED INTRA-GROUP PROFITS RELATED TO ASSOCIATES IS SHOWN AS UNDER:

Downstream Transactions	Upstream Transactions
If the sale of goods/assets at profit is made by the investor to the associates, it is known as a downstream transaction.	If the sale of goods/assets at profit is made by the associates to investors, it is known as a upstream transaction.
The entry is as under	**The entry is as under**
Dr. Cost of Sales	Dr. Cost of Sales
Cr. Investment in associate (CBS)	Cr. Inventory (CBS)
(Being the elimination of group's share in unrealised intra-group profits)	Being elimination of URP on inventory owing to upstream transactions)
Rationale:	**Rationale:**
In this case, URP is included in the associate's inventory, but associate's inventory is not shown in the investor's financial statements as it does not consolidate the accounts of the associate.	In this case, URP is included in the investor's inventory which is included in consolidated financial statements.
Hence URP needs to be eliminated from the investment and not from inventory.	Hence, URP needs to be eliminated from the inventory and corresponding effect will always go to cost of sales/retained earnings.

PROBLEM : 8

H Ltd. holds 35% of Equity share capital of X Ltd. which is classified as an associate of H Ltd. While preparing the consolidated financial statements, the following information has been extracted :

a.Stock of X Ltd. includes goods of Rs. 25,000 purchased from H Ltd. which sells goods @ cost + 25%.

b. Stock of H Ltd. includes goods of Rs. 36,000 purchased from X Ltd. which sells goods @ cost + 20%.

Find out the amount of unrealised profit to be eliminated from consolidated SOFP in respect of above information. Also, record the journal entry in the books of H Ltd.

SOLUTION : 8

14. SEPARATE FINANCIAL STATEMENTS

An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with IAS 27.

15. IMPAIRMENT LOSSES

After application of the equity method an entity applies IFRS 9 to determine whether it is necessary to recognize any additional impairment loss with respect to its net investment in the associate or joint venture. If impairment is indicated, the amount is calculated by reference to IAS 36. The entire carrying amount of the investment is tested for impairment as a single asset, that is, goodwill is not tested separately. The recoverable amount of an investment in an associate is assessed for each individual associate or joint venture, unless the associate or joint venture does not generate cash flows independently.

16. CLASSIFICATION

An investment in an associate or a joint venture is generally classified as non-current asset, unless it is classified as held for sale in accordance with IFRS 5.

17. DISCONTINUANCE OF EQUITY METHOD

The investor shall discontinue the equity method of accounting from the date the investment ceases to be an associate or a joint venture. On sale of the entire interest, the difference between the following shall be reported in profit or loss:

- proceeds from disposing of the interest in the associate or joint venture and
- The carrying amount of the investments in such associate or joint venture at the date of discontinuance of equity method.

Amounts recognized in other comprehensive income in relation to investment of associate or joint venture shall be reclassified to profit or loss only to the extent that will be reclassified on the disposal of such items in entity's own other comprehensive income. For example, unrealized foreign exchange gains or losses of the associate or joint venture is reclassified to profit or loss,while actuarial gains or losses recognized will not be reclassified to profit or loss.

If there is a retained interest in the associate or joint venture that qualifies as financial asset, the asset should be measured at the fair value of the retained interest, with the resulting gain or loss recognized in the entity's profit or loss.

If the investment becomes a subsidiary, then the fair value of the remaining investments in former associate or the current subsidiary shall form part of the consideration in accordance with IFRS .

If an investment in associate becomes an investment in joint venture and vice versa, the entity should continue to apply equity method of accounting.

18. INVESTMENT CLASSIFIED AS HELD FOR SALE:

IAS 28 requires a portion of an investment in an associate or a joint venture to be classified as held for sale if the disposal of that portion of the interest would fulfill the criteria to be classified as held for sale in accordance with IFRS 5.

19. MAJOR CHANGE IN IND AS 28 VIS-À-VIS IAS 28 RESULTING IN CARVE OUT

As per IFRS: IAS 28 requires that for the purpose of applying equity method of accounting in the preparation of investor's financial statements, uniform accounting policies should be used. In other words, if the associate's accounting policies are different from those of the investor, the investor should change the financial statements of the associate by using same accounting policies.

Carve out 1: In IND AS 28, the phrase, 'unless impracticable to do so' has been added in the relevant requirements.

Reasons: Certain associates, e.g., regional rural banks (RRBs), being associates of nationalized banks, are not in a position to use the Ind AS as these may be too advanced for the RRBs. Accordingly, the above-stated words have been included to exempt such associates.

Carve out 2: Further, in IAS 28, Capital Reserve when Investors share in Net Assets exceeds Cost of Investment is recognised in profit or loss while in Ind AS 28, Paragraph 32 (b) has been modified on the lines of Ind AS 103 , *'Business Combinations'*, to transfer excess of the investor's share of the net fair value of the investee's identifiable assets and liabilities over the cost of investment in capital reserve.

PROBLEMS

PROBLEM : 9

Harden acquired 800,000 of Solder's $1 equity shares on 1 October 19X8 for $2.5 million. One year later, on 1 October 19X9 Harden acquired 200,000 $1 equity shares in Active for $800,000, The fair value of the non-controlling interest is $750,000. The SOFP of the three companies at 30 September 20X0 are shown below:

	Harden		Solder		Active	
	$'000	$'000	$'000	$'000	$'000	$'000
Non-current assets						
Property, plant and equipment		3,980		2,300		1 ,340
Patents		250		420		Nil
Investments - in Solder	2.500					
-in Active	800					
-others	150	3,450		200		60
		7,680		2,920		1 ,400
		990				
Current assets						
Inventories	570					
Trade receivables	420		400		300	
Bank	Nil		380	930	400	820
Total assets			150		120	
		8,670		**3,850**		**2,220**
Equity and liabilities						
Capital and reserves						
Equity shares of $1 each						
Reserves		2,000		1,000		500
Share premium						
Retained earnings	1 ,000		500		100	
	4,500	5,500	1 ,900	2,400	1,200	1 ,300
		7,500		3,400		1 ,800
Non-current liabilities						
Deferred tax		200		Nil		80
Current liabilities						
Trade payables	750		450		280	
Taxation	140		Nil		60	
Overdraft	80	970	Nil	450	Nil	340
		8 670		**3,850**		**2,220**

The following information is relevant:

(i) The balances of the retained earnings of the three companies were:

	Harden $'000	Solder $'0000	Active $'000
At 1 October 19X8	2,000	1 ,200	500
At 1 October 19X9	3,000	1 ,500	800

At the date of its acquisition, the fair values of Solder's net assets were equal to their book values, with the exception of a plot of land that had a fair value of $200,000 in excess of its book value.

(ii) On 26 September 20X0 Harden processed an invoice for $50,000 in respect of an agreed allocation of central overhead expenses to solder. At 30 September 20X0, Solder had not accounted for this transaction. Prior to this, the current accounts between the two companies had been agreed at Solder owing $70,000 to Harden (included in trade receivables and trade payables respectively).

(iii) During the year, Active sold goods to Harden at a selling price of $140,000, which gave Active a profit of 40% on cost. Harden had half of these goods in inventory at 30 September 2010

Required :

Prepare the consolidated SOFP of Harden as at 30 September 2010.

PROBLEM : 10

On 1 October 2015 Pumice acquired the following non-current investments:

- 80% of the equity share capital Of Silverton at a cost of $13.6 million.
- 50% Of Silverton's 10% loan notes at par.
- 1.6 million Equity shares in Amok at a cost of $6.25 each.
- The fair value of the 20% non-controlling interest is $2,500. (thousand)

The summarised draft SOFPs of three companies at 31 March are:

	Pumice $'000	Silverton $'000	Amok $'000
Non-current assets			
Property, plant and equipment (note 1)	20,000	8,500	16,500
Investments	26,000	Nil	1,500
	46,000	8,500	18,000
Current assets	15,000	8,000	11,000
Total assets	**61 ,000**	**16,500**	**29,000**
Equity and liabilities			
Equity			
Equity shares of $1 each	10,000	3,000	4,000
Retained earnings	37,000	8,000	20,000
	47,000	11,000	24,000
Non-current liabilities			
8% loan note	4,000	Nil	Nil
10% loan note	Nil	2,000	Nil
Current liabilities	10,000	3,500	5,000
Total equity and liabilities	**61,000**	**16,500**	**29,000**

The following information is relevant:

I . The fair value of Silverton's assets was equal to their carrying amounts, with the exception of land and plant, The land had a fair value of $ 400,000 in excess of its carrying amount and plant had a fair value of $1.6 million in excess of its carrying amount. The plant had a remaining life of four years (straight-line depreciation) at the date of acquisition.

2. In the post-acquisition period, Pumice sold goods to Silverton at a price of $6 million. These goods had cost Pumice $4 million. Half of them were still in Silverton's inventory at 31 March Silverton had a balance of $1.5 million owing to pumice at 31 March 2016 which agreed with Pumice's records.

3. The net profit after tax the year ended 31 March 2016 was $2 million for Silverton and $8 million for Amok. Assume profit accured evenly throughout the year.

4. An impairment test at 31 March 20X6 concluded that consolidated goodwill was impaired by $400,000 and the investment in Amok was impaired by $200,000.

5. No dividend were paid during the year by any of the companies.

Required :

Prepare the consolidated SOFP for Pumice as at 31 March 20X6.

PROBLEM 11 :

P Ltd. owns 80% of S and 40% of J and 40% of A. J is joint venture and A is an associate SOFP of four companies as on 31.03.19. are :

	P Ltd. Rs.	S Rs.	J Rs.	A Rs.
Assets				
Investment in S	800	-	-	-
Investment in J	600	-	-	-
Investment in A	600	-	-	-
PPE	3200	4100	4650	4650
Total	**5200**	**4100**	**4650**	**4650**
Liabilities:				
Share capital Re 1				
Equity share	1000	400	800	800
Retained earnings	4000	3400	3600	3600
Current liabilities	200	300	250	250
Total	**5200**	**4100**	**4650**	**4650**

P Ltd. acquired shares in S many years ago when S retained earnings were Rs.520. P Ltd. acquired its shares in J at the beginning of the year when J retained earnings were Rs.400. P Ltd. acquired its shares in 'A' on 01.04.18. when 'A' retained earnings were Rs.400. The balance of goodwill relating to S had been written off three years ago.

Prepare consolidated SOFP as per IFRS 10 as well as IAS-28.

PROBLEM 12 :

Air Ltd., a listed company, entered into an expansion programme on 1st October, 2019. On that date the company purchased from Bag Ltd. its investments in two Private Limited Companies. The purchase was of

(a) the entire share capital of Cold Ltd.

and

(b) 50% of the share capital of Dry Ltd.

Both the investments were previously owned by Bag Ltd. After acquisition by Air Limited, Dry Ltd. was to be run by Air Ltd. and Bag Ltd. as a jointly controlled entity.

Air Ltd. makes its financial statements upto 30th September each year. The terms of acquisition were:

COLD LTD.

The total consideration was based on price earnings ratio (P/E) of 12 applied to the reported profit of Rs.20 lakhs of Cold Ltd. for the year 30 September, 2019. The consideration was settled by Air Ltd. issuing 8% debentures for Rs.140 lakhs (at par) and the balance by a new issue of Rs.1 equity shares, based on its market value of Rs.2.50 each.

DRY LTD.

The market value of Dry Ltd. on first October, 2019 was mutually agreed as Rs.375 lakhs. Air Ltd. satisfied its share of 50% of this amount by issuing 75 lakhs Rs.1 equity shares (market value* 2.50 Each) to Bag Ltd.

Air Ltd. has not recorded in its books the acquisition of the above investments or the discharge of the consideration.

The summarized statements of financial position of the three entities at 30th September, 2020 are: (Rs. in thousands)

	Air Ltd.	Cold Ltd.	Dry Ltd.
Assets			
PPE	34,260	27,000	21,060
Inventories	9,640	7,200	18,640
Debtors	11,200	5,060	4,620
Cash	-	3,410	40
	55,100	42,670	44,360
Liabilities			
Equity capital:			
Rs.1 each	10,000	20,000	25,000
Retained earnings	20,800	15,000	4,500
Trade and other payables	17,120	5,270	14,100
Overdraft	1,540	-	-
Provision for taxes	5,640	2,400	760
	55,100	**42,670**	**44,360**

The following information is relevant.

a) The book values of the net assets of Cold Ltd. and Dry Ltd. on the date of acquisition were considered to be a reasonable approximation to their fair values.

b) The current profits of Cold Ltd. and Dry Ltd. for the year ended 30th September, 2020 were Rs.80 lakhs and Rs.20 lakhs respectively.

c) Dry Ltd., the joint venture is to be accounted for using Equity Method.

Prepare consolidated SOFP as per IFRS 10 as well as IAS-28.

PROBLEM 13 :

(a) Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 2013 were as follows:

	Alpha	Beta	Gamma
	$'000	$'000	$'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	280,000	225,000	200,000
Investments (Notes 1, 2 and 3)	78,500	40,000	10,000
	358,500	265,000	210,000
Current assets:			
Inventories (Note 4)	85,000	56,000	42,000
Trade receivables (Note 5)	70,000	42,000	38,000
Cash and cash equivalents	14,000	11,000	9,000
	169,000	109,000	89,000
Total assets	527,500	374,000	299,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	160,000	120,000	100,000
Retained earnings	211,396	115,000	76,000
Other components of equity (Notes 2, 3 and 6)	5,604	4,000	2,000
Total equity	377,000	239,000	178,000
Non-current liabilities:			
Provision (Note 7)	1,500	Nil	Nil

Long-term borrowings (Note 8)	60,000	50,000	60,000
Deferred tax	22,000	25,000	17,000
Total non-current liabilities	83,500	75,000	77,000
Current liabilities:			
Trade and other payables (Note 5)	45,000	40,000	34,000
Short-term borrowings	22,000	20,000	10,000
Total current liabilities	67,000	60,000	44,000
Total equity and liabilities	527,500	374,000	299,000

Note 1 – Alpha's Investment In Beta

On 1 April 2012, Alpha acquired 90 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

– Alpha issued eight shares for every nine shares acquired in Beta. On 1 April 2012, the market value of an Alpha share was $2·80.

– Alpha will make a further cash payment to the former shareholders of Beta on 30 June 2015. This payment will be based on the adjusted profits of Beta for the three-year period to 31 March 2015. On 1 April 2012, the fair value of this additional payment was estimated at $25 million. This estimate had increased to $28 million by 31 March 2013 due to changes in circumstances since the date of acquisition.

– Neither component of the investment in Beta has been recorded in the draft financial statements of Alpha presented above.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 2012 can be used for this purpose. On 1 April 2012, the market value of a Beta share was $2·60.

On 1 April 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $86 million.

– Other components of equity $2·4 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2012. The following matters emerged:

– Property having a carrying value of $140 million (depreciable component $80 million) had an estimated market value of $160 million (depreciable component $92 million). The estimated future economic life of the depreciable component at 1 April 2012 was 16 years and this estimate remains valid.

– Plant and equipment having a carrying value of $111 million had an estimated market value of $120 million. The estimated future economic life of the plant and equipment at 1 April 2012 was three years and this estimate remains valid. Beta has not disposed of any of this plant and equipment since 1 April 2012.

– Intangible assets with an estimated market value of $8 million had not been recognised in the individual financial statements of Beta. The estimated future economic lives of these intangible assets at 1 April 2012 was four years.

– The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 April 2012.

Note 2 – Alpha's Investment In Gamma

On 1 April 2012, Alpha acquired 40 million shares in Gamma for a cash payment of $1·85 per share and debited $74 million to investments in its own statement of financial position. This enabled Alpha to exercise significant influence over Gamma but not to control Gamma. In its own financial statements, Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income.

On 1 April 2012, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $66 million.

– Other components of equity $1·2 million.

On 1 April 2012, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

On 31 March 2013, the fair value of Alpha's investment in Gamma was estimated at $78·5 million and this is the balance recorded in Alpha's individual financial statements. On 31 March 2013, Alpha credited $4·5 million to other components of equity. No deferred tax was recognised when making this entry.

In the consolidated financial statements you can ignore deferred tax when measuring the investment in Gamma.

Note 3 – Investments By Beta And Gamma

These investments are financial assets that are measured at fair value through other comprehensive income and have been correctly treated by Beta and Gamma. The other components of equity of Beta and Gamma relate entirely to these investments.

Note 4 – Inter-Company Sale Of Inventories

The inventories of Beta and Gamma at 31 March 2013 included components produced by Alpha. The selling price of the components included in the inventories of Beta was $14 million. The selling price of the components included in the inventories of Gamma was $12 million. Alpha applied a mark-up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

Note 5 – Trade Receivables And Payables

The trade receivables of Alpha included $9 million receivable from Beta and $7·5 million receivable from Gamma in respect of the purchase of components (see Note 4). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 6 – Share Based Payment

On 1 April 2011, Alpha granted share options to senior executives that are due to vest on 31 March 2011. The maximum number of options that can vest is 10 million. However, there are vesting conditions that are service conditions. Each option allows the holder to purchase a share in Alpha for $2·50. Further details are as follows:

Date	Share price	Fair value of an option	Number of options expected to vest on 31 March 2014
1 April 2011	$2·50	36 cents	9 million
31 March 2012	$2·80	55 cents	9·2 million
31 March 2013	$3·00	90 cents	9·3 million

On 31 March 2012, the directors of Alpha correctly credited other components of equity and debited profit or loss with $1,104,000 in respect of these share options. No entries have been made in the financial statements since then in respect of the options.

Ignore any deferred tax implications of the granting of these share options.

Note 7 – Provision

On 1 October 2011, Alpha entered into a 10-year lease of office premises at an annual rental of $20 million. This lease was correctly classified as an operating lease and the rentals appropriately charged to profit or loss.

On 1 October 2011, Alpha began carrying out alterations to the premises. These alterations were completed on 31 March 2012 at a total cost of $18 million. Alpha included $18 million in its property, plant and equipment at 31 March 2012 and charged depreciation in the current year based on a 9½ year useful economic life.

The terms of the lease require Alpha to vacate the premises on 30 September 2021 and leave them in the same condition as they were on 1 October 2011. The directors estimate that this will require restoration expenditure of $14,250,000 on 30 September 2021. Accordingly, the directors recognised a provision of $1,500,000 ($14,250,000/9·5) at 31 March 2013. The directors debited $1,500,000 to profit or loss when recognising this provision.

A relevant discount rate to use in any discounting calculations is 8% per annum. The present value of $1 payable in 9½ years at this discount rate is 48 cents.

Note 8 – Long-Term Borrowings

The long-term borrowings of Alpha include $20 million that was received from a consortium of banks on 1 April 2012. The loan does not carry any interest but $30·6 million is repayable on 31 March 2017. Alpha incurred incremental costs of $1 million in arranging the loan which were charged to profit or loss in the year ended 31 March 2013. The effective annual rate of interest applicable to this loan is 10%.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2013.

Note: You should show all workings to the nearest $'000.

PROBLEM FOR SELF PRACTICE

PROBLEM : 14

Yellow Co invested $20,000 and holds 30% in Orange Co. The post-acquisition profit of Orange Co is $2,000.

The inventory of Orange co includes $2,350 of purchases made from Yellow Co. Yellow Co has made a loss of $150 on this sale to Orange co.

Required;

Determine the investment in associate which will be shown in the consolidated SOFP.

SOLUTION : 14

As Yellow Co owns 30% share in Orange Co, Orange Co is an associate of Yellow Co.

The sale of goods is a downstream transaction. The unrealised intra-group loss in the inventory of Orange Co is $150. Group share is 30% of $150 = $45. The journal entry to be passed is

Dr Investment in associate $45

Cr Cost of sales $45

In the consolidated SOFP, the Group share in associated company will be:

	$	$
Amount invested		20,000
Add: Post-acquisition profit (2,000 x 30%)	600	
Add: group share in unrealised loss	45	645
Group share of associated company profit		**20,645**

PROBLEM : 15

Joyful Co invested $20,000 and holds 30% of Content Co. The post-acquisition profit of Content Co is $2,000

The inventory of Joyful Co includes $1,500 of purchses made from Content Co. Content Co has made a profit of $300 on this sale to Joyful Co.

Required :

Determine the group share of associated company profit.

SOLUTION : 15

Joyful Co owns 30% share in Content Co. Hence, Content Co is an associate Of Joyful Co. The sale of goods is an upstream transaction. URP in the inventory of Joyful Co is $300.

Group share = 30% x $300 = $90.

The journal entry to be passed is:

Dr Cost of sales $90

Cr Inventory $90

Being elimination of URP for sale of goods from Content to Joyful

Joyful's share in profit of Content will be $600 ($2,000 x 30%) and $90 will be reduced from the consolidated retained earnings.

The amount of investment in Content will be shown in the CSOFP as:

	$
Amount invested	20,000
Add: Post-acquisition profit (2,000 x 30%)	600
	20,600

PROBLEM : 16

Geeta and Anjali have entered into a contract to design and produce clothes for sale in a boutique. They have decided to contribute equally towards the capital and share profits or losses equally. However, it has been decided that Anjali will have the final say about the designs of the clothes.

Required :

Determine whether this activity is a joint venture.

SOLUTION : 16

A joint arrangement requires all contracting parties to have equal control. All the decisions related to relevant activities have to be taken with unanimous consent. In this case there exists a contract between two parties to undertake an economic activity. However as Anjali has more control over the decisions related to relevant activities, this activity cannot be called a joint arrangement.

PROBLEM : 17

X Ltd. owns 20 % of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consist of five members. The remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.

A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meeting at the short notice and make decisions in the absence of X Ltd's representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd's representative has attended board meetings, but suggestions for items to be included on the agenda have been ignored and the other directors oppose any suggestions made by X Ltd. Is Y Ltd an associate of X Ltd.?

SOLUTION : 17

Despite the fact that the X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent the from exerting significant influence. Whilst it appears the X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent X Ltd's efforts and stop X Ltd from actually having any influence.

In this situation, Y Ltd would not be an associate of X Ltd.

Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee.

PROBLEM : 18

Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd's board comprise of eight members and two of these members are appointed by Kuku Ltd. Each board member has one vote at meeting. Is Boho Ltd an associate of Kuku Ltd?

SOLUTION : 18

Boho Ltd is an associate of Kuku Ltd as significant influence is demonstrated by the presence of directors on the board and the relative voting rights at meetings.

It is presumed that entity has significant influence where it holds 20% or more of the voting power of the investee, but it is not necessary to have 20% representation on the board to demonstrate significant influence, as this will depend on all the facts and circumstances. One board member may represent significant influence even if that board member has less than 20% of the voting power. But for significant influence to exist it would be necessary to show based on specific facts and circumstances that this is the case, as significant influence would not be presumed.

PROBLEM : 19

Q Ltd manufactures shoes for a leading retailer P Ltd. P Ltd provides all designs for the shoes and participates in scheduling, timing and quantity of the production. The majority (i.e. 90%) of Q Ltd.'s sales are made to the retailer, P Ltd. P Ltd. has 10% shareholding in the Q Ltd. It acquired this interest many years ago at the start of their relationship. Does significant influence exist?

SOLUTION : 19

Q Ltd is highly dependent on the retailer for the continued existence of the business. Despite having only a 10% interest in Q Ltd, P Ltd has significant influence

PROBLEM : 20

X Ltd owns 15% of the voting rights of Y Ltd, and the remainder are widely dispersed among the public.

X Ltd also is the only supplier of crucial raw materials to Y Ltd, further it provides certain expertise guidance regarding the maintenance of Y Ltd's factory.

Discuss the relationship between X Ltd and Y Ltd.

SOLUTION : 20

Y Ltd is effectively functioning because of the participation of X Ltd in the Y Ltd's factory despite having 15% interest in Y Ltd, X Ltd has significant influence.

PROBLEM : 21

Entity X and entity Y, operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provides for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board as well as to entity X's. Analyse.

SOLUTION : 21

The secondment of the board member and a senior manager from entity X to entity Y gives entity X, a range of power over a new production process and may evidence that entity X has significant influence over entity Y. This assessment take into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

PROBLEM : 22

Soul Ltd has 18% interest in God Ltd. Soul Ltd manufacture mobile telephone handsets using technology developed by God Ltd. God Ltd licenses the technology to Soul Ltd and updates the licence agreement for new technology on a regular basis. The handsets are sold by Soul Ltd and represent substantially Soul Ltd's entire sale. Analyse.

SOLUTION : 22

Soul Ltd is dependent on the technology that God Ltd supplies since a high proportion of Soul Ltd's sales are based on that technology. Therefore, Soul Ltd is likely to be an associate of God Ltd because of the provision of essential technical informational.

PROBLEM : 23

Amar Ltd. acquires 40% shares of Ram Ltd. On 1 Apr 20X1, the price paid is ` 10,00,000. Ram Ltd has reported a profit of ` 2,00,000 and paid dividend of ` 1,00,000. Make necessary journal entries in the books of Amar Ltd

SOLUTION : 23

		Amount `	Amount `
Investment in Associate A/c	Dr.	10,00,000	
To Cash A/c			10,00,000
Investment in Associate A/c	Dr.	80,000	
To Share in Profit from Associate A/c			80,000
Cash A/c	Dr.	40,000	
To Investment in Associate A/c			40,000

IFRS 12 — DISCLOSURE OF INTERESTS IN OTHER ENTITIES

1. INTRODUCTION

This standard is the basis for disclosure of interests in "other entities, be it a

- subsidiary,
- associate,
- joint venture or
- unconsolidated structured entities.

Other IFRSs only provide for accounting for these entities. The disclosures are to be based on the disclosure objective set by the standard.

2. DEFINITIONS

Structured entity - An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by, means of contractual arrangements

Income from a structured entity - for the purpose of this IFRS, income from a structured entity includes, but is not limited to, recurring and non-recurring fees, interest, dividends,· gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.

Interest in another entity - For the purpose of this IFRS, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of the equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.

3. SIGNIFICANT JUDGEMENTS AND ASSUMPTIONS

An entity discloses information about significant judgements and assumptions it has made (and changes in those judgements and assumptions) in determining:

- that it controls another entity
- that it has joint control of an arrangement or significant influence over another entity
- the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

4. INTERESTS IN SUBSIDIARIES

An entity shall disclose information that enables users of its consolidated financial statements:

To understand

- the composition of the group;
- the interest that non-controlling interests have in the group's activities and cash flows; and

To evaluate

- the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group
- the nature of, and changes in, the risks associated with its interests in consolidated structured entities
- the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control
- the consequences of losing control of a subsidiaryduring the reporting period.

5. INTERESTS IN UNCONSOLIDATED SUBSIDIARIES

In accordance with IFRS 10 Consolidated Financial Statements, an investment entity is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss.

DISCLOSURE REQUIRED BY AN INVESTMENT ENTITY

Where an entity is an investment entity, this standard requires additional disclosure, including:

- The fact the entity is an investment entity
- information about significant judgements and assumptions it has made in determining that it is an investment entity, and specifically where the entity does not have one or more of the (typical characteristics) of an investment entity
- details of subsidiaries that have not been consolidated (name, place of business, ownership interests held)

- details of the relationship and certain transactions between the investment entity and the subsidiary (e.g. restrictions on transfer of funds, commitments, support arrangements, contractual arrangements)
- information where an entity becomes, or ceases to be, an investment entity

An entity making these disclosures are not required to provide various other disclosures required.

6. INTERESTS IN JOINT ARRANGEMENTS AND ASSOCIATES

An entity shall disclose information that enables users of its financial statements to evaluate:

- the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, jointarrangements and associates
- the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

7. INTERESTS IN UNCONSOLIDATED STRUCTURED ENTITIES

An entity shall disclose information that enables users of its financial statements to:

- understand the nature and extent of its interests in unconsolidated structured entities
- evaluate the nature of, and changes in the risks associated with its interests in unconsolidated structured entities

IAS 24 — RELATED PARTY DISCLOSURES

1. INTRODUCTION

An entity does not operate in solitude. There will be persons and entities that will influence the entity in the normal course of business. The extent of such influence determines the reasonableness of the transaction. This standard in the larger interest of the stakeholders provides guidance on identifying such parties and disclose transactions, outstanding and commitments with such parties.

A related party relationship could have an effect on the profit or loss and financial position of an entity.

Related parties may enter into transactions that unrelated parties would not.

Transactions between related parties may not be made at the same amounts as between unrelated parties.

The profit or loss and financial position of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. **The standard considers that it is necessary to draw attention to the possibility that financial position and profit or loss may have been affected by the existence of such relationship and prescribes disclosures necessary to meet this objective.**

2. WHO IS A RELATED PARTY

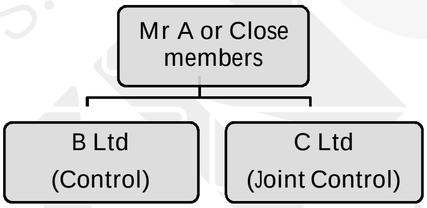
A related party is a **person or entity** that is related to the entity that is preparing financial statements (in this standard referred to as 'reporting entity').

In determining whether related party relationship exists, the substance of the relationship is considered rather than the legal form.

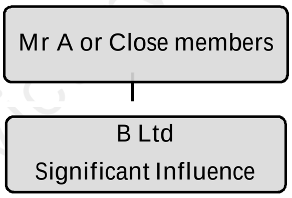
An entity may be related to a **person (individuals)** or **another entity (artificial person).**

9.a. A **<u>PERSON OR A CLOSE MEMBER OF THAT PERSON'S FAMILY</u>** is related to a reporting entity if that person:

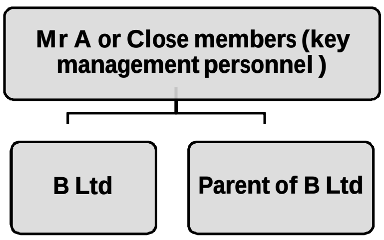
i Has control or joint control over reporting entity **(Example - shareholder holding more than 50% of voting power.);**



ii Has significant influence over the reporting entity **(Example - shareholder holding more than 20% of voting power**); or

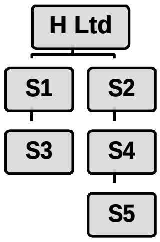


iii Is a member of the key management personnel of the reporting entity or of a parent of a reporting entity**(Example - Executive Directors, CEOs will fall in this cadre)**

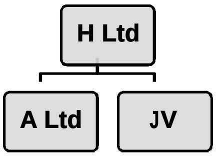


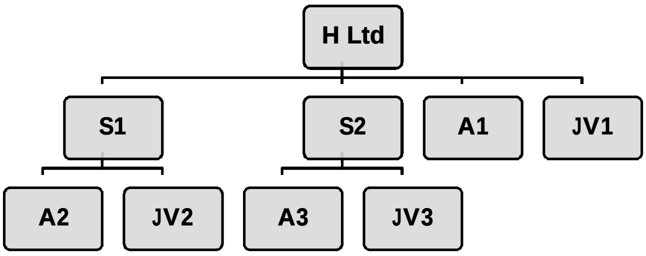
9.b. An **<u>ENTITY is related to a reporting entity</u>** if any of the following condition applies

i) The entity and reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)



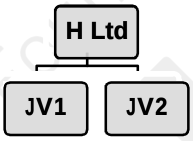
ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member)



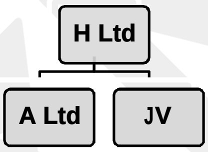


A1, A2, A3, J1,J2,J3 are related parties of H, S1 and S2. A1, A2 and A3 are not related to each other.

iii) Both entities are joint ventures of the same third party

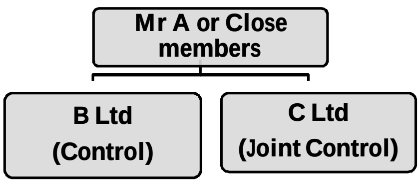


iv) One entity is a joint venture of a third party and the other is an associate of the third party



v) The entity is a post-employment benefit plan for the benefit of employees of the entity, or an entity related to the reporting entity. If the reporting entity itself is such a plan, the sponsoring employers are also related to the reporting entity

vi) The entity is controlled or jointly controlled by a person identified in (a)



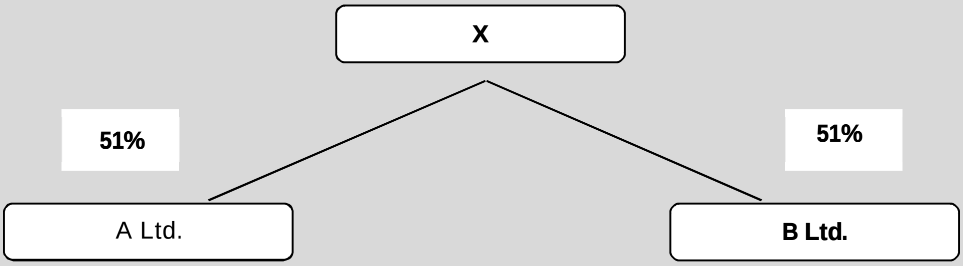
vii) A person identified in (a) (i) has significant influence over the entity or is a member of key management personnel of the entity (or of a parent of the entity)

viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

PROBLEM : 1

Entities under common control or joint control

Mr. X holds 51% shares of both A Ltd. and B Ltd.Whether A Ltd. and B Ltd. are related parties to each other?

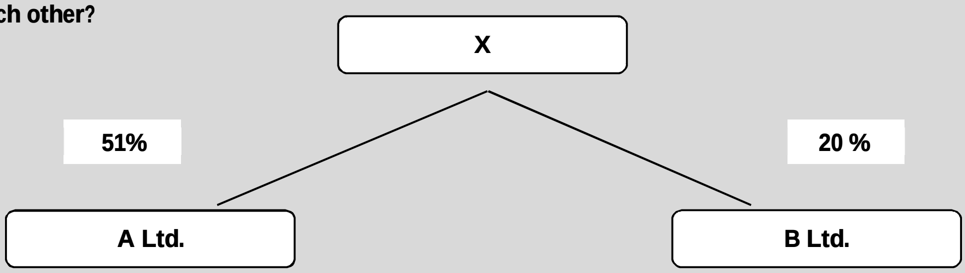


SOLUTION : 1

PROBLEM : 2

Entities under common control and significant influence

Mr. X holds 51% voting right of A Ltd. and 20% voting right in B Ltd.Whether A Ltd. and B Ltd. are related parties to each other?



SOLUTION : 2

PROBLEM : 3

Mr. X and his close family members have investments in A Ltd and B Ltd.

Together they hold 51% of equity share capital of A Ltd, and have joint control over B Ltd. Analyse related party relationship of A Ltd and B Ltd.

SOLUTION : 3

PROBLEM : 4

Mr. X and his close family members have investments in A Ltd and B Ltd.

Together they hold 20 % of equity share capital of A Ltd, and 51% shares in B Ltd. Analyse related party relationship of A Ltd and B Ltd.

SOLUTION : 4

PROBLEM : 5

Mr. X and his close family members have investments in A Ltd and B Ltd.Together they hold 20 % of equity share capital of A Ltd, and 20% shares in B Ltd. Analyse related party relationship of A Ltd and B Ltd.

SOLUTION : 5

PROBLEM : 6

Mr. X and his close family members hold 51 % of equity share capital of XYZ Ltd. Mrs X is a Key Managerial Personnel in A Ltd.

Mr. X and his close family members hold 20 % of equity share capital of B Ltd.

Mr. X and his close family members hold 51 % of equity share capital of C Ltd.

B Ltd is a subsidiary of AB Ltd.

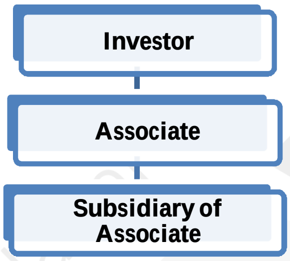
Analyse related party relationship .

SOLUTION : 6

3. SUBSIDIARIES OF THE ASSOCIATE AND SUBSIDIARIES OF THE JOINT VENTURE ARE ALSO RELATED PARTIES.

In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture.

Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.



4. DEFINITIONS

A **related party transaction** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

Compensation includes all employee benefits (as defined in IAS 19 **Employee Benefits)** including employee benefits to which IFRS 2 **Share-based Payment** applies.

Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. **Compensation includes:**

(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave,profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions,other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;

(d) termination benefits; and

(e) share-based payment.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Government refers to government, government agencies and similar bodies whether local, national or international

A Government-related entity is an entity that is controlled, jointly controlled or significantly influenced by the government.

Note - The terms 'control' and 'investment entity', 'joint control' and 'significant influence' are defined in IFRS 10, IFRS 11 Joint Arrangements and IAS 28 Investments in Associates and Joint Ventures respectively and are used in this Standard with the meanings specified in those IFRSs.

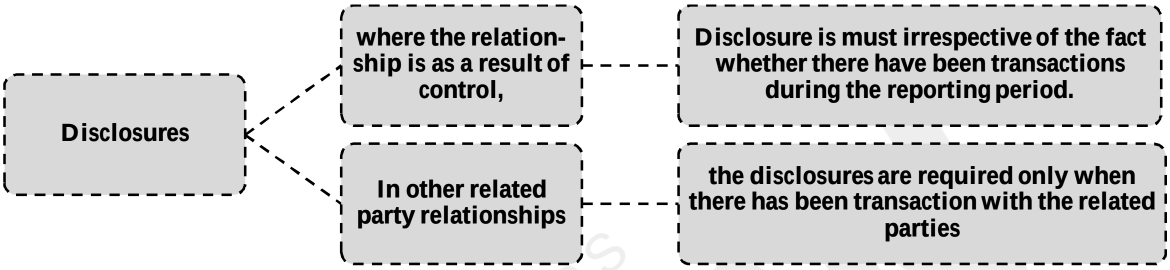
5. WHO ARE NOT NECESSARILY RELATED PARTIES ?

In the context of this Standard, the following **are not necessarily related parties.** They are:

- Two companies having a director other member of key management personnel in common
- Two venturers simply because they share joint control over the joint venture
- Single customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence.
- Specific parties like financiers, trade unions, public entities and government agencies by virtue of their normal dealings with the entity.

Related party transactions are **"transfer of resources or obligations"** between related parties. Consideration is not a criterion. Hence mere transfer without any consideration is also to be disclosed.

6. DISCLOSURES



Relationships between parent and subsidiaries where the relationship is as a result of control, have to be disclosed irrespective of the fact whether there have been transactions during the reporting period.

If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

Next most senior parent - This is the first parent in the group above the immediate parent that produces consolidated financial statements available for public use.

In other related party relationships, the disclosures are required only when there has been transaction with the related parties

If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements.

These disclosure requirements are in addition to the requirements to disclose key management personnel compensation (specified below).

7. MINIMUM DISCLOSURES

At a minimum, disclosures shall include:

- Name of party, nature of relationship and transaction
- Volume of transaction
- Amount of outstanding balances with details of security and guarantee
- Provision for doubtful debts related to outstanding balances
- Amounts written back or written off.

The above disclosure is to be made separately for each category of related party specified in the standard.

- Parent
- Entities with joint control or significant influence over the entity
- Subsidiaries
- Associates
- Joint ventures
- Key Management Personnel
- Other related parties

The compensation to KMP **in total and for each of the following categories are to be disclosed:**

- Short-term employee benefits
- Post-employment benefits
- Other long-term employee benefits
- Termination benefits
- Share based payment

NOTE : If an entity obtains key management personnel services from another entity (the 'management entity'), the entity is not required to give disclosures relating to the compensation paid or payable by the management entity to the management entity's employees or directors.

The following are the examples of transactions that are to be disclosed if they are with a related party:

- Purchases and sales of goods, property or other assets.
- Rendering or receiving of services.
- Leases
- Transfers of research and development or transfers under license agreements / finance arrangements.
- Amounts incurred by the entity for the provision of key management personnel services that are provided by a separate management entity.

Items of a similar nature can be grouped except where the separate disclosure is necessary for understanding of the effects of transactions on the financial statements of the entity.

8. GOVERNMENT-RELATED ENTITIES

The above disclosures are optional for transactions with

- government that has control, joint control or significant influence over the entity
- and another entity in which the same government has control, joint control or significant influence over that entity

When this option is utilized, the following disclosures shall be made by the entity

- name of government and nature of relationship
- nature and amount of each individually significant transaction
- for other significant transactions, a quantitative or qualitative indication of the extent of transactions.

9. MAJOR CHANGES IN IND AS 24 VIS-À-VIS IAS 24 NOT RESULTING IN CARVE OUTS

1. ***Confidentially:*** In IND AS 24, disclosures which conflict with confidentiality requirements of statute / regulations are not required to be made since Accounting Standards cannot override legal / regulatory requirements.
2. ***Additional Clarificatory Guidance Regarding Aggregation of Transactions:*** Paragraph 24A (reproduced below) has been included in the IND AS 24. It provides additional clarificatory guidance regarding aggregation of transactions for disclosure.

   Para 24A -Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.
3. ***Modification of Paragraph 14:*** Paragraph 14 of IND AS 24 has been modified to explain the rationale for disclosing related party relationship when control exists.
4. ***Management Contracts Including for Deputation or Employees:*** In IND AS 24, 'management contracts including for deputation or employees' has been added in the example of transactions that are disclosed if they are with related party.
5. ***Definition of Close Members of the Family of a Person:*** Definition of 'close members of the family of a person' has been amended to include brother, sister, father and mother in the category of family members who may be expected to influence, or be influenced.

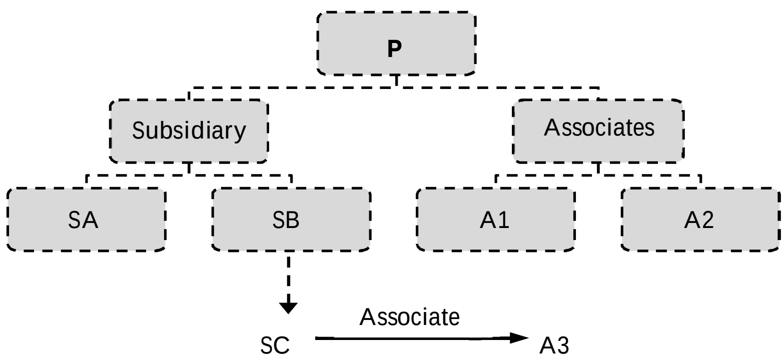
PROBLEM FOR SELF_PRACTICE

PROBLEM : 7

Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited

Required : Examine related party relationships of various entities.

SOLUTION : 7



- For P Limited's separate financial statements, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- For SA Limited's financial statements, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- For SB Limited's financial statements, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- For SC Limited's financial statements, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- **For the financial statements of associates A1 Limited, A2 Limited and A3 Limited;** P Limited, SA Limited, SB Limited and SC Limited are related parties.
- For P Limited's consolidated financial statements, A1 Limited, A2 Limited and A3 Limited are part of the Group.

PROBLEM : 8

Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.

Required

a) Examine related party relationships from the perspective of C Limited for A Limited.

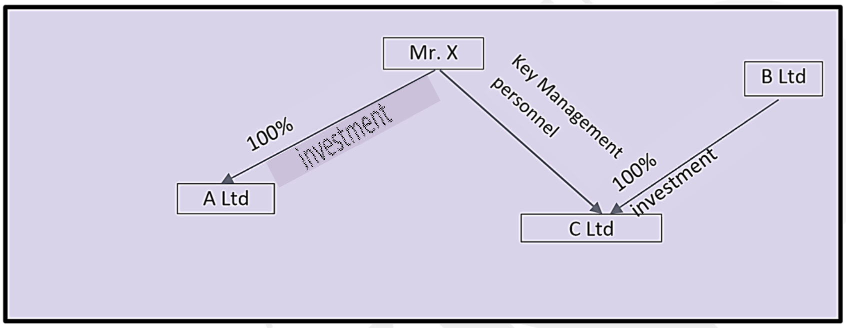
b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

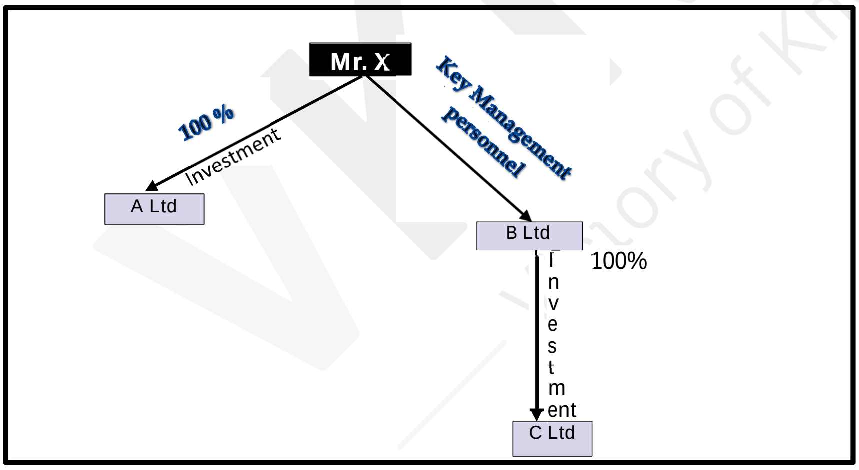
d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited.

SOLUTION : 8

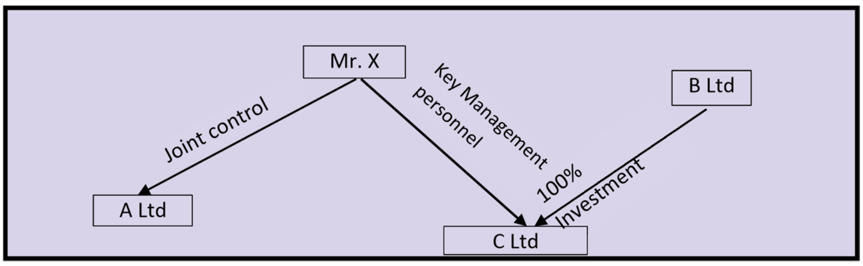
(a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.



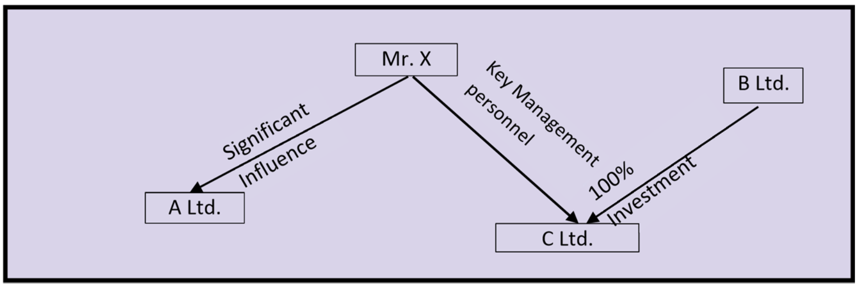
(b) Still A Limited will be related to C Limited.



(c) No, Still A Limited will be related to C Limited.



(d) Despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.



PROBLEM : 9

Mr. X has an investment in A Limited and B Limited.

Required

I. Examine when can related party relationship be established

(a) from the perspective of A Limited's financial statements:

(b) from the perspective of B Limited's financial statements:

II. Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited

SOLUTION : 9

(i) (a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Mr. X has control, joint control or significant influence over Entity B.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to Entity B when Mr. X has control, joint control or significant influence over Entity B.

(ii) No, A Ltd. & B Ltd., will not be considered as related party since no direct or indirect control is exercised on each other in any of the manner.

PROBLEM : 10

Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1.

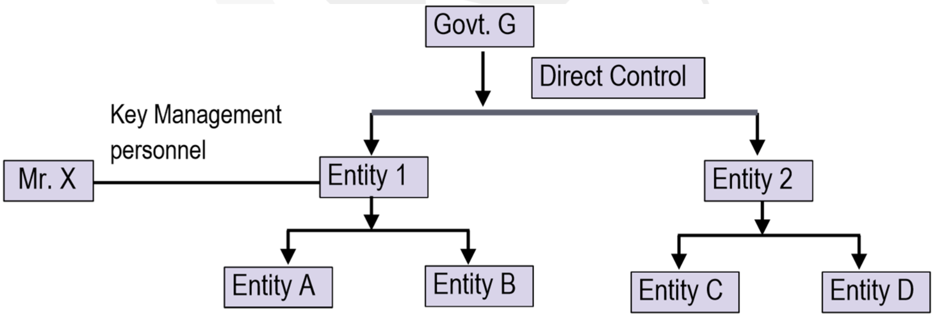
Required : Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

SOLUTION : 10

For Entity A's financial statements, the exemption of IAS 24 applies to:

a) transactions with Government G; and

b) transactions with Entities 1 and 2 and Entities B, C and D. However, that exemption does not apply to transactions with Person X.



PROBLEM : 11

Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from Power Limited. Power Limited whose financial year ends on March 31, 20X2, acquired 100% shareholding of Transmission Limited on July 15, 20X1. However, the entire shareholding is disposed of on March 21, 20X2. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.

What related party disclosures should Power Limited make in its financial statements for the year ended March 31, 20X2 with respect to transactions with Transmission Limited.

SOLUTION : 11

Power Limited should in its financial statements for the year ended March 31, 20X2 make related party disclosures for the period from July 15, 20X1 to March 21, 20X2 when Transmission Limited was its subsidiary.

PROBLEM : 12

Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Limited and Ms. Y has an investment in B Limited.

Required

(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements:

(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements:

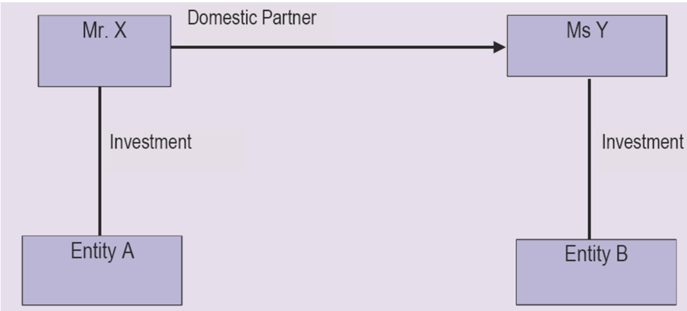
(c) Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited:

SOLUTION : 12

(a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Ms. Y has control, joint control or significant influence over B Limited.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to B Limited when Ms. Y has control, joint control or significant influence over B Limited.

(c) No, Significant influence does not lead to direct / indirect control between the A Ltd. & B Ltd.



PROBLEM : 13

A Limited has both (i) joint control over B Limited and (ii) joint control or significant influence over C Limited Required

(a) Examine related party relationship from the perspective of C Limited's financial statements:

(b) Examine related party relationship from the perspective of B Limited's financial statements:

SOLUTION : 13

(a) C Limited is related to B Limited

(b) B Limited is related to C Limited

PROBLEM : 14

ABC Ltd. is a customer of XYZ Ltd. Mrs. P, whose husband is a director in XYZ Ltd., purchased a controlling interest in entity ABC Ltd. on 1st June, 2017.

Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 2017 to 31st May 2017 totalled Rs. 8,00,000.

Following the shares purchased by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy).

Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 2017 to 31st March 2017 totalled Rs. 60,00,000.

On 31st March 2018, the trade receivables of XYZ Ltd. included Rs. 18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2018 and mention the disclosure requirements also as per IAS 24.

SOLUTION : 14

XYZ Ltd. would include the total revenue of Rs. 68,00,000 (Rs. 60,00,000 + Rs. 8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2018 within its revenue and show Rs. 18,00,000 within trade receivables at 31st March 2018.

Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd.

From 1st June 2017, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party. Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:

- The nature of the related party relationship.
- The revenue of Rs. 60,00,000 from ABC Ltd. since 1st June 2017.
- The outstanding balance of Rs. 18,00,000 at 31st March 2018.

In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

PROBLEM : 15

Mr. X, is the financial controller of ABC Ltd. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director, Mr. Y, for approval.

Mr. Y had raised following query from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period.

Mr. Y own 100% of the shares in PQR Ltd.. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases. Provide answers to the query raised by the managing director Mr. Y as per IAS.

SOLUTION 15 :

On going through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

Related parties are generally characterised by the presence of control or influence between the two parties.

IAS 24 'Related Party Disclosures' identifies related parties as key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd.

Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, IAS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

PROBLEM : 16

Mr X is a member of key management personnel of A Ltd. He also has a 30% voting rights in the share capital of B Ltd. Whether A Ltd and B Ltd will be related parties for the purposes of related party disclosures as per the standard?

What would be your answer if Mr X holds 60% of the voting rights of B Ltd?

Whether A Ltd and B Ltd will be related parties for the purposes of disclosure of this standard, if Mr X is also a member of key management personnel of B Ltd?

(Assume the financial statements are being presented for A Ltd and A Ltd is the reporting entity)

SOLUTION 16 :

Mr. X being a member of key management personnel of A Ltd holds 30% of voting rights (not control) of B Ltd. Hence, A Ltd and B Ltd cannot be related parties for the purposes of the standard.

Mr X's holding 60% voting rights in B Ltd will give him control over B Ltd and is also a member of key management personnel of A Ltd. Therefore, A Ltd and B Ltd are related parties for the purposes of this standard.

Para 11 (a) of the Standard further states that two entities cannot be related parties simply because they have a common director or a member of key management personnel. Hence, Mr X being a member of key management personnel of both A and B Ltd, A Ltd and B Ltd are not related parties.

PROBLEM : 17

M/s ABL is a post-employment benefit plan company Providing post-employment pension benefits to the employees of A Ltd.

1. **In the financial statements ended 31 March 2017, whether transactions between A Ltd and M/S ABL fall within the ambit of IAS 24 for disclosure purposes?**
2. **Would your answer be any different if M/S ABL provided post-employment pension benefits, not to the employees of A Ltd but to the employees of B Ltd (a company which an associate company of A Ltd)?**
3. **If M/S ABL provides post-employment pension benefits to employees of all entities within a particular industry, including to the employees of A Ltd, whether transaction between A Ltd and M/S ABL would be covered under this standard?**

SOLUTION 17 :

As per Para 9b(v), a post-employment benefit plan for the benefit of the employees either the reporting entity or an entity related to the reporting entity, is a related party to the reporting entity.

Transactions between A Ltd and M/S ABL will be reported as related party transactions under IAS 24.

If M/S ABL provides retirement benefits to B Ltd, which is an associate and therefore a related party of A Ltd, transactions between A Ltd and M/s ABL will be reported under IAS 24.

Though the standard does not specifically mention, industry-wide plan schemes cater to employees of all entities within an industry and any one entity cannot control, jointly control or exercise significant over such industry wide pension schemes. Hence, if M/s ABL provides post-employment pension benefits to all employees within a particular industry, then transactions between A Ltd and M/S ABL are not related party transactions for the purposes of this standard.

IAS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

1. INTRODUCTION

The Standard prescribes principles to be applied for initial recognition of foreign currency transactions, subsequent measurement of the items that are denominated in foreign currency and the treatment of exchange differences that arise thereof. The Standard also provides guidance as to the manner in which foreign operations would be incorporated in the reporting entity's Financial Statements and translation of financial statements into **presentation currency.**

2. DEFINITIONS

Closing rate is the spot exchange rate at the end of the reporting period.

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Foreign operation is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted ina country or currency other than those of the reporting entity.

PROBLEM : 1

Candid Internationale (which is located in France) has a subsidiary Candid Inc which is situated in UK.

Required:

Determine whether Candid international has foreign operations?

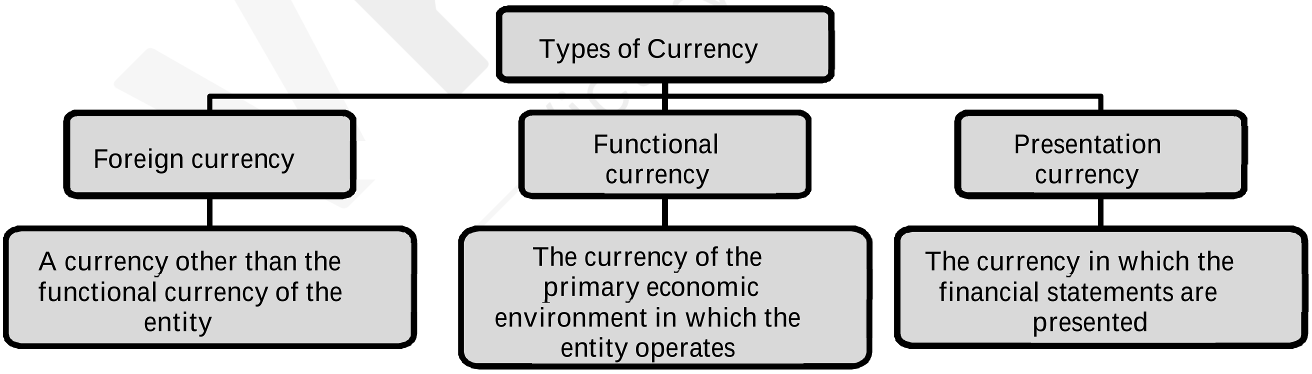
SOLUTION : 1

In this case Candid Inc conducts its business in UK where the national currency is the £ whereas Candid International conducts its business in France where the national currency is the €.

Hence it is said that Candid International has foreign operations.

Foreign currency is a currency other than the functional currency of the entity.

Functional currency is the currency of the primary economic environment in which the entity operates.



A group is a parent and all its subsidiaries.

Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. Example –Cash, bank, Receivables, payables, loans, pension and other benefits to be payable in cash, provisions that are to be settled in cash.

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.

Spot exchange rate is the exchange rate for immediate delivery.

3. DETERMINATION OF FUNCTIONAL CURRENCY

Foreign currency transactions of an entity are required to be recorded in the functional currency of the reporting entity.

Functional currency is identified with reference to the primary economic environment in which the entity normally operates.

4. PRIMARY INDICATORS

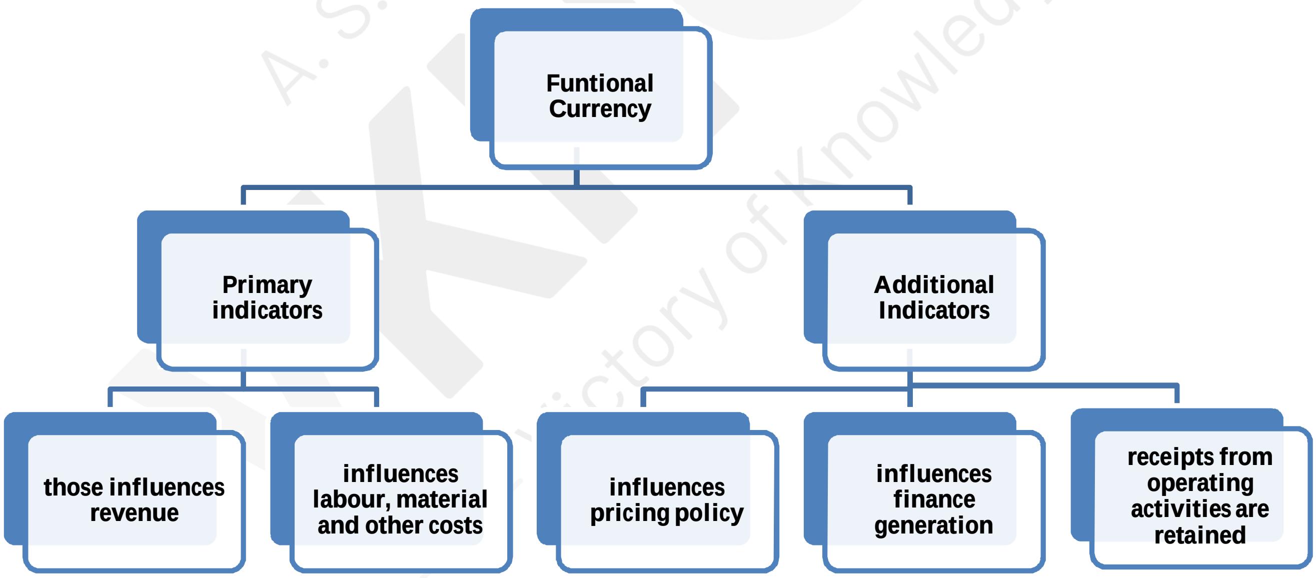
The Standard provides **primary indicators** for determining the functional currency of an entity as under:

- **THOSE INFLUENCES REVENUE – The currency, in which the prices for goods or services (revenue) of the entity are denominated and settled, usually influences those prices.**
- There may be cases where the currency of the country whose regulatory environment and the competitive forces in a particular market may determine the prices of entity's goods or services. The currency of the country such market represents and the currency that exercises influence over the prices of goods or services is the functional currency of the entity.
- **THOSE INFLUENCES LABOUR, MATERIAL AND OTHER COSTS -** Major operating costs of an entity would be material, labour and other costs. **The currency that influences these significant elements of operating costs of the entity is the functional currency.**

5. ADDITIONAL INDICATORS

Where an analysis of the primary indicators does not assist in the determination of functional currency, certain **additional indicators** e.g.,

- **INFLUENCES FINANCE GENERATION** - currency in which funds for financing activities are generated. Example – issue of debt and equity instruments.
- **RECEIPTS FROM OPERATING ACTIVITIES ARE RETAINED** - currency in which the entity retains the receipts may require to be considered, which may provide evidence of an entity's functional currency.



PROBLEM : 2

Senorita Pastures is a Spanish entity.

(1) **The currency that mainly influences its selling price for its goods and services is €.**

(2) **The competitive forces and regulations of Spain mainly influence the pricing policy of Senorita Pastures.**

(3) **Senorita Pastures mainly pays for the labour in € but pays for the imports of raw material and other material in £ which are 80% of its total expenses.**

Required:

State the functional currency of Senorita Pastures.

SOLUTION : 2

The following factors indicate that the functional currency of Senorita Pastures is the €.

(1) The currency that mainly influences its selling price for its goods and services is €.

(2) The competitive forces and regulations of Spain mainly influence the pricing policy of Senorita Pastures. (The € is the currency of Spain).

However 80% of its total expenses are incurred in £ which indicate that the £ can be considered to be the functional currency of Senorita Pastures.

In this case, because there are conflicting indicators, the management has to decide which currencies best reflects the underlying transactions, events and conditions that are relevant to it. Once determined, the functional currency can be changed only when there is a change in the underlying transactions, events and conditions.

PROBLEM : 3

A.S. Foundation International operates in Germany, it has raised its capital in €, incurs all expenses in € and is governed by the laws of Germany. 80 % of its sales revenue comes from France.

Required: State the functional currency of A.S. Foundation International.

SOLUTION : 3

A.S. Foundation Internationaloperates in Germany and earns 80% of its sales revenue from France. Hence the functional currency could be the currency of either France or Germany. However, as the currency of both these countries is the € the management does not need to consider the factors which determine the functional currency because in either case the functional currency will be the €.

6. FUNCTIONAL CURRENCY OF FOREIGN OPERATIONS

An entity is also required to determine

(i) the functional currency of foreign operations, and

(ii) whether it is different from its domestic operations.

7. FACTORS TO BE CONSIDERED IN DETERMINING FUNCTIONAL CURRENCY OF FOREIGN OPERATIONS

The factors to be considered are:

1. **The degree of autonomy of foreign operations**, e.g., if the foreign operation is an extended arm of the activities of reporting entity, or whether the activitiesin a given foreign location are being carried out independently in its own right.
2. **The quantum of transaction** between the entity and its foreign operation being high or low.

PROBLEM : 4

A.S. Foundation Global (a British entity) has a subsidiary in Bermuda. This subsidiary sells all its products to A.S. Foundation Global. Determine the functional currency of subsidiary.

SOLUTION : 4

In this case the proportion of transactions which the foreign operations (the subsidiary) have with A.S. Foundation Global (the reporting entity) is high. Hence the functional currency of the subsidiary will be the £ which is the functional currency of the reporting entity A.S. Foundation Global (assuming it satisfies the other conditions).

3. **Whether the cash flows generated in foreign operations affect the reporting entity's cash flows**, and

PROBLEM : 5

A.S. Foundation Global, an entity incorporated in Germany sells 80% of its products through its branch office which is situated in China. The head office at Germany depends upon the remittances made by its branch office in China to finance its normal operating activities. The Chinese branch is able to readily remit cash to its head office. Determine the functional currency of the Chinese branch of A.S. Foundation Global.

SOLUTION : 5

In this case the functional currency of the Chinese branch of **A.S. Foundation Global** is the € (the national currency of Germany) because:

- The cash flow of the foreign operation directly affects the cash flow of **A.S. Foundation Global** in Germany, and
- There is no obstacle to the remittance of cash by the branch to the head office.

4. **whether the net cash flows generated by the operating activities of foreign operations are self-sufficient.**

PROBLEM : 6

SurefireInc an Austrian entity whose functional currency is €, has a subsidiary Fireaway Co. in UK. The following information is available of Fireaway Co.

Ordinary share capital	**£20,000**
Loan from bank	**£40,000**

As it has not commenced its operations, it depends upon SurefireInc for repayment of the bank loan.

Required: Determine the functional currency of Fireaway Co.

SOLUTION : 6

Under these circumstance, even if Fireaway Co has an equity capital of £20,000 its functional currency is € (the functional currency of Surefire Inc) because it depends upon Surefire Inc to repay its dues.

PROBLEM : 7

YaberGmbh is a German entity which makes machine tools. It has a subsidiary in Singapore called Shape Inc to which it sells some of its finished goods. Shape Inc is the authorised dealer of YaberGmbh for the whole of South-East Asia and engages in no other in no other activity of its own.

Determine the functional currency of shape Inc.

SOLUTION : 7

In this case Shape Inc only resells the goods manufactured by YaberGmbh throughout South-East Asia. It does not do any value addition nor does it engage in any other independent activity of its own.

Hence Shape Inc (the foreign operation of YaberGmbh) is just an extension of YaberGmbh. So the functional currency of Shape Inc is:

- the € (the functional currency of YaberGmbh assuming that the other factors also indicate that the € is the functional currency of YaberGmbh) and;
- not the Singapore $ (the national currency of the country in which Shape Inc operates).

8. MANAGEMENT's JUDGMENT

Generally, an in-depth analysis of these factors should assist in the determination of functional currency of reporting entity and its foreign operations. In rare cases where it is impracticable to determine functional currency based on these factors, **the management may use its judgment and determine the functional currency.**

PROBLEM : 8 Nice Corp is located in England and its functional currency is the £. It manufactures electronic goods and sells some of its finished products to Flash Inc in France.

Flash Inc is an associate of Nice Corp and its total revenue can be split as follows:

% of revenue	
Sale of goods purchased from Nice Corp	35%
Sale of other goods	65%

Determine the functional currency of Flash Inc.

SOLUTION : 8

In this case Flash Inc operates with a significant degree of autonomy because the share of goods from Nice Corp in its total revenue is only 35%.

Hence the functional currency of Flash Inc can be:

- the € the national currency of France(assuming that the other factors also indicate that the € is its functional currency) and

➢ not the £ (which is the functional currency of Nice Corp).

However, before taking a decision management has to consider other factors also. Its decision depends upon answers to the following:

- Which currency influences the revenue of the entity?
- Which currency influences the pricing policy of the -entity?
- Which currency influences the overhead costs?
- In which currency is finance generated?
- In which currency are the receipts retained by the entity?

If answers to most of these questions indicate the €, then it will be the functional currency of Flash Inc. However if there are conflicting indications then the management has to decide which currency best reflects the underlying transactions, events and conditions that are relevant to it.

9. PRESENTATION CURRENCY

The Standard permits an entity to present its financial statements (stand-alone or consolidated financials) in any currency.

The currency in which financial statements are presented is the presentation currency.

The Standard stipulates conditions relating to translation of amounts, to be complied with, where an entity presents its financial statements in a currency other than the functional currency (or where the functional currencies of the component-entities that form a part of consolidated financials differ from the presentation currency).

10. REPORTING OF FOREIGN CURRENCY TRANSACTIONS

INITIAL RECOGNITION

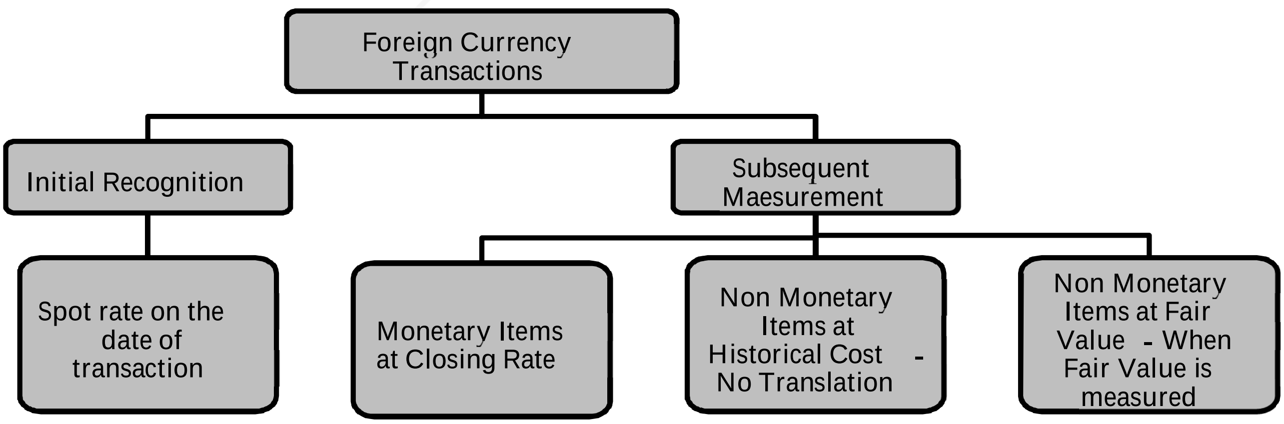
The foreign currency transaction shall be recognized at the spot exchange rate between the foreign currency and the functional currency of the entity prevailing **on the date of the transaction.** For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used.

Example -average rate may be used **if there is no significant fluctuations.**

AT THE END OF REPORTING PERIOD

For the purpose of determining the exchange rate to be applied at the end of each reporting period, transactions are classified into monetary and non-monetary items.

Monetary items	translated at the **closing rate** on the reporting date. For example, receivables of the reporting in foreign currency are translated at the closing rate in the financial statements of reporting entity.
Non-monetary items that are measured at historical cost	Translated using the exchange rate at the date of the transaction. For example, an entity adopts 'cost model' of valuation of fixed assets.
Non-monetary items that are measured at fair value	Translated at exchange rates prevalent on the date of determination of fair value. For example, an entity adopts 'revaluation model' of valuation of fixed assets, the fair value of fixed assets purchased in foreign currency is available only in foreign currency, the exchange rate prevailing on the date when fair value is determined will be applied for translation.



PROBLEM : 9

X Ltd. has certain items of property, plant and equipment (PPE) purchased and located abroad. These are depreciable assets and depreciation is charged on straight line basis.

The asset is purchased on 1.4.2015 for US$ 80,000 having useful life of 20 years and residual value of 2%. There is a related payable of $ 60,000 which is paid on 31.7.2015.

How should the foreign currency denominated PPE and related payable be translated?

Exchange rates: 1.4.2015 US $ 1 = Rs. 61.4193, 31.7.2015 Rs. 62.4135, and 31.3.2016 Rs. 64.1000.

SOLUTION : 9

Property, plant and equipment is a non-monetary asset. An initial recognition, the asset is recorded at a value translated at spot rate. Subsequent to initial recognition, it is measured by translating at historical exchange rate. No exchange fluctuation loss or gain is measured. Depreciation is translated at historical exchange rate.

However, payable is a monetary liability. At initial recognition it is measured at the spot rate and an on settlement during the same accounting period it is measured at spot rate of the date of settlement. The difference between the initial translated amount and settlement amount is treated as exchange difference.

Date		US$	Exchange rate	Amount in Rs.
1.4.2015	Property, Plant and Equipment	80,000	61.4193	49,13,544
31.3.2016	Depreciation	3,920	61.4193	2,40,764
31.3.2016	Balance	76,080	61.4193	46.72,780
1.4.2015	Payable to supplier	60000	61.4193	36,85,158
31.7.2015	Exchange Fluctuation Loss			59.652
	Payment	-60000	62.4135	374481

11. RECOGNITION OF EXCHANGE DIFFERENCES

Exchange differences arise on initial recognition, subsequent reporting at the end of reporting period and final settlement of **monetary items** in foreign currency. **Such differences arerecognized in profit or loss** in the period in which the recognition, reporting or settlement takes place.

In case of **non-monetary items**, the **component of Financial Statement where the recognition of gain or loss on such non-monetary items is made, determines the component for recognition of exchange differences.**

If the gain or loss is recognized in other comprehensive income, then the related exchange differences are also recognized in the other comprehensive income. **For example, if revaluation gain or loss is recognized in other comprehensive income, the exchange difference is recognized in other comprehensive income**.

If gain or loss on non-monetary item is recognized in profit or loss, then the exchange difference is also recognized in profit or loss.

PROBLEM : 10 [Initial recognition and settlement of a monetary item within the reporting period]

On 13 April,,2014, X Ltd. Purchased raw material on credit from a US supplier for US$ 10,000 @ Rs. 60.3520/US$. Balance of Trade payable was settled on 30th July, 2014 @ Rs. 59.5625.

Show Accounting Entries.

SOLUTION : 10

The purchase transaction is recorded at spot exchange rate i.e. Rs. 60.3520/US$. At a subsequent date when the transaction is settled the payment to trade payable is recorded at the spot exchange rate of Rs. 59.5625/US$. Whereas trade payable is initially recorded at Rs. 60.3520/US$ Therefore, trade payable which is a monetary item (as it is to be settled in monetary terms) is adjusted for an exchange difference.

Exchange difference = US$ 10,000 X (Rs. 60.3520 – Rs. 59.5625) = Rs. 7895

The amount settle is lower than the original amount settled. Thus there arises an exchange fluctuation gain. This is recognised in the profit or loss.

Date	Particulars		Exchange Rate	Dr.	Cr.
				Amount in Rs.	
13.4.2014	Purchase A/c Trade Payables A/c (Foreign currency denominated Credit purchases)	Dr. Cr	US$ 10,000 @ 60.3520/US$		
30.7.2014	Trade Payables A/c Exchange Fluctuation Gain A/c Bank A/c	Dr. Cr. Cr.	US$ 10,000 @ 59.5625/US$		
31.3.2015	Exchange Fluctuation Gain A/c Profit & Loss A/c (Transfer of exchange fluctuation gain)	Dr. Cr.			

PROBLEM : 11

X Ltd. Sold goods on 17 June 2014 for € 15,000 when spot rate was € 1 = Rs81.2184. Trade receivable was collected on 17 August, 2014 when spot rate was € 1 = Rs81.4703. Show accounting entries

SOLUTION : 11

Exchange fluctuation gain = € 15,000 X (81.4703 – 81.2184) = € 3,779.

Date	Particulars		Exchange Rate	Dr.	Cr.
				Amount in Rs.	
17.6.2014	Trade Receivable A/c Sales A/c Foreign currency denominated credit sales	Dr. Cr	€ 15,000 @ 81.2184/€		
17.8.2014	Bank A/c Exchange Fluctuation Gain A/c Trade Receivable A/c Collection of trade receivable	Dr. Cr. Cr.	€ 15,000 @ 81.4703/€		
31.3.2015	Exchange Fluctuation Gain A/c Profit & Loss A/c Transfer of exchange fluctuation gain	Dr. Cr.			

PROBLEM : 12 [Translation of trade payable at the reporting date]

On 20 January 2015, X Ltd. Purchased goods from a US supplier amounting to US$ 15,000 which is settled on 2 July, 2015 The reporting date of the entity is 31 March, 2015.

Exchange rates: 20 January, 2015 Rs. 61.6758/US$

31 March, 2015 Rs. 62.5300/US$

2 July, 2015 Rs. 63.5845/US$

Show Accounting Entries

SOLUTION : 12

Exchange differences arise- (i) Out of translation of trade payable on reporting date at closing and (ii) on settlement of trade payable.

Date of transaction
20.1.2015
US$ 1 = 61.6758

Reporting Date
31.3.2015
US$ 1 = 62.53

Settlement Date
2.7.2015
US$ 1 = 63.5845

Exchange difference on the reporting date US$ 15000 X (62.53 – 61.6758) = Rs. 12,813

Exchange difference on the Settlement date US$ 15000 X (63.5845 – 62.53) = Rs. 28.631

Accounting Entries:

Date	Particulars	Exchange Rate	Dr.	Cr.
			Amount in Rs.	
20.1.2015	Purchases A/c Dr. Trade Payables A/c Cr Foreign currency denominated credit purchases	US$ 15,000 @ 61.6758/US$		
31.3.2015	Exchange Fluctuation Loss A/c Dr. Trade Payables A/c Cr. Market –to market valuation difference. This increases balance of trade payable to Rs. 9,37,950	Closing rate US$ 1 = Rs. 62.53		
31.3.2015	Profit & Loss A/c Dr. Exchange Fluctuation Loss A/c Cr. Transfer of the translation difference to profit & Loss			
02.7.2015	Exchange Fluctuation Loss A/c Dr. Trade Payables A/c Cr. Exchange Fluctuation loss on the date of settlement. This increases balance of trade payable to Rs. 9,53,768	US$ 15,000 @ 63.5845/US$		
02.7.2015	Trade Payables A/c Dr. Bank A/c Cr. Settlement of trade payable.			
31.3.2016	Profit & Loss A/c Dr. Exchange Fluctuation Gain A/c Cr. Transfer of exchange fluctuation loss.			

PROBLEM : 13

A company had imported raw materials worth US dollars 50,000 on 15th January, 2018 when the exchange rate was Rs. 46 per US dollar. The company had recorded the transaction at that rate. The payment for the imports was made only on 15th April, 2018 when the exchange rate was Rs. 49 per US dollar. However on 31st March 2018, the rate of exchange was Rs. 50 per US dollar. The company passed an entry on 31st March, 2018 adjusting the cost of raw materials consumed for the difference between Rs. 49 and Rs. 46 per US dollar.

SOLUTION : 13

The foreign exchange difference should not be adjusted against cost of raw-material. It should be transferred to profit and loss account. In the next year the company would record a gain of Rs. 1 per $.

PROBLEM : 14

	Exchange Rate
Goods purchased on 24-2-2015 of US $ 10,000	**Rs. 46.60**
Exchange Rate on 31-3-2015	**Rs. 47.00**
Date of actual payment 5-6-2015	**Rs. 47.50**

Calculate the loss / gain for the financial years 2014-2015 and 2015-2016.

SOLUTION : 14

PROBLEM : 15

A.S. Foundation Global whose functional currency is the £ has purchased goods worth €250,000 (payable after 3 months) from Bliterzeg Co on 15 November when the rate of exchange was €1 = £0.60 The rate of exchange at the end of reporting period 31 December was €1 = £0.65.

Required:

How will the trade payables be recorded by A.S. Foundation Global?

SOLUTION : 15

In this case the trade payables are recognised by **A.S. Foundation Global**in the following manner:

Date	Rate used	Rate	Amount
15/11/2016 (IR)	Rate on date of transaction		
31/12/2016 (SR)	Rate at the end of reporting period		

As trade payables are monetary assets they will be recognised at the end of reporting period at the spot exchange rate at the end of reporting period.

PROBLEM : 16

Fairplay Publishers whose functional currency is the £ publishes books in France. On 4 September 2016 it has paid €30,000 to its publishers when the rate of exchange was €1 = £0.70 However no work has been done by the publishers up to 31 December (end of reporting period) when the rate of exchange was €1 = £0.65.

Required: How will the prepaid expenses be recorded by Fairplay Publishers?

SOLUTION : 16

In this case the prepaid expenses are recognised by Fairplay Publishers in the following manner:

Date	Rate used	Rate	Amount
04/09/2016 (IR)	As on date of transaction		
31/12/2016 (SR)	As on date of original transaction		

As prepaid expenses are non-monetary assets they are recognised in the subsequent statement of financial position at the rate of exchange as on the date of original transaction.

PROBLEM : 17

Perfect International is situated in Germany and raises bills and makes expenses primarily using the €. On 12 October it has purchased goods worth £40,000 from Deliberate Inc of England. 50% of these goods are included in the inventory of Perfect International. The net realisable of these goods is £21,500. The rates of exchange as on 12 October is €1 = £0.73 and on 31 December is €1 = £0.65.

Required: At what value will the inventory appear in the statement of financial position?

SOLUTION : 17

In this case the inventory (50% of purchases) is recognised by Perfect international in the statement of financial position as at 31 December 2016 at €27.397 (see working below)

Carrying amount	€ 20,000	Rate of original transaction		
Net realisable value	€ 21,500	Rate at the end of reporting period		

Inventory = lower of carrying amount or net realisable value = € ____________

PROBLEM : 18

A.S. Foundation Global whose functional currency is the £ has purchase land worth € 125,000 on 1 July 2015. The fair value of the land was determinded at € 140,000 on 15 October 2015 and € 190,000 1 November 2016. The relevant rates of exchange are :

On 01/07/2015 €1 = £0.80

On 15/10/2015 €1 = £0.73

On 31/12/2015 €1 = £0.82

On 01/11/2016 €1 = £0.60

On 31/12/2016 €1 = £0.65

Required:

Determine how land will be recognised initially and at the subsequent end of reporting periods. Assume cost model is used.

SOLUTION : 18

Land will be recognised by **A.S. Foundation Global** in the following manner **Date**	**Rate used**	**Rate**	**Amount**
On 01/07/2015 (IR)	Rate on date of purchase		
On 31/12/2015 (SR)	End of reporting period		
On 31/12/2016 (SR)	End of reporting period		

As land is a non-monetary asset it is recognised in the subsequent statement of financial of financial position at the rate of exchange as on the date of original transaction i.e. on the date of purchase of land where the cost model is used. If the revaluation model was used, then the rate prevailing on the revaluation date will be used.

PROBLEM : 19

On 1 April 2016 Fortune International, whose functional currency is £, had purchased a non-current assets for € 40,000 when the rate of exchange was €1 = £0.67 it was revalued on 1 July 2016 for €41,000 when the rate of exchange was €1 = £0.70 it was sold on 1st October 2016 for € 45,000 when the rate of exchange was € 1 = £0.60. Determine the profit or loss on this transaction and state how it will be recognised in the books. (ignore depreciation)

SOLUTION 19 :

On revaluation of asset

Date	**Foreign Currency**	**Rate used**	**Rate**	**Amount**
01/04/2016 01/07/2016	€40,000 €41,000	Rate on date of purchase Rate on date of revaluation		

Profit transferred to revaluation reserve (€28,700 - £26,800) is £1 ,900.

On sale of asset

Date	**Foreign currency**	**Rate**	**Functional currency**
Carrying amount 01/10/20X6	41,000 45,000	 €1 = £0.60	£28, 700 £27 ,000

The loss of £1,700 (£28,700 - £27,000) will be recognized in the profit or loss. The revaluation reserve will be transferred directly to retained earnings.

PROBLEM : 20

Mission has carried out transactions denominated in foreign currency during the financial year ended 31 October 2016. Mission's functional currency is USD. Mission has purchased goods from a foreign supplier for 8 million Euros on 31 July 2016. At 31 October 2016 the trade payable was still outstanding and the goods were still held by mission. Mission has sold goods to a foreign customer for 4 million Euros on 31 July 2016 and it received payment for the goods in Euros on 31 October 2016.

Exchange Date	Euro / $	Average rate for Year
31/07/2016	**1.6**	
31/10/2016	**1.3**	**1.5**
Advice on how to treat these transactions in the financial statements for the year ended 31 October 2016.		

PROBLEM : 21

ASF Ltd (functional currency - INR) has entered into following transactions:

Date	Transaction
01.04.2020	**Purchased machine on credit Rs 10 Lacs**
01.05.2020	**Purchased goods for $30,000 on credit. Spot rate Rs 62/$**
01.06.2020	**Paid to creditors for goods $ 20,000 Spot rate Rs 65/$**
01.07.2020	**Purchased Car $ 40,000. Spot rate Rs 67/$**
01.08.2020	**Revalued car upward by $ 5,000. Spot rate Rs 68/$**
01.09.2020	**Sold goods $ 10,000. . Spot rate Rs 69/$**

Closing rate on 30.09.2020 is Rs 70/$. Pass Journal Entries and Prepare Trial balance.

12. CHANGE IN FUNCTIONAL CURRENCY

- Functional currency of an entity can be changed only when the underlying conditions that were decisive factors for determining the functional currency change.

  Example:

  A change in currency that mainly influences the sales prices of goods may lead to change in an entity's functional currency.
- All items are translated to the new functional currency **on the date of change of functional currency.**
- The translation procedures with respect to new functional currency will have to be done **only prospectively.** For example, the translated amounts to the new functional currency on the date of change will be taken as the historical cost for nonmonetary items.
- Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.

CASE STUDY

- A, located in Germany, is a wholly owned subsidiary of Z. $ is Z's functional currency. € is A's functional currency as all sales, purchases and labour costs were in €. Z started using A's facility to meet its orders. A closed down its sales department as 80% of its supplies would be to Z. Z built a new facility to produce materials required in its manufacturing process and Z started receiving all material from A. A now expects cash inflows and outflows, except for wages in $.
- The currency of revenues has changed from € to $. It seems to be permanent as the sales dept. has been closed. Currency of outflows has changed from € to $. Position of A within Z's overall operating strategy has changed from self-supporting, stand alone entity to a manufacturing facility of Z. There will be a change in the functional currency from € to $.

13. PRESENTATION CURRENCY BEING OTHER THAN FUNCTIONAL CURRENCY

Presentation currency of the reporting entity may be different from the functional currency of the reporting entity as also the functional currency of the entities within the group.

In those cases, transactions recorded in functional currency are subsequently translated into the presentation currency of the reporting entity. On translating from functional currency to presentation currency, the entity's financials including comparatives are converted at following rates:

- Assets and liabilities are converted at closing rates.
- Income and expenses are converted at the exchange rates at the date of transaction. or average rate may

be used if there is no significant fluctuations

- The resulting **difference** as a result above conversion is transferred to **other comprehensive income** and not to profit or loss since it does not affect the cash flows from operations.

The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to non-controlling interests are allocated to, and recognised as part of, non-controlling interests in the consolidated statement of financial position.

PROBLEM : 22 Grand international is established in Germany but has extensive dealings in the UK. The following details are available

The currency of the primary economic environment in which the entity operates is € and it presents its financial statements in £. What is the Presentation currency and functional currency of Grand International?

SOLUTION : 22

Presentation currency -

Functional currency -

14. TRANSLATION OF FOREIGN OPERATION

Foreign operation i.e. subsidiary, branch can be in the functional currency of the foreign operations as discussed above for determination of functional currency. Later the results of such operations have to be translated into the presentation currency of the reporting entity at the end of the reporting period.

ITEMS	Rate
Assets and liabilities for each reporting date presented including comparatives	Closing rate at the date of SOFP.
Income and Expense of each statement of profit and loss presented (Including comparatives)	Exchange rate at the date of transaction or average rate may be used if there is no significant fluctuations

Exchange differences arising on such translation of foreign operations are to be recognized in **other comprehensive income only.**

15. ELIMINATION OF INTRAGROUP TRANSACTIONS INVOLVING A FOREIGN OPERATION

In consolidated financial statements, elimination of intragroup transactions involving a foreign operation will not eliminate the exchange difference arising on such transactions. In **consolidated financial Statement**, such exchange differences shall be recognized in

- profit and loss account,
- or if it relates to a monetary item that forms part of a reporting entity's net investment in a foreign operation, initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment.

16. TRANSLATION OF GOODWILL

Goodwill relating to acquisition of any foreign operation, is treated as asset of that foreign operation to which it relates. And consequently, this is translated at the closing rate to the presentation currency of the reporting entity and the difference is treated as exchange difference of foreign operation.

17. NET INVESTMENT IN FOREIGN OPERATION

Any monetary item receivable from or payable to foreign operation for which settlement is not likely to happen in foreseeable future is in substance equity investment in that foreign operation.

Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate.

In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment.

18. DISPOSAL OF A FOREIGN OPERATION

This recognition in other comprehensive income is reclassified into profit or loss on disposal of the foreign operation.

19. FOLLOWING PARTIAL DISPOSAL OF A FOREIGN OPERATION ARE ACCOUNTED AS DISPOSAL

In certain circumstances the reporting entity may retain some interest after disposing of major portion of interest in foreign operation but still have to account for as disposal of foreign operation such as loss of control in subsidiary, loss of significant influence in associate and loss of joint control in jointly controlled entity.

PROBLEM : 23

A parent has 80% interest in a subsidiary for number of years. The subsidiary has been classified as a foreign operation and $ 5 million have been recognised in other comprehensive income. 80% have been accumulated in a separate component of equity and balance 20% attributed to non-controlling interest. The parent disposes 40% of its interest resulting in loss of control. What would be treatment on date of disposal?

SOLUTION : 23

$ 4 million (5 x 80%) of cumulative translation exchange differences are transferred from equity to profit and loss. $ 1 million already reflected as part of non-controlling interest are derecognised and included in the calculation of the profit or loss on disposal.

20. PARTIAL DISPOSAL OF A FOREIGN OPERATION NOT RESULTING IN LOSS OF CONTROL OR SIGNIFICANT INFLUENCE OR JOINT CONTROL

Reporting entity may dispose off interest in a foreign operation not resulting in loss of control or significant influence or joint control as the case may be. Such a disposal is termed as partial disposal.

- **PARTIAL DISPOSAL OF INTEREST IN SUBSIDIARY**- On partial disposal of interest in subsidiary, the entity still has control overthe foreign operation, therefore only **the proportionate share**of the exchange difference in other comprehensive income transferred **from owner's interest to non-controlling interest.**

PROBLEM : 24

A parent has 100% interest in a subsidiary for a number of years. The subsidiary has been classified as a foreign operation and $ 5 million relating to the translation differences of subsidiary has been recognised in other comprehensive income and accumulated in a separate component of equity. The parent disposes of 30% of its interest but retains control. What would be the treatment on the date of disposal?

SOLUTION : 24

$ 1.5 million (5 x30%) of cumulative translation exchange differences are transferred within equity from foreign currency translation reserve to non-controlling interest. No amounts are reclassified to profit or loss.

- **OTHERS CASES (Associate or Joint Venture)** - In case of others, the proportionate interest is transferred to profit or loss.

21. FOLLOWING ARE NOT DISPOSAL, HENCE NO RECLASSIFICATION NECESSARY

- A write-down of carrying amount of a foreign operation. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.
- The exchange difference in respect of a foreign operation classified as held for sale as per IFRS 5 does not result in reclassification unless the foreign operation is disposed of ultimately.
- Change in the functional currency of the foreign operation to the functional currency of the reporting entity or even presentation currency of the reporting entity does not result in reclassification of the exchange difference into profit or loss unless it is disposed off.

22. INCOME TAX EFFECT

Tax effects of all foreign currency transactions and translations will have tax effect that is to be dealt with as prescribed in **IAS 12.**

23. DISCLOSURES

In the financial statements:

- The amount of exchange difference recognized in profit or loss and other comprehensive income.

In the notes to accounts

- The presentation currency if different from functional currency.
- Had there been any change in functional currency, the reason for the same.
- Any supplementary financial information identified as not in compliance with IFRSs, if so and currency adopted for its presentation.

24. SUMMARY of IAS 21

- An entity does not have a free choice of functional currency
- **Translation of foreign currency assets and liabilities**
  - i. Monetary items at the reporting date
  - ii. Non-monetary items at the date of transaction or revaluation
  - iii. Unrealised and realised exchange gains and losses recognised in P/L
- **Monetary item forming part of a net investment in foreign operation.** - Exchange differences recognised in equity in the consolidated financial statements
- **Translation into presentation currency**
  - i. Assets and liabilities at the reporting date
  - ii. Income, expenses and capital transactions at transaction dates
  - iii. Translation gain or loss recognised in equity

25. MAJOR CHANGE IN IAS 21 VIS-À-VIS IAS 21 NOT RESULTING IN CARVE OUT

In case of Change in Functional Currency: When there is a change in functional currency, IAS 21 requires disclosure of that fact and the reason for the change in functional currency. IAS 21 requires an additional disclosure of the date of change in functional currency.

PROBLEMS

QUESTION 25 :

A's functional currency is €. A accounts for 47% in Z, a US company, using the equity method of accounting. During the current year, Z entered into a € 50 million third party borrowing. Most of Z's operations, labour costs and purchases are denominated in $ and incurred in domestic market. What is Z's functional currency?

SOLUTION : 25

Z's functional currency is $. Since majority of Z's operations are in $, and USA is the country that drives the competitive forces and regulations, Z should continue using $ as its functional currency.

QUESTION 26 :

M Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA. Purchases are done in USD and are based on prices in the US Market. It sells goods in USD and the sale price is influenced by the holding company. Other expenses are incurred locally.M Ltd. has an External Commercial Borrowing from A Inc. for financing its activities. What is M Ltd's functional currency?

SOLUTION : 26

Factors	Influenced by which currency
Sales	USD
Sales Market influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash Flows	INR/USD
Functional currency (based on above answers)	**USD**

The above conclusions are based on Primary indicators.

QUESTION 27 – IDENTIFICATION OF FUNCTIONAL CURRENCY

N Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA. Purchases are done in USD and are based on prices in US Market. It sells goods in INR but the sale price is influenced by the country of the holding company. Other expenses are incurred locally. N Ltd. has an External Commercial Borrowing from A Inc. for financing it activities.What is N Ltd's functional currency?

SOLUTION : 27

Factors	Influenced by which currency
Sales	INR
Sales Market influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash Flows	INR/USD
Functional currency (based on above answers)	**USD**

QUESTION 28 – IDENTIFICATION OF FUNCTIONAL CURRENCY

USA Ltd (U) owns a subsidiary in India, Dragon Ltd (D). D assembles all goods in India using a combination of locally sourced materials and materials manufactured by U. All goods are then exported and sold in Australia, based on selling prices determined by U and influenced by Indian market. The company has a loan from an Indian Bank.What is Dragon Ltd's functional currency?

SOLUTION : 28

Factors (Dragon Ltd.)	Influenced by which currency
Sales	AUD
Sales Market influenced by	INR
Expenses	INR
Purchases	INR/USD
Financing	INR
Cash Flows	INR/USD/AUD
Functional currency (based on above answers)	INR

The above conclusions are based on Primary indicators

QUESTION 29 – IDENTIFICATION OF FUNCTIONAL CURRENCY

a. X Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
b. Purchases are done in USD and are based on prices in US Market.
c. It sells goods in INR and the sale price is market determined.
d. Other expenses are incurred locally.
e. It remits its proceeds to the holding company.
What is X Ltd's functional currency?

SOLUTION : 29

- Sales are in INR and are market determined whereas goods are purchased from USA.
- The primary indicators do not give a clear picture.
- On the basis of **additional factors**, in the given case X Ltd. is carrying out its activities as an extension of holding company's foreign operations since it only sells goods imported from the reporting entity and remits its proceeds to it, its functional currency should be USD.

QUESTION 30 : REVALUATION

1. Company Apple's reporting currency is INR
2. On 01.01.2012 company buys a building for US$100,000
3. The exchange rate is INR 54.48:US$1
4. Company Apple's year end, 31st March
5. The building is not depreciated as it is not yet available for use
6. On 31.03.2012 the exchange rate is INR 55.54:US$1 and the value of building is US$110,000

SOLUTION : 30

Initial Recognition

- On 01.01.2012 the building is capitalized at the rate at the transaction date
- Building Dr………. 54,48,000
  To Bank Cr…………. 54,48,000

Subsequent Recognition

Situation 1 - cost model adopted -If cost model adopted as accounting policy under Ind AS 16 for PPE, Building is carried at its historical cost, hence no adjustment to be made

Situation 2 -revaluation model adopted- If revaluation model adopted as accounting policy under Ind AS 16 for PPE, value of building to be adjusted for revised value.

- Hence the building being a non-monetary item and held at fair value, is to be translated at the date of valuation
- Building Dr………. 6,61,400
  To Revaluation Reserve Cr….. 661,400
- Revaluation reserve includes exchange component ($ 100000 * (55.54-54.48)) + ($ 10000 * 55.54)

QUESTION 31 :

Entity A's functional currency is Rupee. It has a building located in US acquired at a cost of USD 10000 when the exchange rate was USD = Rs. 50. The building is carried at cost in the financial statement of entity A. Depreciation is ignored in this case. At the reporting date, there is an indication of impairment of this building. Consequently, an impairment test has been made in accordance with IAS 36 as at the reporting date and the recoverable amount of the building is determined to be USD 9,500. The exchange rate as at the balance sheet date was USD 1 = Rs. 55. Show treatment.

QUESTION 32 :

Functional currency of A Ltd is INR. Year ending date is 31st December. On 1st July 2023, A Ltd purchased a machinery on credit for yen 400,000. A follows historical cost accounting and depreciation rate is 20% p.a. On 1st Nov 2023, A Ltd made a payment of Yen 180,000 to the supplier.

Relevant exchange rates are to Rupee 1 are as follows:

Date	Yen /INR
1.7.23	10
1.11.23	7.2
1.12.23	9
31.12.23	8

Pass Journal entries.

QUESTION 33 :

On 1 October 2016, A Ltd entered into a contract for purchase of machinery from ABC Inc. (a company in USA) for US$ 50,000 made an advance payment of US$ 10,000 as on date. The machinery installation was complete on 31 December 2016. The terms of payment were US$ 10,000 an installation and balance with a six-month credit period (i.e, on 30 June 2017). How would you account for the foreign currency transaction in the books of A Ltd assuming the exchange rate as given below?

Date	Exchange Rate
1.10.2016	$ 1 = Rs. 40
31.12.2016	$ 1 = Rs. 42
31.03.2017	$ 1 = Rs. 45
30.06.2017	$ 1 = Rs. 44

QUESTION 34 :

ASF SOFP as at 31.03.2020 is as follows:

	(Rs)
Assets	
Non-Current Assets – PPE	8,00,000
Current Assets -	
• Inventory	2,00,000
• Trade Receivables	11,00,000
Total	21,00,000
Equity and Liabilities	
Share Capital	10,00,000
Reserves and Surplus	
• Opening balance	1,00,000
• Profit for this year	2,00,000
Current Liabilities	8,00,000
Total	21,00,000

ASF wants to present its Financial statement in \$. Opening rate was Rs 60/\$, Average rate was Rs 63/\$ and closing rate was Rs 69/\$.

QUESTION 35 :

Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L\$).

The following is the statement of financial position of Infotech Global Ltd. prior to translation:

	USD	L\$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	9,85,000	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit for the year	20,000	
Accounts payable	8,40,000	
Accrued liabilities	47,000	
Total equity and liabilities	9,85,000	

Required:

Translate the statement of financial position of Global Ltd. into L\$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.) Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L\$ 1 = USD 1.22

Average rate for the year L\$ 1 = USD 1.175

Rate at end of the year L\$ 1 = USD 1.13

QUESTION 36 :

H Ltd (Functional currency INR) sold goods to S Ltd (Subsidiary of H Ltd) for \$ 15,000. Spot rate is Rs 61/\$. The debt is still outstanding on reporting date. Closing rate is Rs 69/\$. Pass Journal Entries. Show SFS and CFS extracts.

QUESTION 37 :

H Ltd (Functional currency INR) has investment in 80% shares S Ltd (Foreign Subsidiary) for Rs 12,20,000. Spot rate is Rs 61/$. A Ltd had given long-term loan (whose settlement is not planned) for $ 5,000. Spot rate is Rs 62/$. Closing rate is Rs 69/$. Show SFS and CFS extracts.

QUESTION 38 :

Parent P owns 35 percent of Associate B. P sells a 5 percent stake and retains significant influence over B.

What would be the treatment on the date of disposal?

QUESTION 39 :

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$ What is the functional currency of Future Ltd.?

SOLUTION 39

The functional currency of Future Ltd. is the L$ Looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

QUESTION 40 :

Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is Small's functional currency?

SOLUTION 40 :

Small, although based in India with its cash inflows generated within India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big for financing and goods to be sold, despite the fact that goods are sold within India and in Indian Rupees. Therefore, Small is not a self-contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on the parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India Private Limited would have the US Dollar as it functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than the US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

QUESTION 41 :

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

SOLUTION 41 :

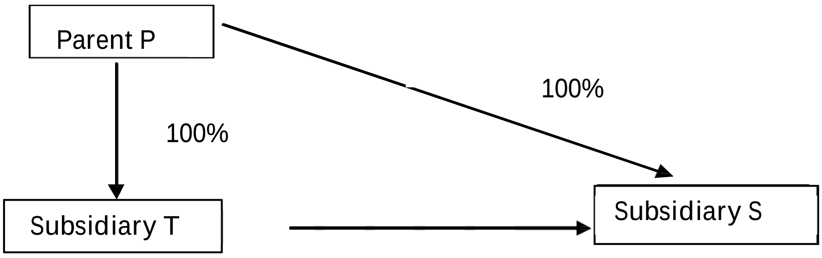
The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was not due for three years (for example) or even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by P on the EURO 500 loan should be recognised in profit or loss in P's separate financial statements, but recognised in other comprehensive income and presented within equity in the consolidated financial statements.

QUESTION 42 :

Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where should the exchange differences be recognised?

SOLUTION 42 :



Loan

Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

QUESTION 43 :

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements?

SOLUTION 43 :

At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary's statement of profit and loss has no equivalent gain in the parent's financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

QUESTION 44 :

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ` 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ` 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ` 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of `180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ` 20 lakhs

Calculate P's gain on disposal.

SOLUTION 44:

P's gain on disposal would be calculated in the following manner:

	(` in Lakhs)
Sale proceeds	1500
Net assets of S	(1000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

IFRS 15 — REVENUE FROM CONTRACTS WITH CUSTOMERS

1. REVENUE RECOGNITION

Revenue is something that every business entity would like to have more and more of. It is often a sign that the business is growing; it is also one of the most important factors being analysed by the financial analysts and other stakeholders. It's simple to state that you should recognise revenue on an accrual basis when it arises, but for the problem is identifying the point when it arises. For small traders this can be a simple issue but for businesses like real estate, construction contracts. information technology, tele-communication and many other, deciding the point of recognition and the quantum of revenue to be recognised can be a complex issue. If there are no proper guidelines available for revenue recognition and there is no consistency, the comparison of financial performance of entities can be misleading.

IFRS 15 gives specific guidelines about the timing and the quantum of revenue recognition. The principles of timing and amount of revenue recognition need to be carefully understood as an incorrect interpretation will lead to errors in the financial statements.

Understanding this chapter will ensure that you never face problems recognising when revenue should be accounted for!

2. PRINCIPLES OF REVENUE RECOGNITION:

The concept of substance over form plays a significant role in the evaluation of financial transactions and disclosures. It dictates that accountants must utilise critical thinking in determining how to present information by assessing the "reality" of a transaction.

Substance over form is an important aspect that impacts revenue recognition of any entity. IFRS 15 has established a 5 step approach to ensure that the concept is systematically applied.

i. Identification of contracts
ii. Identification of performance Obligations
iii. Determination of transaction price
iv. Allocation of the price to the performance obligations
v. Recognition of revenue when/as performance obligations are satisfied.

1.1 DEFINITIONS

Contract: An agreement between two or more parties that creates enforceable rights and obligations.

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 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 good or service (or a bundle of goods or services) that is distinct: or
b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Revenue: Income arising in the course of an entity's ordinary activities.

1.2 SCOPE OF IFRS 15

IFRS 15 applies to contracts to deliver goods and services to a customer and will not apply when those contracts are:

a) Leases: covered under IAS 17
b) Insurance: covered under IFRS 4 / IFRS 17
c) Rights and obligation which fall within the scope of financial instrument guidance- covered under IFRS 9.
d) Rights and obligations which fall within the scope of IAS 110 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures; and
e) Non-monetary transactions between entities in same line of business where this is done to facilitate sales to customers / potential customers.

QUESTION : 1

A TV channel released an advertisement in a newspaper. Instead of paying for the same, the TV channel allowed the newspaper company a free advertisement spot, which was duly utilised by the newspaper company. How revenue for these barter transactions in the area of advertising will be recognised and measured?

SOLUTION : 1

IFRS 15 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. 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, however, will be covered under IFRS 15 since the same is exchange of dissimilar goods or services. Both of the entities deal in different mode of media, ie, one is print media and another is electronic media.

Also, as per IFRS 15, "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."

In accordance with the above, the TV channel and the newspaper company will measure the revenue as the amount they expect to be entitled to.

QUESTION : 2

A Ltd and B Ltd both are engaged in manufacturing of bottles. A Ltd has factory in Gujarat. B Ltd has factory in Maharashtra. A Ltd fulfils the demands of its customers based in Maharashtra by using the bottles manufactured by B Ltd. Similarly, B Ltd fulfils the demands of customer based in Gujarat by delivering bottles manufactured by A Ltd. How A Ltd and B Ltd should recognise the revenue?

SOLUTION : 2

IFRS 15 states that it shall not apply to non-monetary exchanges betwvn entities in the same line of business to facilitate sales to customers or potential customers. 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.

For a transaction to qualify as a barter transaction, the exchange shall be monitored in terms of quantities and not in monetary terms. Exchanges monitored / settled in monetary terms are not barter transaction.

In this case, since the bottles are being exchanged irrespective of its monetary value, it will qualify as a barter transaction. Also, it will qualify as non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. Hence, IFRS 15 would not apply to the contract between A and B Ltd, and thus they should not recognise any revenue on account of exchange of goods.

QUESTION : 3

Entities N Ltd and S Ltd are both engaged in the extraction and supply of natural gas to different parts of India. Plants of N Ltd are located in North India while that of S Ltd are located in South of India. N Ltd also contracts to supply natural gas customers in the South of India. Similarly, S Ltd contracts to supply natural gas to customers in North India. Consequently, N Ltd purchases from S Ltd to supply natural gas to customers located in the South and S Ltd purchases from N to supply natural gas to customers in the North. The price of natural gas for this transaction would be based on actual delivery date of gas by either parties. Further, the parties would do a monthly calculation of supplies and receipts of gas and do a net settlement based on the prices calculated as above. How will this situation be treated under IFRS 15?

SOLUTION : 3

IFRS 15 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

For a transaction to qualify as a barter transaction, the exchange shall be monitored in terms of quantities and not in monetary terms. Exchanges settled in monetary terms shall not be classified as barter transaction.

In the above case, entities N Ltd and S Ltd operate in the same line of business and agree to supply natural gas to each other's customers due to ease of supplying in geographically closer areas. However, they calculate the price based on date of delivery and do a net settlement. Thus, the above stated situation does fall within the scope of IFRS 15, *Revenue from Contracts with Customers.* Hence, N Ltd will book revenue from sale of goods to S Ltd and also book revenue from sale of goods to its customers in the South of India. N Ltd will also book purchase of good from S Ltd.

3. CONTRACT WITH A CUSTOMER FALLING PARTIALLY WITHIN THE SCOPE OF IFRS 15 AND PARTIALLY WITHIN THE SCOPE OF OTHER STANDARDS

A contract with a customer may partially fall within the scope of IFRS 15 and partially within the scope of other standards discussed above. In such circumstances the following guidance needs to be applied:

- **If other standard have specifies guidance:** If the other Standards have specific guidance and specify how to separate and / or initially measure one or more parts of the contract, then an entity shall first apply the separation and / or measurement requirements in those Standards.

  Example :

  Omega Ltd contracts with a customer to lease an asset and also to provide for its maintenance. The leased asset will be accounted applying the guidance under IAS 17 leases and remaining part of the contract pertaining maintenance will be accounted as per IFRS 15.

- **If other standard does not specify how to separate:** If the other Standards do not specify how to separate and / or initially measure one or more parts of the contract, then the entity shall apply this Standard to separate and / or initially measure the part (or parts) of the contract.

1.3 REVENUE RECOGNITION MODEL

IFRS 15 model follows a five-step approach to account for revenue. The guidance under IFRS 15 will be applicable to all sectors and this will replace the separate guidance required for the sale of goods, service contract and construction contracts. As required by the old guidance under IAS 18 as regards to transfer of the risks and rewards to recognise revenue will no longer be sufficient to recognise revenue. Under IFRS 15, revenue will be recognised when there is a transfer of control. There is a shift of base from transfer of risks and rewards to transfer of control by assessing the fulfilment of obligation by the entity.

DIAGRAM 1 : Five step approach

Step 1	▪ Identify the contract with customer
Step 2	▪ Identify the performance obligation in contract
Step 3	▪ Determine the transaction price
Step 4	▪ Allocate the transaction price to the performance obligations in the contract
Step 5	▪ Recognise the revenue when (or as) the entity satisfies a performance obligation

Now let us understand the above five steps in detail:

1. IDENTIFY THE CONTRACT WITH THE CUSTOMER

A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations. An entity shall account for such a contract with a customer that is within the scope of IFRS 15 only when all of the following criteria are met:

Diagram 2: Conditions for recognising revenue from contracts

Parties to the contract have :
- approved the contract (in writing,
- orally or in accordance with other customary business practices) &
- are committed to perform their respective obligations

The entity can identify each party's rights regarding the goods or services to be transferred

The entity can identify the payment terms for the goods or services to be transferred

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)

It is probable that the consideration will be received (Considiring only the customer's ability and intention to pay)

An entity shall recognise the consideration received from any customer as a liability, until the above criteria are subsequently met. The entity shall recognise the consideration received as revenue only when either of following events has occurred:

- 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;
- the contract has been terrninated and the consideration received from the customer is non-refundable.

CONTRACT MODIFICATION

A contract modification is a changes in the scope or price (or both) of a contract that is approved by the parties to the contract.

Sometimes the price or scope of the original contract may be modified. A contract modification that has been approved (i.e. it creates enforceable rights and obligations) shall be accounted as a separate contract if both the following conditions are satisfied.

- ➢ The scope of the contract increases because of the addition of promised goods or services that are distinct and
- ➢ The price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.

Digram 3: Contract modifications

A separate contract	Not a separate contract
Additional goods/services are distinct	Additional goods/services are NOT distinct
Consideration for modification reflects the stand alone price	Consideration for modification DOES NOT refelects the stand alone price
Account by termination of original contract and creation of new contract	Account as if it were a part of original contract

NOTE : If the goods and services from the original contract remain unsatisfied on the date when the original contract is modified, then in such a case, the unsatisfied performance obligations along with the new performance obligations in the modified contract have to be accounted as a modified contract only.

CASE STUDY :
Mercury Ltd promises to sell 120 guitars to a customer for $ 12,000 (i.e. $100 per guitar). The guitars are transferred to the customer at various points in time over a six-month period. The contract is modified after 60 guitars have been transferred and Mercury promises to deliver an additional 30 products for an additional $2,850 or $95 per guitar. This means totally 150 guitars will be transferred. The pricing for the additional guitars reflects the stand-alone selling price of the guitars at the time of the contract modification. In addition, the additional guitars are distinct from the original products because the Mercury regularly sells the guitars separately. Therefore, the contract modification for the additional 30 guitars is, in effect, a new and separatc contract. It should not affect the accounting for the existing contract. In accordance with IFRS 15, if the pricing for the additional guitars did not reflect the stand-alone selling price of the additional guitars, Mercury would allocate the modified transaction price (less the amounts allocated to products transferred at or before the date of the modification) to all remaining guitars to be transferred. Applying IFRS 15, the amount recognised as revenue for each of the remaining guitars would be a blended of price of $98.33 [($100 x 60 products not yet transferred under original contract) + ($95 x 30 products to be transferred under the contract modification)] ÷ 90 remaining products} per product.

2. IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

Applying IFRS 15, revenue recognition is depends on when an entity satisfies a performance obligation. In order to recognise revenue, proper identification of distinct performance obligation is one of the prime steps towards revenue recognition, This needs to be done at the start of the contract.

In order to be classified as a distinct performance obligation, a contract should be such that the customer can benefit from:

- the good or service separately identifiable and distinct; or
- a bundle of goods or services that is distinct

CASE STUDY :
PTC Software sold a software license to one of its clients. The contract with the client States that PTC is to provide software updates and technical support for the next 3 years from the date of sale. The software remains functional without updates and technical support, In this case PTC needs to identity distinct performance obligations in order to recognise revenue. The software is delivered to the client before providing updates and technical support and also the customer can benefit from the software distinctly on its own. Also the other parts of the contract requiring technical support and updates are separately identifiable. On the basis of this evaluation, PTC concludes three performance obligations which are: - Software license - Software updates - Technical support

CASE STUDY :
Persistent Ltd licences customer relationship management software to a customer. In addition, Persistent promises to provide consulting services to significantly customise the software to the customer's information technology environment for total consideration of Rs 600,000. Persistent Ltd is providing a significant service of integrating the goods and services (the licence and the consulting services) into the combined item for which the customer has contracted. In addition, the software is significantly customised by Persistent in accordance with the specifications negotiated with the customer. Hence, Persistent would account for the licence and consulting services together as one performance obligation. Revenue for that performance obligation would be recognised over time by selecting an appropriate measure of progress towards complete satisfaction of the performance obligation.

For distinct goods and services: If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct.

For bundled goods and services: If a promised good or service is not distinct (bundled), an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct.

CASE STUDY :
B Ltd, an entity in the construction sector enters into a contract with a client to build a residential bunglow. B Ltd is overall responsible for timely completing the project and handing over the possession to its client. Building construction being a complex activity would require various goods and services to be provided which include laying foundation, laying structure, piping, finishing, etc. In this case B Ltd would account for the bundle of goods or services as single performance obligation, because the goods or services are provided as a single bundle and are highly interrelated.

CASE STUDY :
Depending on the contract, promised or services may include, but are not limited to, the following i sale of goods produced by an entity (for example, inventory of a manufacturer) : ii resale of goods purchased by an entity (for example, merchandise of a retailer) iiiresale of rights to goods or services purchased by an entity iv granting licenses v constructing, manufacturing or developing an asset on behalf of a customer vi granting options to purchase additional goods or services

3. DETERMINATION OF TRANSACTION PRICE

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 tax.)

The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

4. ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS IN THE CONTRACTS

For a contract that has more than one separate performance obligation, an entity would allocate the transaction price to each separate performance obligation at an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

To allocate an appropriate amount of consideration to each separate performance obligation, an entity would determine the standalone selling price at contract inception of the good or service underlying each separate performance obligation and allocate the transaction price on a relative standalone selling price basis. If a standalone selling price is not observable, an entity would estimate it.

IFRS 15 also specifies the circumstances in which an entity would allocate a discount or a contingent amount entirely to one (or some) distinct goods or services promised in a contract rather than to all promised goods or services in the contract.

An entity would allocate to the separate performance obligations in a contract any subsequent changes in the transaction price on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation would be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

CASE STUDY

Grace Ltd enters into a contract with a customer to sell Products A. B and C for a total transaction price of $36. The entity regularly sells Products A, B and C on a stand-alone basis for the following prices:

Product	Stand-alone selling rices
	$
A	9
B	11
C	20
Total	**40**

The customer receives a $4 discount for buying the bundle of three products, Products A and B are transferred at the same time and therefore Grace Ltd accounts for only two separate performance

- Products A and B combined and
- Separately for Product C

Grace Ltd regularly sells Products A and B as a bundle for $16 (i.e. at a $4 discount). Since Grace Ltd regularly sells Products A and B together for $16 and regularly sells Product C for $20, it has observable prices as evidence that the $4 discount in the contract should be allocated only to Products A and B. Hence, Grace Ltd allocates the transaction price of $36 as follows:

Product	Allocated amounts
	$
A and B	16
C	20
Total	**36**

5. RECOGNISE REVENUE WHEN A PERFORMANCE OBLIGATION IS SATISFIED

An entity would recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

Thus transaction price allocated in Step 4 is recognised as and when the performance obligation is satisfied either:

- Over time or
- At a point in time

CASE STUDY

Maxcare Inc entered into a contract with one of its customers to sell a machine and provide free servicing for the next three years. The total consideration under the contract is $6,000 and Maxcare expects to receive the full amount as agreed. Maxcare generally sells such a machine for $5,000 and charges $750 per year for servicing.

Here, revenue will be recognised based on a five step model as prescribed by IFRS 15.

a) Identify the contract

A contract can be in any form; here the contract between Maxcare Inc and its customer is related to the sale of machine and servicing, and is for three years.

b) Identify the performance obligation

According to the contract, there are two contractual obligations arising in this case: a) obligation to deliver the machine; and b) obligation to provide servicing for the next three years.

c) Determine the transaction price:

Here, the transaction price agreed and expected to be received is $6,000.

d) Allocate the transaction price to each performance obligation:

The standalone transaction price for the obligation to deliver the machine is $5,000 and the transaction price identification for the servicing obligation is $750 x 3 = $2,250. However, the total transaction price agreed for these obligations taken together is $6,000. The transaction price of $6,000 will be allocated to each obligation which forms a part of this contract. The transaction price to be allocated to the delivery of the machine is $4,138 ($6,000 x $5,000 / $7,250) and the transaction price to be allocated to the servicing obligation is $1,862 ($6,000 x $2250 / $7,250).

e) Revenue recognition

I, For the first performance obligation, the control is transferred at the point of time when risk and rewards and legal title is transferred, hence, revenue of $4,138 from the sale of the machine is recognized immediately.

II. For the servicing obligation, benefits are provided over time, so the revenue shall also be recognized over a period of time i.e. $620.67($1,862 / 3) per year.

QUESTION : 4

Dairy Products enter into a contract with Publicity Ad agency for an advertisement campaign to increase the sale of its product. The advertisement would be aired on television after due approval from the central authorities of Dairy Products. The commission for the work was fixed at $13,000, out of which 50% advance to be paid on signing the contract and 50% on completion of the contract.

Required:

State the accounting treatment in the above case.

SOLUTION : 4

Publicity Ad agency will recognise revenue only when the advertisement is telecast on television; as only then the performance obligation will be met. Until then the amount received whether as advance or for completion of the project will be recognised as a liability in the SOFP.

QUESTION : 5

C Ltd entered into a contract to construct a factory building for M Ltd. According to the contract, C Ltd will undertake the construction work of the factory for a consideration of $200,000. C Ltd expects to receive the full amount and does not expect any credit risk or default in payment from M Ltd.

C Ltd started the construction activity on 1st April, 2015. On 1st April, 2016 while the construction of the factory was yet to be completed, M Ltd requested construction of quarters (residential building) for its workers next to the factory premises. The price for this construction of residential building was negotiated separately and agreed at $100,000.

Required:

Explain the accounting treatment for this modification.

SOLUTION : 5

In this case the construction of residential building for employees is a separate contract as the scope of activity increases due this modification. This modification requires construction of an additional building which is distinct from the factory building as agreed in the initial contract and the price for the contract reflects the standalone price for this additional construction activity. Here, the revenue from the initial contract and the modification resulting into distinct performance obligation shall be accounted for separately over a period of time based on the progress in the satisfaction of the performance obligation.

QUESTION : 6

Which of the following fall within the scope of IFRS 15?

i. Revenue from contract of insurance
ii. Revenue from an operating lease
iii. Revenue from non-monetary transactions between entities engaged in same line of business to facilitate sales
iv. Revenue from contract with variable consideration

A. (i) and (ii) **B. (i) and (iii)**
C. Only (iv) **D. (iii) and (iv)**

SOLUTION : 6

The correct option is C.

IFRS 15 covers contract with variable considerations.

If the other Standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement requirements in those Standards. Therefore the options are incorrect.

QUESTION : 7

Z Ltd is a manufacturer of electronic products. It enters into a distribution agreement with P Ltd.

The terms and conditions of the agreement provide the following:

a) **P Ltd will obtain title to the goods and will sell them to retailers.**
b) **P Ltd will earn a fixed margin on the products sold to retailers, but will have no authority in establishing the sale price of the goods for retailers.**
c) **P Ltd has the right to return the goods to Z Ltd if they remain unsold for 2 years.**

Accordingly, Z Ltd sold goods worth $10,000 to P Ltd.

Required: When should the sale be accounted for?

SOLUTION : 7

The terms of contract between Z Ltd and P Ltd clearly state that P Ltd has a right to return the goods to Z Ltd if they remain unsold for two years. P Ltd will be entitled to a fixed margin and will have no authority in establishing the sale price. Based on the terms of contract between Z Ltd and P Ltd even though Z Ltd has sold goods of $10,000 to P Ltd stores, it shall not recognise the revenue immediately.

Here, even though the normal sale transaction has taken place, all the requirements of IFRS 15 are not satisfied as there is still an uncertainty related to consideration and no effective transfer of control has taken place. The consideration will be confirmed and control will be effectively transferred by Z Ltd only when P Ltd sells the goods to retailers or if goods are not returned even after two years. Here, Z Ltd will recognise the sale only when P Ltd sells the goods to retailers and receipt of transaction price is confirmed or after two years from the date of sale if goods are not returned by P Ltd even till that date.

QUESTION : 8

C Ltd is a multinational pharmaceutical company with operating divisions in eight countries. Since each of these countries has its own legislative requirements, on 1 January 2017. C Ltd has employed the services Of Miller, Martinez and Ichikawa (MMI), an international management consultancy firm to study and recommend ways to streamline their operation through corporate restructuring. For this, C Ltd would provide MMI with all the necessary resources. The entire process is agreed to be completed within six months, at the end of which MMI would present its findings to C Ltd's management. For its services, MMI would be paid $5 million atter three months and another $5 million at the end of six months. The progress in satisfaction of contractual obligation is expected to be in the same proportion of payment as stated. If MMI breaches any of the terms of the agreement or are not able to come up with specific recommendations, then C Ltd would not pay MMI for its services. MMI is unsure about the outcome as it has never undertaken such assignment before.

Required: On which dates would MMI recognise the revenue?

SOLUTION : 8

MMI as well as C Ltd have agreed upon the following conditions:

1. C Ltd would provide all the necessary resources to MMI.
2. The consideration of $10 million to be paid and the manner of settlement of the consideration.

Here there exists a contract and as per the contract the contractual performance obligation is to come up with recommendations. The obligation will be satisfied only when the recommendations are stated and hence revenue shall be recognised on satisfaction of this obligation. As there is no conformity on transaction price and satisfaction of obligation the revenue shall only be recognised on 30 June 2017. The amount received shall be recorded as advance from customers.

4. ACCEPTABLE METHODS FOR MEASURING PROGRESS TOWARDS COMPLETE SATISFACTION OF PERFORMANCE OBLIGATION.

As per the 5 step approach specified by IFRS 15. revenue shall be recognised over time or at point of time based on satisfaction of performance obligation.

Measuring progress towards complete satisfaction of performance obligation is a basic requirement while recognising revenue in case of long contracts where revenue is recognised over time.

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

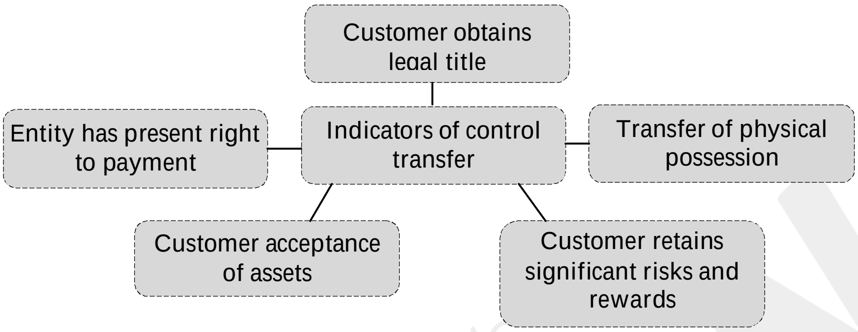
Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential 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.

Step 1 : The first step while measuring satisfaction of performance obligation is to verify whether control is transferred over time or at a point of time.

1. Indicators of control passed at a point of time

Factors which may indicate that control is passed at a point in time are summarised in the diagram below.



Note : These are illustrative conditions and the indications will not be limited to the above circumstances

2. Indicators of control passed over time

Control is assumed to have been transferred and revenue is recognised over time only if any of the following three criteria are met:

Criteria to be met	Example
a) The benefit is transferred to a customer when the entity is performing its obligation	A Ltd provides annual maintenence service to many software companies. It charges an annual amount as per contract but undertakes to provide monthly repair and maintenance on ongoing basis. Here the benefit of the maintenence service is transfered as A Ltd performs its obligation, therefore revenue shall be recognised over a period of time i.e. over the period of twelve months.
b) Entity's ongoing efforts create or enhance the asset for the customer	Buildcon Plc undertakes a contract to construct factory building for one of its client. Here as the asset is enhanced or created over time, revenue shall also be recognised accordingly over the period of time.
c) Entity's performance creates a unique\specialised asset with no other alternative use to the entity and the entity has a right to recover payment for performance completed	Multicon Inc entered into a contract to construct a specialised vehicle for Bingo Mining Plc . The vehicle is according to the specification provided by Bingo and it cannot be sold to any other party. According to the contract, Bingo is liable to pay for any cost incurred by Multicon. Here revenue shall be recognised over a period.

Note: If any of the conditions (for recognising revenue over time) are **NOT** met, revenue is recognised at a point of time.

Step 2: Selection of an appropriate measure of progress of performance obligation

For a performance obligation satisfied over time, a company would select an appropriate measure of progress to determine how much revenue should be recognised as the performance obligation is satisfied. This is especially applicable in long duration contracts.

In long term contracts (mostly construction contracts) the calculation of revenue to be recognised is a key factor for accounting as the performance obligation is satisfied over a period of time and hence recognition shall also follow the same pattern. Instead of recognising the revenue at the point of completion, we recognise it over a period of time as and when the performance obligation is satisfied. The important question here is how to ascertain the progress in satisfaction of performance obligation. IFRS 15 specifies two methods for estimating the progress made in completion of performance obligation over time.

a) Output methods

This includes surveys of performance completed to date, appraisals of results achieved, milestones reached, units produced/delivered etc. Here the thrust is on ascertaining the revenue that can be billed to the customer for obligation satisfied till date or any similar element related to revenue.

Example

A report of an expert, given after surveying the work, states the work is 45% complete.

45% would be used for percentage completed.

Example

A record of physical progress e.g. cubic metres of work done can be referred to for finding out the proportion of performance obligation satisfied over time.

If 6,000 cubic metres out of 10,000 have been completed, it can said that 60% of that activity is completed.

Example

Total contract price is $20m; work certified by the archited based on the work performed is $12m.

We can conclude that work completion is 60%.

b) Input Methods

These methods use cost and cost related factors as a basis for ascertaining the satisfaction of the obligation. Entity shall make reference to cost factors while using this approach to ascertain the satisfaction of obligation. It include factors like resources consumed, labour hours, costs incurred, time lapsed, machine hours etc.

Example

Total contract cost is $10m, and costs incurred for the work performed are $7m. We can conclude that work completion is 70%.

TIPS

If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

The entity needs to consider various aspects before selecting an appropriate method; a biased approach towards selection of the appropriate method can result in unreliable financial statements.

Example: if a contract includes manufacturing 20 distinct products of which 18 products constituting 30% of the total expected cost are completed, the output method might lead to a misleading picture and non-compliance with matching principle.

The entity needs to estimate the relevance and appropriateness of the method being used to measure the progress, if the circumstances and cost structure is changing entity shall consider the need for change in the method. If the method for measuring the progress is changed, it shall be considered as change in accounting estimates and shall be accounted for accordingly as per IAS 8.

Specific guidance is provided in relation to revenue arising from provision of licence related to intellectual properties (Patents, Softwares etc.)

In case of revenue arising from such license:

i. Revenue is recognised at point of time, if the licence provides the right to the licensee to use the intellectual property from the day the licence is granted

ii. Revenue is recognised over a period of time, if the licence provides a right to use intellectual property over the period of licence.

QUESTION : 9

Nigel & Co is a London based firm of architects and structural engineers specialising in the restoration of old heritage sites. On 31 December they received an $8 million contract from the Peruvian government to restore a 600 year old Inca worship site on the Peruvian Ecuadorian border. Nigel & Co has estimated that they would require two years to complete the restoration project. The Peruvian government would pay Nigel & Co in the following manner:

- **$4 million to be paid immediately**
- **$4 million on completion of the project**

These charges pertain only to Nigel & Co's consultation and design fees. Nigel & Co. would have charged $5 million for consultation and $3 million for design fees had it agreed for these services on a standalone basis. It has also been specifically agreed upon to follow the Peruvian government's recommendations in addition to their ideas in order to preserve the cultural heritage of Peru.

Required:

State with reasons whether the revenue from service shall be recognised in the financial statements for the financial year ended on 31st December 20X7 and if yes, how?

SOLUTION : 9

The enforceable rights of both Nigel & Co as well as the Peruvian government have been agreed upon with Nigel & Co detailing and restoring a heritage site according to the specifications of the Peruvian government as per the contract.

The consideration (transaction price) of $8 million and the manner of its settlement have also been agreed upon. As a result, the revenue from the service will be recognised by Nigel & Co. However, here the problem is in identifying the performance obligation and recognising the revenue based on performance of obligation. Here the contract involves two performance obligation i.e. consultation and designing. As for both the performance obligation the criteria for recognising the revenue over time are not met. Revenue will be recognized at the point of time when the obligations are fulfilled. Here the revenue will be recognised in the following manner:

- As there are two performance obligations involved in the form of consultation and design fees, the transaction price will have to be allocated to these two obligations.
- Based on information provided the transaction price $5 million will be allocated to consultation and $ 3 million will be allocated to designing obligation.
- As and when these obligations are satisfied by Nigel (i.e. in case of designing when the design is provided and in case of consultation when the report is presented and recommendations are made as the requirement of the contract) the revenue will be recognised for each of the obligation at a point of time.

ADDITIONAL INDICATORS OF CONTROL.

The following are the circumstances when **the entity has not passed the control** in the goods and services to the buyer

1. When the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions

EXAMPLE

Perfect Co is a manufacturer of stereos and offers a warranty of a 'six months free repair period' for all its models. However a manufacturing defect is revealed in the model 234 and Perfect Co has declared that it will refund the money for the model even after the warranty period is over, but before one year from sale.

What should be the accounting treatment?

In this case, for model 234, the risk of ownership remains with Perfect Co till the end of one year from the date of sale. This is because the customers have an option to return the product within one year from the date of sale. Therefore Perfect Co should not recognise revenue from the sale of Model 234. The revenue will be recognised only after one year from the date of sale, if the goods are not returned by the customers.

2. When the **receipt of revenue from a particular sale is contingent** on the receiving of revenue by the buyer from its sale further of the goods;

Example

Generally, in the case of car dealerships, the dealer takes cars from the manufacturer on consignment. In some agreements, payment is not made from the dealership (consignee) to the manufacturer (consignor) until the dealer sells the car on to a third party. The dealer often has the right to return cars to the manufacturer if they are not sold within a specified period of time.

3. When the goods are shipped subject to installation and the installation is a significant part of the contract **which has not yet been completed by the entity;**

Example

Heavy Machines Ltd sells a machine worth $25,000 to Superfine Polyesters. This machine has to be embedded into the ground before it can start manufacturing goods.

Heavy Machines Ltd cannot recognjse this sale as revenue until it completes the installation of this machine in the premises of Superfine Polyesters.

4. When the buyer has the right to cancel the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

Example

Goods sold on approval basis cannot be recognised until the persons taking the goods have agreed that they want them.

5. **No recognition of revenue in spite of outflow of inventory**

Any replacement of the damaged goods during the warranty period by the company is not recognised as revenue because of the following reasons:

a) revenue was already recognised during the sale of the original stock of goods
b) there is no consideration received by the entity for the damaged goods

EXAMPLE

T Ltd purchased plastic containers from S Ltd worth Rs 6,000. The terms of the sales contract stipulated that in the event of damage to the containers, S Ltd would replace the containers free of cost to T Ltd.

On their arrival at T Ltd's 50% of the consignment was damaged. Though S Ltd would replace the damaged goods, he could not recognise this outflow of his inventory as revenue

5. SPECIFIC TRANSACTIONS:

5.1 PRINCIPAL VERSUS AGENT

In principal-agent relationship, the agent only acts for and on behalf of the principal, Therefore the control of the goods and service is primarily with the principal who bears significant risks and rewards associated with the sale of goods or the rendering of services. The agent merely follows principal's terms and conditions and assumes an obligation of duties towards the principal.

The entity must determine whether its performance obligation is to provide the good or service itself (i.e. the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent). This information is crucial for the revenue recognition.

Indicators to identify a principal

An entity is a principal if the entity:

- controls a promised good or service before the entity transfers the good or service to a customer.
- satisfies the performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf.

Indicators to determine whether an entity is an agent:

An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party.

Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:

Diagram : Indicators to determine whether an entity is an agent

- Another party is responsible for the fulfillment
- Does not have inventory risk at any point of time
- No discretion in establishing prices for the other party's goods of services
- Consideration received in form of commission
- Not exposed to credit risk for the amount receivable from a customer

- **If the entity is the principal in the arrangement :** The revenue is recognised at the gross amount to which the entity expects to be entitled.
- **If the entity is the agent :** The revenue recognised is the net amount the entity is entitled to retain in return for its services as the agent. In such a case 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.

CASE STUDY

Lata Co manufactures clothing and sends the goods to Snehal Co on the following terms:

- The legal title of ownership passes to Snehal Co when it receives the clothes.
- Snehal Co stores the merchandise in its warehouse.
- Snehal Co does not have to pay for the merchandise until it receives payment from the third party.
- After three months, if the goods are not sold, Snehal Co. can either return the clothes to Lata Co or pay Lata Co for the goods and keep them.
- Snehal Co is entitled to retain a fixed amount from the sales made to third party.

In this case as Snehal Co

- does not hold inventory risk,
- it has no obligation for payment until goods are sold to third party and
- it is entitled to a fixed commission.

These conditions suggest that Snehal Co is working in the capacity of an agent in this arrangement. The revenue recognised by Snehal Co in this arrangement is the net amount that it is entitled to be retained in return for its services as the agent. In such a case the commission will be the net amount of consideration that Snehal Co retains after paying the consideration to Lata Co.

Here, Lata Co, as a principal, should recognise revenue at the gross amount which it expects to be entitled to, at the earlier of receiving payment from the third party, or three months after the sale, provided that the goods are not returned.

CASE STUDY

Vesta Travels negotiates with King 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 must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

Vesta determines the prices at which the airline tickets will be sold to its customers. Vesta sells the tickets and collects the consideration from customers when the tickets are purchased; therefore there is no credit risk.

Vesta also assists the customers in resolving complaints with the service provided by airlines. However, each airlines is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

To determine whether Vesta's performance obligation is to provide the specified goods or services itself (i.e. Vesta is a principal) or to arrange for another party to provide those goods or services (i.e. Vista is an agent), Vesta considers the nature of its promise. Vesta determines that its promise is to provide the custorner with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. In determining whether Vesta obtains control of the right to fly before control transfers to the customer and whether the entity is a principal, Vesta considers the following indicators:

a) **Vesta is primarily responsible for fulfilling the contract,** which is providing the right to fly. However, Vesta is not responsible for providing the flight itself, which will be provided by the airline.
b) **Vesta 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) **Vesta has discretion in setting the sales prices** for tickets to its customers.
d) As a result of Vesta's ability to set the sales prices, the amount that the entity earns is not in the form of commission but instead depends on the sales price it sets and the costs of the tickets that were negotiated with the airline.

Vesta consludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the above indicators of IFRS 15, Vesta concludes that it controls the ticket before it is transferred to the customer. **Thus Vesta concludes that it is a principal in the transaction and recognises revenue in the gross amount of to consideration** to which it is entitled in exchange for the tickets transferred.

QUESTION 10 :

Which of the following statements indicate that the entity is an agent to a principal in accordance with IFRS 15?

(i) Entity does not have the inventory risk
(ii) It has discretion in establishing the selling price
(iii) Consideration received in form of commission
(iv) Exposed to credit risk for amounts receivable from a customer

A (i) and (ii)
B (i) and (iii)
C Only (iv)
D (iii) and (iv)

SOLUTION : 10

The correct option is B. An agent to the principal does not have discretion in establishing the sales price and also does not carries the credit risks for amounts receivable from customers.

QUESTION : 11

Newsoft Inc sells software developed by emerging software companies through a number of specialty stores throughout the globe. There is a provision that these stores can return the software CDs within a period of 4 months from their purchase. The products being new are yet to be established in the commercial market. It is unclear whether they will be successful and whether customers will accept and retain the license after 4 month. When shall Newsoft Inc recognise the revenue in its books?

SOLUTION : 11

There exists an uncertainty as far as receipts from the stores and performance of obligation is concerned. This uncertainty is removed only when the stores sell the software or the period of four months expires. The control can is assumed to be transferred only when the stores sell the software. Thus, revenue should be recognised only when the four-month period has expired, or when the stores sell the software if earlier. Here the stores are agent and it is a situation of consignment sale.

5.2 SALES WITH A RIGHT OF RETURN

In Some contracts, an entity transfers control of a product to a customer 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

Accounting for sale with a right of return

An entity shall recognise all of the following:

Diagram : Accounting for sales with a right of return

Revenue	Refund liability	Asset
For the transferred products in the amount of consideration to which the entity expects to be entitled (i.e. excluding retur products)	For the products which might be returned by customers in future	For the entity's right to recover products from customers on setting the refund liability (Corresponding adjustment in cost of sale)

CASE STUDY

B Ltd sells 100 books for $100 each. As per the customary business practice B Ltd allows a customer the right to return any unused product within 30 days and receive a full refund. The cost of each book is $60.

Using the most likely amount, the B Ltd estimates that three books will be returned by the customer. B Ltd's experience is predictive of the amount of consideration to which it will be entitled. Further, B Ltd estimates that the costs of recovering the books will be immaterial and expects that the returned books can be resold at a profit.

Upon transfer of control of the books, B Ltd would not recognise revenue for the three books that it expects to be returned. Consequently, it would recognise the following:

a) **Revenue** of $9,700 ($ 100 x 97 books expected not to be returned).
b) **A refund liability** for $300 ($100 refund x 3 books expected to be returned)-
c) **An asset** of $ 180 ($60 x 3 books) for its right to recover books from customers on settling the refund liability.

Hence the amount recognised in cost of sales for 97 books is $5,820($60 x 97 books).

5.3 REPURCHASE AGREEMENTS

The repurchase agreements are generally in the following three forms:

i, A forward contract where an entity selling the asset has an obligation to repurchase the asset.

CASE STUDY

M Ltd had a plot of land which it has sold to Q Ltd for $300,000 (the prevailing market price of the land is expected to be $250,000). It was decided at the time of the sale that M Ltd will repurchase that plot after a year. The repurchase price was fixed at $320,000. Here the repurchase agreement is in the form of forward contract as M Ltd has an obligation to repurchase the asset. As the repurchase price is higher than the initial selling price, M Ltd shall recognise the amount received as liability and continue to recognise the asset in its books. The excess amount of $20,000 paid at the time of repurchase shall be recognised as finance cost in the books of M Ltd.

QUESTION 12 :

Superb Co had a plot of land which it has sold to ASF co for $400,000 (the prevailing market price of the land). It was decided at the time of the sale that Superb Co would repurchase that plot after four years. The repurchase price was fixed at $500,000.

Required: How should this transaction be accounted for?

SOLUTION : 12

In this case the legal form is that of a sale of land by Superb Co. However, the substance of the transaction shows that:

- Superb Co has obtained a loan from ASF Co.
- It has handed over the plot of land as security.
- The repurchase price includes an element of interest.

Hence, Superb Co will not recognise this sale as revenue as land is expected to be returned. It will be reflected as Loan from ASF Co i.e. refund liability for expected return of land in the statement of financial position. Land will be continued to be shown in the books of Superb Co. The difference between amount received from ASF and to be paid for purchase shall be stated as finance cost.

ii. A put option where the entity selling the asset will have to repurchase the asset from the seller if seller requires the asset to be purchased

In the case of a put option where the buyer can decide on the repurchase of the asset, the transaction shall be recognised as sale if the repurchase price is lower than the selling price and it is estimated that the repurchase won't be an appropriate decision considering the financial impact. However, if it is expected that the repurchase will be beneficial for the buyer and the option will be exercised, then recognise the transaction as a financial arrangement.

CASE STUDY :

M Co had a plot of land which it has sold to Q Co for $400,000 (the prevailing market price of the land is expected to be $ 4,20,000). It was decided at the time of the sale that Q Co will decide on the repurchase of that plot after a year and M Co will have to repurchase the land if Q Ltd requires. The repurchase price was fixed at $ 3,20,000. Here the repurchase agreement is in the form of a put option as the buyer, Q Co, will decide on the repurchase of the asset. Here as the repurchase price is lower than the selling price on initial sale there are lower chances of Q Co requiring the repurchase and hence M Co shall recognise revenue immediately.

iii A Call option where the entity selling the asset has a right to repurchase the asset

In case of repurchase agreements which are in the form of a call option or a forward option the control is not effectivity transferred from the entity even after the sale and transfer of asset as the entity has a right / obligation to repurchase the asset. The entity shall account for these transactions either as a lease contract or a financial arrangement depending on the repurchase price.

If the repurchase price is below the original selling price it will be accounted under IAS 17, Leases.

However, if the repurchase price is higher than or equal to the initial selling price the entity shall account for this transaction as a financial arrangement, by recognising a liability for amount received and asset sold and shall continue to be stated in the financial statements.

5.4 BILL AND HOLD ARRANGEMENTS

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.

CASE STUDY

A customer may request an entity to enter into such bill and hold contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

In bill and hold arrangement the entity does not control the product and merely custodial services to the customer. Therefore sales revenue is **recognised** as soon as the goods are invoiced i.e. when the buyer takes control of the goods. **Further all of the following criteria need to be met in order to treat the contract as bill and sales:**

1. The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
2. The product must be identified separately as belonging to the customer;
3. The product currently must be ready for physical transfer to the customer; and
4. The entity cannot have the ability to use the product or to direct it to another customer.

Sales revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

CASE STUDY :

Lolo has entered into an agreement to supply 10 computers worth $30,000 to Bebo. Bebo has made the payment but as her office is under renovation she has asked Lolo not to deliver the computers until further instructions.This is a bill and hold arrangement.

In this case Lolo can recognise the revenue as the control of the computers has passed to Bebo. Further the following conditions are also met:

1. The bill and hold arrangement is at the request of Bebo
2. The computers are identified separately belonging to Bebo
3. The computers are ready for delivery and Lolo is only waiting for instructions from Bebo to deliver the computers.
4. Lolo cannot transfer these computers to another customer or use it in any other manner.

However, if Lolo dispatches these computers (identified for Bebo) to some other person then the amount received cannot be recognised as revenue.

QUESTION 13 :

M Ltd has entered into an agreement to supply a machine worth $200,000 to B Ltd. B Ltd has made the payment and identified the machine. Special packing as required by M Ltd has been done but as the factory setup is not ready B Ltd has asked to hold the delivery for 20 days

Required: How should this transaction be accounted for?

SOLUTION : 13

This is a bill and hold arrangement.

In this case M Ltd can recognise the revenue irrespective of transfer of physical possession of Machine to B Ltd. Here the control of the machine has passed to the B Ltd as following conditions are met:

- The bill and hold arrangement is at the request of B Ltd.
- The machine is identified separately belonging to B Ltd.
- The machine is ready for delivery and M Ltd is only waiting for instructions from B Ltd to deliver the computers.
- M Ltd cannot transfer this machine to another customer or use it in any other manner.

5.5 CONSIGNMENT ARRANGEMENTS

A 'consignment sale' is a transaction where one entity (the consignor) sells goods to another entity (the consignee), The consignee has the option of returning any unsold goods at the end of time period specified in the contract-

Further other indications of consignment arrangement include :

- The product is controlled by the entity.
- The entity can direct the consignee to return the goods back or transfer to another dealer.
- The consignee / dealer does not have an obligation to pay for the product (though some deposit money may be collected from such consignors).

When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall not recognise revenue as the other party has not obtained control over such goods delivered.

In this case **sales revenue** is **recognised by the consignor** when the consignee **sells the goods to a third party.** Any unsold goods held by the consignee are reflected as an asset in the SOFP as inventory with consignee.

CASE STUDY :
Rain Co sells goods amounting to $25,000 on a consignment basis to Gain Co. During the year, Gain Co sold goods amounting to $15,000 to retail dealers.
How will Rain Co treat the transaction in its books of accounts?
Rain Co will recognise $15,000 as sale revenue in the statement of profit or loss to the extent of the retail dealers obtaining control over the goods sold.
The remaining $10,000 ($25,000 - $15,000) is recognised in the SOFP as consignment inventory at cost with Gain Co. This is because sales revenue is recognised by the consignor when the consignee sells the goods to third party.

6. ACCOUNTING FOR DIFFERENT TYPES OF CONSIDERATION INCLUDING VARIABLE CONSIDERATION AND WHERE A SIGNIFICANT FINANCING COMPONENT EXISTS IN THE CONTRACT.

While determining the transaction price. The entity shall consider the effects of all of the following.

1. VARIABLE CONSIDERATION

An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. If the promised amount of consideration in a contract is variable due to the factors mentioned, an entity can estimate the transaction price by using either the

- expected value (that is, probability-weighted amount) or
- the most likely amount,

The above depends on which method the entity expects to better predict the amount of consideration to which it will be entitled.

CASE STUDY
Pride Ltd enters into a contract with IPL for two software licences (Licence X and Licence Y). These are identified as two separate performance obligations arising out of this contract. The price for Licence X is a fixed amount of $750 and for Licence Y the price is agreed as 5 percent of the IPL future sales of products that use Licence Y. Pride estimates the transaction price to be $1,750 (including $1,000 estimated as royalties from Licence Y). The estimated stand-alone selling prices of Licences X and Y would have been $750 and $1,150 respectively
Applying the criteria specified by IFRS 15, Pride would allocate the contingent royalty payment of $1,000 entirely to Licence Y because that contingent payment relates specifically to an outcome from the performance obligation to transfer Licence Y (as it is based on subsequent sales of products that use Licence Y), In addition, allocating the expected royalty amounts of $1,000 entirely to Licence B is consistent with the allocation principle when considering the other payment terms and performance obligations in the contract.
Pride transfers Licence Y at inception of the contract and transfers Licence X a month later. Upon transfer of Licence Y, Pride recognises as revenue only the amount to which it is reasonably assured to be entitled. Because the expected royalty amount of $1,000 varies entirely on the basis of the customer's subsequent sales of products that use Licence B, Pride is not reasonably assured to receive that amount until the customer's subsequent sales occur. Therefore, pride would not recognise revenue at the $1,000 allocated amount until the customer sells the products that use Licence Y.
When Licence X is transferred, pride would recognise as revenue the $750 allocated to Licence A.

IMPORTANT

Examples of where a variable consideration can arise

- Discounts
- Rebates
- Refunds
- Credits
- Price concessions
- Incentives
- Performance bonuses
- Penalties

An entity shall include in the transaction price the variable consideration estimated above, only if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved.

CASE STUDY
On 1 April, 2020, F Ltd entered into a contract with H Ltd to provide asset management services for one year. F Ltd receives a semi-annual management fee, which is based on a percentage of H Ltd's assets under management at the end of each half year. In addition, F Ltd receives a performance-based incentive fee of 10% of the fund's return in

excess of the return of an observable index at the end of the year.

Although each increment of service is distinct, F Ltd accounts for the contract as a single performance obligation to provide investment management services for one year because the services have the same pattern of transfer to the customer.

To recognise revenue for satisfying the performance obligation over time, F Ltd selects an output method of measuring progress towards complete satisfaction of the performance obligation

F Ltd concludes that it is not reasonably assured to be entitled to the incentive fee until the end of the year. Although F Ltd has experience with similar contracts, that experience is not predictive of the outcome of the current contract because the amount of consideration is highly susceptible to volatility in the market. In addition, the incentive fee has a large number and high variability of possible consideration amounts,

Because F Ltd is not yet reasonably assured to be entitled to the incentive fee, the cumulative amount of revenue recognised during the year is limited to the semi-annual management fees. Therefore, in accordance with IFRS 15, F Ltd directly measures the value of the services provided to the customer to date by reference to the semi-annual management fees for which F Ltd has a right to invoice. In other words, the semi-annual management fee is an appropriate depiction of the amount of consideration to which F Ltd expects to be entitled in exchange for the services provided on six monthly basis.

2. Existence of a significant financing component in the contract

In determining the transaction price, an entity shall adjust the transaction price for the effects of the time value of money. This will require adjusting the transaction price by discounting it with an appropriate interest rate and recognising the interest income or expense over the financing period. This is not required if the time period between the transfer of goods of service is less than one year,

CASE STUDY

On 31 March 2019, Delta sold goods for a price of $12.1 million. The terms of the sale allowed the customer to extend the credit and the price was payable by the customer in cash on 31 March 2021. A discount rate that is appropriate for the risks in this transaction is 10%.

In this case, on 31 March 2019, Delta should rccognise only $10 million i.e. [$12.1 million / $(1 + 10\%)^2$] as revenue and receivables. On 31 March 2020, it should recognise $1 million ($10 million x 10%) as finance cost and increase the receivables on 31 March 2021, finance cost (income) will be recognised for $1.1 million ($11 million x 10%) and also the receivables.

QUESTION : 14

Textgo Co entered into a contract with Mingo Co to sell a machine for $230. However, according to the terms of the contract, Mingo will pay the amount as agreed immediately but the machine will be sold and delivered only after 12 months. The transaction includes the impact of the financing arrangement, and the finance cost on the advance received is estimated to be $20. How much revenue shall Textgo Co recognise from this contract on the date of sale when the contract is executed?

SOLUTION : 14

Here as Textgo Co has received $230 in advance and the transaction includes the impact of financial arrangement, Textgo needs to consider the impact of the finance cost. Textgo Co shall not recognise any revenue on the date of receipt of advance as performance obligation under the contract is not satisfied.

However, Textgo Co shall recognise the following:

- Contract liability on receipt of advance of $230
- Finance cost of $20 on the advance received as it's the finance cost related to the advance received from Mingo Co 12 months before the sale of the machine. It constitutes the cost of using funds which were received in advance.
- Revenue on satisfaction of obligation to sell the machine; it will be recognised for $250 including advance of $230 and finance cost of $20.

3. Non-cash consideration

Sometimes the customer may pay the consideration in a sales transaction in form other than cash. In such a case the entity shall recognise the non-cash consideration **at fair value.**

If an entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration indirectly **by reference to the stand-alone selling price** of the goods or services promised to the customer in exchange for the consideration.

CASE STUDY

Genius Ltd, a company engaged in manufacturing computers and laptops supplied 150 computers to Gemini Ltd under a contract. In accordance with the contract Gemini agreed to pay Genius by transferring the rights to one of its patents.

This patent will allow Genius to improve the display quality of its computer screens. The fair value of patents was estimated at $0.5 million. The stand-alone price of each computer is $2,500.

In this case, Genius will measure the non-cash consideration i.e. patents at $0.5 million.

If the fair value of patent was not available, then in such case, the non-cash consideration would be measured at the stand-alone selling price of computers promised i.e. $2,500 x 150 computers = 0.375 million.

QUESTION : 15

T Ltd is a telecommunication company. P Ltd is engaged in generation and supply of power. T and P enter into an arrangement whereby T; Ltd will provide 1,00,000 minutes of talk time free to employees of P Ltd in exchange for getting free power equivalent to 20,000 units. A Ltd normally charges Re 0.50 per minute and B Ltd charges Rs 3 per unit. How to measure revenue in this case?

SOLUTION : 15

IFRS 15 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. Thus, the current scenario will be covered under IFRS 15 since the same is exchange of dissimilar goods or services.

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.

On the basis of the above, revenue recognised in the books of T Ltd will be the amount the entity expects to be entitled for talk-time sold, ie, Rs 60,000 (20,000 units x Rs 3) and in the books of P Ltd, the amount entity expects to be entitled for the power units sold, ie, Rs 50,000 (1,00,000 minutes x Re 0.50).

4. Consideration payable to a customer

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to 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).

An entity shall account for such consideration payable to a customer as a reduction of the transaction price.

QUESTION 16 :

Limo Plc entered into a contract with Sean Inc to sell machines X and Y. According to the contract Sean Inc will pay a consideration of $75,000 upfront. Sean Inc has agreed to provide machine X after 2 years and machine Y after 5 years from the date of contract. Limo Plc feels that the transaction price can be allocated to machine X and machine Y in the ratio of 20:80. The appropriate finance cost for the entity based on its average cost of capital is estimated to be 6%.

Required: How should Limo Plc recognise the revenue arising from this contract?

SOLUTION : 16

1. **Allocate the transaction price of $75,000 to machine X and machine Y.**

   Here based on the ratio given:

   - transaction price to be allocated to machine X will be $15,000 ($75,000 X 20 / 100)
   - transaction price allocated to machine Y will be $60,000 ($75,000 X 80 / 100)

   On the date of contract Limo Plc will recognise the amount received upfront as contract liability as performance obligation has not been satisfied. Therefore contract liability for receipt of upfront amount needs to be recognised.

2. **Journal entry to recognise the receipt of the upfront amount of $75,000**

Dr	Cash	$75,000	
Cr	Contract Liability		$75,000

Being receipt of upfront amount

3. **During the two years from contract inception until the transfer of machine X, we need to recognise the interest expense on $75,000 @ 6% for two years.**

End of year 1

Dr	Interest expenses	$4,500	
Cr	Contract Liability		$4,500

Being interest expenses at end of year I ($75,000 x 6%)

End of year 2

Dr	Interest expenses	$4,770	
Cr	Contract Liability		$4,770

Being interest expenses at end of year 2 (($75.000 + 4,500) x 6%)

4. **Recognise revenue for the transfer of machine X at the end of year 2**

End of year 2

Dr	Contract Liability	$16,854	
Cr	Revenue		$16,854

Being recognition of revenue for machine X ($15,000 + 20% x (4,500 + 4,770))

5. **Recognise the interest expense for three years on the remaining contract liability of $67,416 (i.e. $75,000 + $4,500 + $4,770 — $16,854)**

End of year 3

Dr	Interest expenses	$4,045	
Cr	Contract Liability		$4,045

Being interest expense at end of year 3 ($67,416 x 6%)

End of year 4

Dr	Interest expenses	$4,288	
Cr	Contract Liability		$4,288

Being interest expenses at end of year 4 (($67,416 + $4,045) x 6%)

End of year 5

Dr	Interest expenses	$4,545	
Cr	Contract Liability		$4,545

Being interest expenses at end of year 5 (($67,416 +$4,045 + $4,288) x 6%)

6. **At end of year 5 when the other machine i.e. machine Y is transferred Limo Plc shall recognise revenue of $80,294.**

End of year 5

Dr	Contract Liability	$80,294	
Cr	Revenue		$80,294

Being recognition of revenuer for machine Y ($67416 + $4,045 + $4,288 + $4,545)

QUESTION : 17

Zylo Plc entered into a contract with Milo Inc to sell machines A and B. Under the contract, Milo Inc will pay the consideration of $50,000 upfront. Sean Inc has agreed to provide machine A immediately and machine B after a year from the date of contract. Zylo Plc feels that the transaction price can be allocated to machine A and machine B in the ratio of 40:60. The appropriate finance cost for the entity based on its average cost of capital is estimated to be 10%.

Required: How should Limo Plc recognise the revenue arising from this contract?

SOLUTION : 17

1. **Allocate the transaction price of $50,000 to Machine A and Machine B.**

   Here based on the ratio given:

   - transaction price to be allocated to machine X will be $ 50,000 X 40 / 100 = $20,000 and
   - transaction price allocated to machine Y will be $50,000 X 60 / 100 = $30,000.

   On receipt of the upfront amount of $50,000 and the delivery of Machine A, Milo will recognise the revenue of $ 20,000 against Machine A and a contract liability of $30,000 towards the performance obligation which has not been satisfied against Machine B.

2. **Journal entry to recognise the receipt of the upfront amount of $50,000**

		$	$
Dr	Cash	$50,000	
Cr	Contract Liability		$50,000

Being receipt of upfront amount

3. **Journal entry to recognise the revenue of Machine A**

Dr	Contract liability	$20,000	
Cr	Revenue		$20,000

Being recognition of revenue against Machine A

4. **During the first year from contract inception until the transfer of Machine B, we need to recognise the interest expense on $30,000 @ 10% for one year**

End of year 1

Dr	Interest expenses	$3,000	
Cr	Contract Liability		$3,000

Being interest expenses at end of year 1 ($30,000 x 10%)

5. Recognise revenue for the transfer of Machine B at the end of year 1,

End of year 2

Dr	Contract Liability	$33,000	
Cr	Revenue		$33,000

Being recognition of revenuer for machine X ($30,000 + 3,000)

QUESTION : 18

A seller provides sales incentives to a customer when entering into a contract. For examples it provides Free goods that the seller normally sells or provides as part of its business (e.g, on purchase of two products, third product is free). How should an entity account for such sales incentives?

SOLUTION : 18

An entity grants "free" goods to a customer as part of the sale transaction, which it sells separately as part of its operations. The transaction price is allocated to the each separate component based on IFRS 15 which requires that revenue from sale of goods shall be recognised when the entity satisfies a performance obligation by transferring a promised good or service to a customer. In the current transaction, the total consideration received will be allocated to all elements in the sale, including the free goods

QUESTION : 19

A Manufacturer enters into a contract to deliver a product to Customer for Rs 5,00,000. Customer pays a deposit of Rs 200,000 with the remainder due upon delivery (delivery will occur 3 weeks later and a significant financing component does not exist). Revenue will be recognised upon delivery as that is when control of the product transfers to the customer. How should the manufacturer present the advance payment prior to delivery in the statement of financial position?

SOLUTION : 19

The Rs 2,00,000 deposit was received in advance of delivery, so the producer should recognise a contract liability for that amount.

Cash A/C	Dr..Rs 2,00,000	
To Contract Liability A/C		Rs 2,00,000

The contract liability will be reversed and recognised as revenue (along with the Rs 3,00,000 remaining balance) upon delivery of the product.

Contract Liability A/C	Dr. Rs 2,00,000	
Cash A/C	Dr..Rs 3,00,000	
To Revenue		Rs 5,00,000

7. CRITERIA FOR THE RECOGNITION OF CONTRACT COSTS

7.1 CONTRACT COSTS

Definition

The incremental costs of obtaining a contract are those costs that an entity incurs

- in its efforts to obtain a contract with a customer and
- that it would not have been incurred if the contract had not been obtained (for example, a sales commission)

Diagram : Treatment of incremental costs

Recognise as an asset

- If the entity expects to recover those costs from the customer

Recognise as an expense

- Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained, unless these costs are specifically chargeable to the customer

As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have been recognised is 1 year or less.

If the costs incurred in fulfilling a contract with a customer are in the scope of another IFRS (for example, IAS 2, IAS 16 or IAS 38), an entity shall account for those costs in accordance with those other IFRSs. Otherwise, an entity shall recognise an asset from the costs to fulfil a contract only if those costs meet all of the following criteria:

- **The costs relate directly to a contract** or to an anticipated contract that the entity can specifically identify. For example cost of material, labour, designing an asset to be transferred under a specific contract (discussed below)
- The **costs generate or enhance resources** of the entity that will be used to satisfy performance obligations in the future; and
- The entity **expects to recover the costs**

Costs that relate directly to a contract (or a specific anticipated contract) include the following:

COSTS	EXAMPLES
➢ Direct materials	➢ Supplies used in fulfilling the contract
➢ Direct labour	➢ Salaries and wages of employees who provide the promised services directly to the customer
➢ Allocation of costs that relate directly to the contract or to contract activities	➢ Costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract
➢ Costs that are explicitly chargeable to the customer under the contract	➢ Any specific cost specified in the contract
➢ Other costs that are incurred because the entity entered into the contract	➢ Payment to sub-contractors

An entity shall recognise the following costs as expenses when incurred:

1. **General and administrative costs** (unless those costs are explicitly chargeable to the customer under the contract);
2. **Costs of wasted materials, labour** or other resources to fulfil the contract that were not reflected in the price of the contract;
3. **Costs that relate to satisfied performance obligations** (or partially satisfied performance obligations) in the contract (i.e., costs that relate to a past performance); and
4. Costs related to remaining performance obligations that **cannot be distinguished from costs related to satisfied performance obligations.**

Amortisation of contract asset

Capitalised costs are amortised in a manner consistent with the pattern of transfer of goods or services to which the capitalised costs relate.

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 IAS 8.

CASE STUDY

ACS Ltd enters into a contract to outsource a customer's information technology data centre for five years. ACS Ltd incurs selling commission costs of $1 to obtain the contract. Before providing the services, ACS Ltd designs and builds a technology platform that interfaces with the customer's systems. That platform is not transferred to the customer.

The customer promises to pay a fixed fee of $20,000 per month. The $10,000 incremental costs of obtaining the contract are recognised as an asset. The asset is amortised over the term of the contract. The initial costs incurred to set up the technology platform are as follows:

Particulars	$
Design services	40,000
Hardware	120,000
Software	90,000
Migration and testing of data centre	100,000
Total costs	**350,000**

The initial set-up costs relate primarily to activities to fultil the contract but do not transfer goods or services to the customer. The entity would account for the initial set-up costs as follows:

a) **Hardware costs :** accounted for in accordance with IAS 16 Property, plant and equipment.
b) **Software costs :** accounted for in accordance with IAS 38 Intangible assets.
c) **Costs of the design, migration and testing of the data centre :** considered for capitalisation i.e. the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. Any resulting asset would be amortised systematic basis over five years as the entity provides the services outsourced by the customer.

QUESTION 20 :

When are incremental cost recognised as an asset?

A If the entity expects to recover those costs from the customer
B If the entity does not expects to recover those costs from the customer
C If the entity expects to incur such costs over a long period of time
D If the entity wants to defer such non-recurring expenses

SOLUTION : 20

The correct option is A. Under IFRS 15, an entity capitalises the incremental costs of obtaining a contract if it expects to recover those costs.

8. CONTRACTS WHERE PERFORMANCE OBLIGATIONS ARE SATISFIED OVER TIME.

8.1 RULES OF RECOGNITION

For contracts where performance obligations are satisfied over time revenue is recognised based on **calculation of progress made towards complete satisfaction of performance obligation,** in short, proportion of contractual obligation satisfied. These are mostly construction contracts that take substantial period of time to get complete and also meet the criteria that establish that control is transferred over a period of time.

Once it is established that control is transferred over time the entity needs to measure the progress to satisfaction of the performance obligation arising from the contract by using any of the methods prescribed i.e. input method or output method (We have already covered these).

Once this calculation is done both the revenue recognition and amortisation of capitalised cost of contract is done in a manner consistent with the pattern of transfer of goods or services.

Long term contracts are subject to some uncertainties that are not applicable to other transactions.

Recognition of revenues and expenses depends on whether the **outcome of a performance obligation can be estimated reliably.**

Therefore, the **rules of recognition** are divided between the following **two classes:**

- When the outcome of a performance obligation **can be estimated reliably.**
- When the outcome of a performance obligation **cannot be estimated reliably.**

These are discussed in detail below:

1. When the outcome of a performance obligation can be estimated reliably

Recognition of profits will be the result of recognising the contract revenues and costs. Both revenue and costs are recognised in a manner consistent with the pattern of transfer of goods or services to which the capitalised costs relate. The revenue is calculated using the transaction price that is allocated to the performance obligation after considering the variation, credit risks and other factors which impact transaction price. An expected loss on the contract shall be **recognised as an expense** immediately using the basis for onerous contracts as specified in IAS 37. Thus in the case of loss making contract only unavoidable costs are considered and the loss is recognised immediately as an expense in SOPL.

CASE STUDY

Golden Construction Co is executing a contract worth $15m. The **outcome** of this contract **can be estimated reliably**. On 31 December 20X6 (its end of the reporting period), it estimates that 50% of obligation have been satisfied.

It will recognise 50% of the expected transaction price as revenues and 50% of contract cost related to the contract in SOPL.

The entity keeps track of the progress of work as well as the cost of the work done. When it is **probable that total costs will exceed total revenue after considering the impact of impairment and credit risk if any,** this indicates that there is likely to be an overall loss. Such a loss is to be **recognised immediately as per IAS 37, although IFRS 15 do not prescribe any specific treatment.**

The **loss** is determined and **recognised irrespective** of the following:

a) Whether the contract work has commenced or not.
b) The proportion of performance obligation satisfied over time.
c) The amount of profit expected to arise on other contracts not part of this single contract or other contractual obligation which is a part of same contract.

8.2 PROGRESS BILLING (AMOUNTS INVOICED OVER A PERIOD OF TIME)

Progress billing is the amount that is billed by the contractor for work performed. It may or may not have been paid by the customer by the end of the reporting period. The part not collected by the end of the reporting period is an asset similar to receivables.

8.3 RETENTIONS

Out of the progress billings, depending on the agreement. the customer while paying the amount holds some part back. This amount is known as retention. It is not paid until certain conditions specified in the contract are satisfied or any defects noticed have been rectified.

At times, a period may be specified in the agreement for which the retentions will be held back. Retentions are amounts retained by the customer, and therefore, **assets for the contractor.**

8.4 ADVANCES

That part of the collection from the customer which is received **before** the work is performed is known as an **advance.** This amount is a liability for the contractor

QUESTION 21:

ASF Ltd is carrying out a contract. It raised progress billings worth $600,000 on customer no. 1. The customer paid $540,000 after deducting 10% of the amount to he held as retention for year. Customer no. 2 paid $50,000 for an activity not yet commenced.

Required:

How will the items be disclosed in the financial statements?

SOLUTION : 21

Customer no.1: assuming it is probable that $60,000 will be received after 1 year, full revenue of $600,000 will be recognised and the amount of $60,000 will be disclosed as receivables (an asset).

Customer no.2: the amount of $50,000 received towards an activity not yet commenced is an advance and will be recognised as a liability.

QUESTION 22 :

Skymark Contractors is working on a contract and has progress bills amounting to $815,000 on Garry. Garry paid $652,000 after deducting 20% retention amount to be held for 2 years. Larry paid $100,000 for a contract not yet commenced.

Required:

State the treatment given for the above transactions by Skymark Contractors.

ANSWER : 22

Garry : Assume that $163,000 will be received after 2 years, recognise the full revenue of $815,000 and disclose the amount of $163,000 as receivables (an asset).

Larry : $100,000 is received towards an activity not yet commenced, therefore is an advance and will be recognised as a liability.

8.5 EXTRACTS OF SOFP

The SOFP contains two elements relating to contracts where performance obligations are satisfied over time:

- Contract asset / (contract liability) and
- Trade receivable \ (advance)

The basis of calculation and recognition is stated below.

Contract Asset / (Contract Liability):

	$
Contract cost incurred till date	xxx
Add: Profit / (loss) recognised	xxx / (xxx)
Less: Progressive Billing (amount Invoiced till date)	xxx
Contract asset / Contract Liability	**xxx**

If the above calculation results into a positive amount it constitutes contract asset and is presented separately under current assets.

If the calculation results in a negative amount it constitutes a contract liability and is separately presented under the category of current liabilities.

Trade Receivable or Advance:

The difference between amount invoiced and amount received from the customer is stated as trade receivable under current assets. However, if amount received exceeds the amount invoiced, the excess amount is stated as an advance under current liabilities.

Let us now see how the application of the accounting principles discussed until now leads to a disclosure in financial statements.

QUESTION 23 :

Following are the details of a contract:

	$
Total contract price	**200,000**
Cost incurred to date	**90,000**
Estimated cost to completion	**64,000**
Progress Billing	
(of this $100,000 is received)	**116,000**
Estimated progress towards completion	**60%**

Required:

Prepare relevant extracts from SOPL and SOFP.

SOLUTION : 23

Stage 1

Check whether the contract makes a profit:

(Else we have to provide for full anticipated loss)

	$
Total revenue	200.000
Total cost (90,000+64, 000) profit	154.000
	46,000

Stage 2

Calculate progress towards completion:

Given in this example 60%

Extract of SOPL

		$
Revenue	(60% of 200,000)	120,000
Costs	(60% of 154,000)	92,400
Profit		27,600

Stage 3

Extract of SOFP

Gross amounts due from customers (part of current assets)

	$
Contract costs incurred	90,000
Add: Recognised profits-recognised losses	27.600
	117,600
	116,000
Less Progress Billing	**1,600**
Contract Asset	

Trade receivables current assets	**$**
Progress Billing	116,000
Less: Cash received	100,000
	16,000

Note : The accounting entries and the ledger accounts are as follows
(These are not the part of solution, but are given to help in understanding.)

Entries during the year

On spending cash on goods and services

1. Dr Contract Asset $90,000
Cr Cash $90,000
Being cash spent for the contract

When a bill is raised on the client

2. Dr Trade Receivables $116,000
Cr Contract Asset $116,000
Being the entry to record bills raised on the client.

When cash is received from the client

3. Dr Cash $100,000
Cr Trade receivables $100,000
Being the entry to record cash received from client

Entries at the end of the year

Revenue for the period

4. Dr Contract Asset $120,000
Cr Revenue (SOPL) $120,000
Being entry to recognise revenue for the period (calculated as per stage 3).

5. Dr Costs (SOPL) $92,400
Cr Contract Asset $92,400
Being entry to recognise costs for the period (calculated as per stage 3).

Ledger Accounts

Contract Asset Account

This may or may not be equal to costs incurred

Dr. **Cr.**

Date		**$**	**Date**		**$**
	(1) Cash: Costs incurred	90,000		(2) Trade receivabs:	116,000
	(4) SOPL : Revenue recognised	120,000		(5) SOPL : Cost recognise	92,400
	Total			Balance c/f	1,600
				(Amount due from)	
	Total	**210,000**		**Total**	**210,000**

Cash Account (extracts)

Dr. **Cr.**

Date		**$**	**Date**		**$**
	(3) Receivables : collections	100,000		(1) contract asset-costs	90,000
	Total			**Total**	

Trade Receivables

Dr. **Cr.**

Date		$	Date		$
	(2) Contract asset : Billing	116,000		(3) Cash : collection	90,000
				Balalce c / f	16,000
	Total	**116,000**		**Total**	**116,000**

SOPL

Dr. **Cr.**

Date		$	Date		$
	(5) Contract asset : Cost	92,400		(4) Contract Asset	120,000
	Profit	27,600			
	Total	**120,000**		**Total**	**120,000**

Example for Contract liability

Example

In the above example, suppose that the progress billing amounted to $126,000. only the SOFP presentations will change as follows:

SOFP

Gross amounts due to customers (part of current liabilities)

	$
Contract costs incurred	90,000
Add: Recognised profits-recognised losses	27,600
	117,600
	126,000
Less: Progress Billing	
Contract Liability	**8,400**

Trade receivables (current assets)

	$
Progress Billing	126,000
Less: Cash received	100,000
	26,000

QUESTION 24 :

From the following details, calculate contract profits or loss and show the presentation in the financial statements.

	Contract X - $	Contract Y - $
Costs incurred to date	**39,200**	**42,000**
Total contract price	**70,000**	**56,000**
Progress billing	**33,600**	**28,000**
Anticipated future costs	**16,800**	**25,200**
Payments received	**11,200**	**-**
Contractual obligation satisfied at 31/12/20X6	**60%**	**50%**
Contractual obligation satisfied at 31/12/20X5	**30%**	*****
Recognised as revenue at 31/12/20X5	**19,600**	**5,600**
Recognised as costs at 31/12/20X5	**15,400**	**5,600**

No loss was expected on contract Y as at 31/12/20X5

*** Not determinable**

SOLUTION : 24

Stage 1 - Calculation of anticipated final result

	Contract X $		**Contract Y ($)**	
Total contract price (a)		70,000		56,000
Costs incurred to date	39,200		42,000	
Anticipated future costs	16,800		25,200	
Expected total costs (b)		(56,000)		(67,200)
Anticipated final result (a) — (b)		**14,000**		**(11,200)**

Stage 2

Revenue disclosure in the SOPL	Contract X	Contract Y	
	$	$	
Cumulative revenue to 31/12/20X6 $70,000 x 60% and $56,000 x 50% (total contract price x % completion)	42,000	28,000	Note - 1
Cumulative revenue recognised previously at 31/12/20X5	(19,600)	(5,600)	
Revenue to be recognised for year	**22,400**	**22,400**	

Note : where the **outcome of a performance obligation** cannot be estimated reliably, IFRS 15, requires the revenue recognised to be equal to the costs incurred (to the extent they are recoverable). Therefore, it is assumed that the revenue recognised for contract Y for the year ended 31/12/20X5 was $5,600 i.e. the cost incurred.

Stage 3

Expense disclosure in the SOPL	Contract X	Contract Y	
	$	$	
Costs proportionate to the stage of completion $56,000 x 60% and $67,200 x 50% (expected total costs x % completion)	33,600	33,600	Note - 2
Add allowance for future losses		5,600	
Less: Costs recognised until the previous year	(15,400)	(5,600)	
	18,200	**33,600**	

Note 2: Cumulative loss	11,200
Less: Cumulative revenue — cumulative expense (28,000 – 33,600)	(5,600)
Since full loss is to be recognised, additional loss	(5,600)

SOPL summary		Contract X	Contract Y
		Current Year	Current Year
		$	**$**
Revenue	(Stage 2)	22,400	22,400
Expense (including anticipated losses)	(Stage 3)	18,200	33,600
Net income / (expense)		**4,200**	**(11,200)**

Stage 4

SOPL summary		Contract X Cumulative	Contract Y Cumulative
		$	**$**
Revenue	(Stage 2)	42,000	28,000
Expense (including anticipated losses)	(Stage 3)	(33,600)	(39,200)
Net income / (expense)		**8,400**	**(11,200)**

SOFP Presentation	Contract X	Contract Y
	$	**$**
Costs incurred to date (given)	39,200	42,000
Add: Recognised cumulative profits (less losses) (Stage 4)	8,400	(11,200)
Less: Progress billings (given)	(33,600)	(28,000)
Contract Asset / (contract liability)	**14,000**	**2,800**
	Contract X	**Contract Y**
Trade receivables	**$**	**$**
Progress Billing	33,600	28,000
Less: Amount received	(11,200)	-
	22,400	**28,000**

QUESTION : 25

An accountant of a construction company approaches you. He informs you that there is a likely loss of $200,000 on one of its contracts. He requests you to suggest a method whereby this loss, being only a future loss, need not be recognised.

SOLUTION : 25

The method is not open to choice, but rather it depends on the circumstances. However, whichever method is followed, any expected loss should immediately be recognised as an expense as per IAS 37.

QUESTION : 26

An enterprise incurs a cost of $40,000, not related to the progress of work to date, but related to a future activity. How should it be presented?

SOLUTION : 26

It should be presented as an asset to the extent it is probable that the costs will be recovered.

QUESTION : 27

Franc Pipes Plc is awarded a contract worth $22,500 to lay a pipeline. The revenue agreed initially in the contract is $22,500. Initially, Franc estimated contract costs at $20,000. It is expected that the work will take 3 years to complete.

Franc's estimate of costs increased to $21 ,000 by the end of the second year, and to $21,500 by the end of year 3. The customer approved a variation worth $2,000 by the end of year 3.

Standard materials valued at $500, stored at the site to be used in future to complete the project, were included in the costs for year 1 .

Franc determines the progress in performance of contractual obligation for the contract by calculating the proportion of (i) costs incurred for work performed to (ii) estimated total contract costs.

A summary of the data is given below:

	Year 1 $	Year 2 $	Year 3 $
Initial amount of revenue agreed in contract	**22,500**	**22,500**	**22,500**
Variation	**-**	**-**	**2,000**
Total contract revenue	**22,500**	**22,500**	**24,500**
Contract costs incurred to date	**5,233**	**15,420**	**20,500**
Contract costs to complete	**14,892**	**5,080**	**-**
Total estimated contract costs	**20,125**	**20,500**	**20,500**
Estimated profit	**2,375**	**2,000**	**4,000**
Progress billings	**5,000**	**12,500**	**7,000**
Cash received	**4,500**	**13,500**	**6,500**

Find out the amount of revenues, expenses and profits to be recognised for each of these years.

SOLUTION : 27

First of all, let us determine the stage of completion:

Progress in satisfaction of obligation (costs to date / total estimated costs) for year 1 determined by deducting the value of unused material ($500) from the costs incurred $5,233	24% (5,233-500) / 20,125	75% (15,420 / 20,500)	100% 20,500 / 20,500

The table below gives the amounts of revenue, expenses and profits to be recognised in the three years:

	To date	Prior years	Current year
Year 1			
Revenue (22,500 x 24%)	5,400	-	5,400
Expenses (20,125 x 24%)	(4,830)	-	(4,830)
Profit	**570**	**-**	**570**
Year 2			
Revenue (22,500 x 75%)	16,875	5,400	11 ,475
Expenses (20,500 x 75%)	(15,375)	(4,830)	(10,545)
Profit	**1,500**	**570**	**930**
Year 3			
Revenue (24,500 x 100%)	24,500	16,875	7,625
Expenses (20,500 x 100%)	(20,500)	(15,375)	5,125
Profit	**4,000**	**1,500**	**2,500**

9. SERVICE CONCESSION ARRANGEMENTS

Increasing participation of private sector in building, upgrading and maintaining public infrastructure has resulted in new form of arrangements involving public-private partnership. Such partnerships are referred to by terms 'public to private' service concession arrangements, 'build-operate-lease-transfer' arrangements, and `rehabilitate-operate-transfer' arrangements. All these forms of arrangements gives the private party the right to construct or upgrade public infrastructure, for which it is usually conveyed right to collect fees from users of such infrastructure and other materials that are provided.

Essentially the control of the infrastructure usually vests with the grantor. This appendix applies only to service concession arrangements where:

- the types of services that must be provided, to whom it must be provided and the price at which it must be provided are regulated by the grantor and
- any significant residual interest in the infrastructure at the end of the term is controlled by the grantor through ownership, beneficial entitlement or otherwise.

10. OPERATOR'S RIGHT OVER INFRASTRUCTURE

The operator is given the right to construct, upgrade and manage the infrastructure of the public. Such infrastructure should not be recognised as property, plant and equipment as this right is not an absolute right to control the use of such infrastructure. This right is just a right to access on behalf of the grantor.

11. ARRANGEMENT CONSIDERATION

The arrangement is essentially rendering of construction or upgrade services. The consideration is given in the form of `right of access' to the infrastructure. Normally the consideration would have resulted in a financial asset which is receivable in cash. In this case, it takes the form of intangible asset.

12. CONSTRUCTION OR UPGRADE SERVICES

The revenue and costs should be measured and recognised as per IFRS 15.

The consideration received or receivable should be recognised at fair values and may take the form of

13. RIGHT TO FINANCIAL ASSET

The amount due is recognised in accordance with IAS 32, IFRS 9 and IFRS 7. It can be classified as loan or receivable, Available for sale or FVTPL and treated accordingly.

14. RIGHTS TO AN INTANGIBLE ASSET

IAS 38 is applied for measuring assets acquired for non-monetary assets or assets or combination of monetary and non-monetary assets.

15. OPERATION AND MAINTENANCE SERVICES

The revenue and costs should be measured and recognised as per IFRS 15 .

The contractual obligations, if any to maintain or restore the infrastructure as per the terms of arrangements should be recognised and measures as provision under IAS 37 — Provisions, Contingent Liabilities and Contingent Assets. However if maintenance or restoration is in the nature of upgrade services, it should be treated as mentioned above.

If both construction or upgrade services and operation services are performed under a single arrangement, then consideration should be allocated on the basis of relative fair values of services delivered.

16. BORROWING COSTS

The borrowing costs incurred are to be capitalised only if the operator has the contractual right to receive an intangible asset i.e. borrowing costs incurred during the construction phase of the arrangement can be capitalised.

17. ITEMS PROVIDED BY GRANTOR

The grantor may in certain cases provide other items to the operator for use in the construction or other services. These items may be part of the consideration payable by the grantor (Government). These are to be recognised in the operator's books as assets at fair value and are not in the nature of government grants.

18. SERVICE CONCESSION ARRANGEMENTS — DISCLOSURES

In service concession arrangements, the operator is generally granted a right and also is under an obligation to perform. This interpretation prescribes the disclosure requirement of such arrangements in the books of both the grantor and operator.

For each service concession arrangement the grantor and operator shall disclose the following:

(a) a description of the arrangement; (b) significant terms of arrangement that may affect the amount, timing and certainty of cash flows; (c) the nature and extent of (i) right to use the asset, (ii) obligations to provide or rights to expect provision of services, (iii) obligations to acquire or build items of PPE, (iv) obligations to deliver or rights to receive specified assets at the end of concession period, (v) renewal and termination options, (vi) other rights and obligations; (d) changes in arrangement during the period; (e) how the service arrangement has been classified.

An operator should disclose the amount of revenue and profits or losses recognised in the period on exchanging construction services for a financial asset or an intangible asset.

SELF EXAMINATION QUESTIONS

QUESTION : 28

What is the principle of substance over form?

SOLUTION : 28

Substance over form is the principle that transactions and other events are accounted for and presented in accordance with their substance and economic reality, and not merely their legal form.

QUESTION : 29

State whether following statements are true or false.

(a) A contract related to construction of asset or assets will always be assumed to have only one performance obligation.

(b) Revenue recognition depends on satisfaction of contractual obligation and control will always be transferred at a point of time.

SOLUTION : 29

a) **False,** the accounting does not depend on the contract but on the contractual performance obligation. A single contract may have more than one performance obligation.

b) **False,** even though revenue recognition depends on satisfaction of contractual obligation, control can either be transferred at a point of time or over a period of time.

QUESTION : 30

Alpha Inc entered into contract with Beta Inc to sell a software licence. As per the agreement Beta Inc can use the software for next 5 years. Alpha will not provide any other service or assistance in future. Should revenue be recognised at point of time or over the period of time?

SOLUTION : 30

According to the special provisions related to licensing as specified by IFRS 15, in the case of licence where there is transfer of right to use with no further involvement or obligation, revenue shall be recognised at a point of time. Hence, here revenue shall be recognised at a point of time.

QUESTION : 31

State whether the following statement is correct or incorrect.

While estimating the progress in the completion of a contractual obligation, an entity can use any of the two methods i.e. input method or output method irrespective of the other factors and basis.

SOLUTION : 31

The statement is incorrect. While estimating the progress in completion of contractual obligation an entity can use any of the two methods prescribed. However the selection of method shall be based on judgement and factors so that it matches with the success in performance of obligation.

QUESTION : 32

The total sales value of a contract is $700,000. At the end of the reporting period, an entity estimates that 30% of the performance obligation has been satisfied. The outcome of the contract cannot be reliably estimated. Management wants to recognise 30% of the profit. Do you agree?

SOLUTION : 32

No. When the outcome of the contract cannot be reliably estimated, the performance obligation satisfied basis will not to be followed. The entire cost incurred is to be recognised as an expense and the revenue is to be recognised only to the extent that the recovery of the costs is probable.

QUESTION : 33

Dorco Motors sold cars worth $500,000 in May on credit with a warrantee of one year from the date of sale. According to the warrantee Dorco Motors will make a free replacement of faulty parts for next 1 year. Dorco Motors do not sell such warranty as a separate standalone service. Based on previous experience, Dorco can make a reliable estimate for the expected warrantee costs.

Required:

State with reasons whether this sale can be recognised as revenue in the financial statements immediately when cars are sold.

SOLUTION : 33

In this case almost all the conditions required for recognising a sale have been satisfied:

1. **Identification of contracts:** there exists a clear contract between Dorco Motors and its customers
2. **Identification of performance obligations:** the performance obligation is related to sale of car; free replacement cannot be identified as separate obligation as it is not a separate standalone service. So there is only one performance obligation.
3. **Determination of transaction price:** the transaction price is agreed at $500,000.
4. **Allocation of the price to the performance obligations:** the transaction price can be easily allocated to the performance obligation related to the sale of the car.
5. **Recognition of revenue when/as performance obligations are satisfied:** the revenue can be recognised as the car is sold and hence the obligation is satisfied. Revenue of $500,000 shall be recognised immediately.

However, any subsequent risk or benefit that can be attributed to the car will accrue to the seller because of the warrantee given.

As based on previous experience, Dorco Motors can make a reliable estimate of the provision required for the free replacements and as it is not a distinct performance obligation, Dorco Motors shall recognise the revenue to the extent of the transaction price it expects to receive. Dorco Motors shall also create a provision for warranty using reliable estimates based on previous experiences.

QUESTION : 34

Thinksoft Inc, a software company, sold software licences to Mac Plc as part of a package deal involving the sale of hardware, other required software, maintenance and training. The package was negotiated as a whole. Both the parties negotiated with each other and entered into the contract.

Required:

State how this revenue shall be allocated amongst the elements.

SOLUTION : 34

The transaction involves more than one performance obligation i.e. sale of software licence, sale of hardware, maintenance and training.

Hence the transaction price as agreed between parties and expected to be received shall be allocated to different performance obligations i.e. hardware, required software, maintenance and training. For allocating the transaction price to each performance obligation, Thinksoft Inc needs to allocate the transaction price to each separate performance obligation at an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation. To allocate an appropriate amount of consideration to each separate performance obligation, Thinksoft would determine the standalone selling price at contract inception of the good or service underlying each separate performance obligation and allocate the transaction price on a relative standalone selling price basis. If a standalone selling price is not observable, Thinksoft would estimate it.

QUESTION : 35

Bento Inc entered into a contract with Ceto Inc to sell a franchisee licence under which Ceto Inc can open a store in its locality. According to the contract, Ceto Inc will pay a fixed amount on the date of entering into this contract. Under the agreement, Ceto Inc can use the logo and trademark of Bento for its outlet. Should revenue be recognised at a point of time or over a period of time?

SOLUTION : 35

Here, there is no transfer of goods and services but a licence agreement which entitles Ceto Inc to use the logo and trademark on an on-going basis. Any actions by Bento Inc will have an impact on the working of Ceto Inc also. Hence considering these facts, the fixed amount received shall be recognised as revenue over a period of time

QUESTION : 36

Company A has a customer which is undergoing restructuring due to issues related to liquidity. The Company A has decided not to do any further business with the Customer. The Customer has informed Company A that he will get Letter of Credit from a nationalised bank against which the Company A can dispatch goods. As on 31 March 2017, the Company A has manufactured the goods exclusively for the customer, but the Letter of Credit has not yet been arranged because it is in process. When should revenue be recognised?

SOLUTION : 36

As per IFRS 15:

"An entity shall account for a contract with a customer that is within the scope of this Standard only when:

(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"

In the given case, as the customer has liquidity issues, the collectability cannot be ensured. Accordingly, till the time the letter of credit is not arranged from a nationalised bank in favour of Company A, condition (e) mentioned above is not met. Alternatively, companv may, through any other mechanism, demonstrate that the above criteria would be fulfilled in favour of Company A.

Additionally, an entity shall continue to assess the contract to determine whether the criteria (e) is subsequently met. Hence, the company shall recheck the criteria until it b omes eligible to recognise revenue.

QUESTION : 37

A real-estate developer, R Ltd enters into a contract with a Company B for the sale of an entire building for Rs 30 crore. B, which is facing some liquidity issues, intends to shift part of its operations in this new building as one of its cost cutting activity. R Ltd comes across a news article claiming that B has laid off substantial staff as a cost cutting measure. B pays a non-refundable deposit of Rs 2 crore at the inception of the contract and enters into a long-term financing agreement with R Ltd. The financing arrangement is provided on a non-recourse basis, which means that if B defaults, R can repossesses the building, but cannot seek further compensation from the customer, even if the collateral does not cover the full value of the amount owed. R's cost of building is Rs 20 crore. B obtains control of the building at contract inception. How will this arrangement be treated under IFRS 15?

SOLUTION : 37

In assessing whether the customer meets the criteria of IFRS 15, R concludes that the criterion in Paragraph 9(e) of IFRS 15 is not met because it is not probable that the R will collect the consideration to which it is entitled in exchange for the transfer of the building. Jn reaching this conclusion, the entity observes that the customer's ability and intention to pay may be in doubt because of the following factors:

1. B intends to repay the loan (which has a significant balance) primarily from its business income, (which is probably currently volatile);
2. B does not have any other source of income or any other asset that could be used td repay the loan; and
3. B's liability under the loan is limited because the loan is non-recourse.

R has not received substantially all of the consideration and it has not terminated the contract. Consequently, R accounts for the non-refundable payment as deposit liability. R continues to account for initial deposit and any future payments of principal and interest, as a deposit liability, until such time that it concludes that the criteria are met or one of the following events has occurred, ie:

(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.

QUESTION : 38

Entity enters into a 3-year service contract with customer for Rs 6,00,000 (Rs 2,00,000 per year). The standalone selling price for 1 year of service at inception of the contract is Rs 2,00,000 per year. Entity accounts for the contract as a series of distinct services.

At the beginning of the third year, the parties agree to modify the contract as follows: (1) the fee for the third year is reduced to Rs 1,75,000; and (2) customer agrees to extend the contract for another 3 years for Rs 4,50,000 (Rs 1,50,000 per year). The standalone selling price for 1 year of service at the time of modification is Rs 2,00,000. How should entity account for the modification?

SOLUTION : 38

As per IFRS 15, "A good or service that is promised to a customer is distinct if both of the following criteria are met:

a) the scope of the contract increases because of the addition of promised goods or services that are distinct; and

b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the stand-alone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer."

The modification should not be accounted for as a separate contract, even though the remaining services to be provided are distinct, because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for as if the existing arrangement was terminated and a new contract created (that is, on a prospective basis) because the remaining services to be provided are distinct.

Entity should reallocate the remaining consideration to all of the remaining services to be provided (that is, the obligations remaining from the original contract and the new obligations). Entity will recognise a total of Rs 6,25,000 (Rs 1,75,000 + Rs 4,50,000) over the remaining 4-year service period (1 year remaining under the original contract plus 3 additional years).

QUESTION : 39

Entity A enters into a contract to build a house for a customer B. A Ltd is responsible for the overall management of the project and identifies various goods and services that are provided, including architectural design, site preparation, construction of the home, plumbing and electrical services, and finish carpentry. A Ltd regularly sells these goods and services individually to customers. How many performance obligations are in the contract?

SOLUTION : 39

IFRS 15 states that "A good or service that is promised to a customer is distinct if both of the following criteria are met:

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

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

In accordance with the above, the promised goods and services are capable of being distinct because B Ltd could benefit from the goods or services either on their own or together with other readily available resources. This is because A Ltd regularly sells the goods or services separately to other customers and the customers could generate economic benefit from the individual goods and services by using, consuming, or selling them.

However, the goods and services are not separately identifiable from other promises in the contract. A Ltd's overall promise in the contract is to transfer a combined item (the house) to which the individual goods or services are inputs. This conclusion is supported by the fact that A Ltd provides a significant service of integrating the various goods and services into the home that the homeowner has contracted to purchase.

QUESTION : 40

Company A is an auto component supplier and supplies auto parts to Original Equipment Manufacturer (OEM). It has received a contract to make a tooling. This tooling requires a design to be created and approved from the customer and then the process of manufacture of the tooling will begin. This process is completed in a short period of time, ie, around 1 month. When should revenue be recognised in such a situation? The customer can cancel the contract at any point in time without penalty.

SOLUTION : 40

As per IFRS 15, "In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable, the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) 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,

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently."

In the given case, if the design activity and the tooling activity are satisfying the above stated indicators, eg, designing is highly interrelated with the tooling activity, the total revenue is recognised on a combined basis as and when performance of the assigned task is completed.

However, if the design activity and the tooling activity are not highly interrelated, the company provides the designing services on a stand-alone basis and the customer can use the design to get the tooling manufactured by another vendor, the two can be treated as separate components and revenue is recognised accordingly.

QUESTION : 41

X Ltd enters into a contract for the construction of building that includes scheduled milestone payments for the performance by X Ltd throughout the contract term of 5 years. The performance obligation will be satisfifd over time and the milestone payments are scheduled to coincide with X Ltd's expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (ie retained) by the customer throughout the arrangement and paid to X Ltd only when building is complete. This amount is withheld purely for the purpose of protecting itself from non-performance of X Ltd. Whether the amount with held shall be considered for h ssessment of financing component under IFRS 15?

SOLUTION : 41

In case the contract requires amounts to be retained for reasons other than the provision of finance, then the Company may conclude that the contract with the customer does not involve any financing element. Since in the current case, the withholding of a specified percentage of each milestone payment is intended to protect the customer from X Ltd failing to adequately complete its obligations under the contract, it may be concluded that the contract does not include a significant financing component.

QUESTION : 42

A TV manufacturer sells TV sets to its dealers at the list price of Rs 10,000 per TV. If a dealer purchases more than 8,000 sets during the contract period, then it is eligible for a discount of 5% on the list price. The contract period starts in June and ends in May of each year. On the reporting date, ie, 31 March 2018, a particular dealer has purchased 5,000 sets. Based on the past trends, it is expected that the total purchases to be made by dealer during the contract period up to May 2018 will be more than 8,000 sets. Should revenue be adjusted for the discount expected to be availed by such a dealer? esponse:

SOLUTION : 42

The 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.

The entity determines if it has significant experience with this product and with the purchasing pattern of the entity and if 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 the instant case, based on past trends and other available evidence, it is probable that the total purchases made by the dealer during the contract period up to May 2018 will exceed 8,000 sets and thus a 5% discount may have to be allowed. Additionally, any credit or discount that can be applied against amounts owed to the entity is, a consideration payable to the customer. Likewise, an entity shall account for it as a reduction to the transaction price. Therefore, the amount of revenue should be adjusted kor the probable discount that may have to be allowed, as the economic benefits to that extent may not flow to the entity. Revenue shquld be adjusted for probable discount on sales made till 31 March 2018.

QUESTION : 43

Entity A enters into a contract with entity B on 1 April 2017 to sell goods for Rs 100 per good. As per the terms of the contract, if entity B purchases more than 1,000 goods till March 2018, the price per good will be retrospectively reduced to Rs 90 per unit. Till September 2017, entity A sold 95 goods to entity B: Entity A estimates that the B's

purchases will not exceed the 1,000-units threshold required.

In October 2017, entity B acquires entity C. Consequent, from October to December 2017, the entity A sells an additional 600 units of product to entity B. In the light of the new fact, the entity A estimates that the customer's purchases will exceed the 1,000 units threshold for the period and therefore it will be required to retrospectively reduce the price per charger to Rs 90. How should the revenue be recognised in such a situation?

SOLUTION : 43

An entity shall include in the transaction price some or all of an amount of estimated variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised 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 good 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.

Entity A estimates that the consideration in the above contract is variable. Therefore, it is required to consider the constraints in estimating variable consideration. Entity A determines that it has significant experience with this product and with the purchasing pattern of thp eniity B. Thus, entity A concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie, Rs 100 per unit) will not occur when the uncertainty is resolved (ie, when the total amount of purchases is known). Consequently, the entity recognisés revenue of Rs 9,500 (95 units x Rs 100 per unit) for the half year ended 30 September 2017.

On account of entity B acquiring entity C and sale of additional 600 chargers, the entity A estimates that B’s purchases will exceed the 1,000 units threshold till March 2018 for the period and therefore it will be required to retrospectively reduce the price per charger to Rs 90.

Consequently, the entity recognises revenue of Rs 53,050 for the quarter ended December 2017. That amount is calculated from Rs 54,000 for the sale of 600 units (600 units x Rs 90 per unit) less the change in transaction price of Rs 950 (95 units x Rs 10 price reduction) for the reduction of revenue relating to units sold till September 2017.

QUESTION : 44

Entity A is a dealer in electronic goods. Entity A has entered into a contract to sell a television to a customer for a consideration of Rs 1,00,000. The payment for the equipment to be made after 2 years. The cash selling price of the product is Rs 80,000, 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. Should revenue be measured at Rs 1,00,000 or at Rs 80,000?

SOLUTION : 44

An entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

In accordance with the above, entity A assesses that the contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of Rs 1,00,000 and the cash selling price of Rs 80,000 at the date that the television are transferred to the customer.

Entity A assesses that the contract includes an implicit interest rate of 12%, ie, the interest rate that over 24 months discounts the promised consideration of Rs 80,000. Entity A concludes that the rate is commensurate with the rate in a separate financing transaction between entity A and the customer.

On transfer of television to the customer, entity A will recognise revenue with a corresponding receivable as equal to the cash selling price of Rs 80,000.

Until the entity receives the cash payment from the customer, interest revenue would be recognised 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.

QUESTION : 45

Entity A manufactures auto components. It enters into a 2-year contract with a customer B who is a car manufacturer. The total contract value is Rs 20,00,000. Additionally, entity A agrees to pay Rs 4,00,000 to customer B as compensation for storage facility. This storage facility is controlled by customer B and will be utilised to store goods received from A. What will be the accounting treatment for the consideration payable to customer ?

SOLUTION : 45

Payment to the customer is not in exchange for a distinct good or service since the entity A does not obtain the control of storage facility. Thus, Rs 400,000 would be a reduction, from the transaction price.

The reduction of revenue is recognised as and when transfer of the related goods or services to the customer occurs. In the current scenario, the revenue is recduced proportionately, ie, (Rs 4,00,000 / Rs 20,00,000). If in month 1, components worth Rs 5,00,000 are transferred, the reduction would be Rs 1,00,000 (20% X Rs 5,00,000).

QUESTION : 46

Entity X is a technology company and regularly Sells Software S, Hardware H and Accessory A. The standalone selling prices are available for these items as stated below:

Software S - Rs 50,000; Hardware H - Rs 1,00,000 and Accessory A - Rs 20,000. Since the demand for Hardware H and Accessory A is low, Entity A sells H and A together at Rs 1,00,000. Entity A enters into a contract with a certain customer to sell all three items for a consideration of Rs 1,50,000.

What will be the accounting treatment for the discount of Rs 20,000 considering the three items are three different performance obligations being satisfied at different points in time.

SOLUTION : 46

The contract includes a discount of Rs 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 Hardware H and Accessory A together for Rs 1,00,000 and Software S for Rs 50,000, it has evidence that the entire discount should be allocated to the promises to transfer Hardware H and Accessory A.

Further complication would arise if Hardware H and Accessory A are transferred over different point in time. The discount of Rs. 20,000 is allocated to Hardware H and Accessory A in the proporation of their standalone selling prices.

QUESTION : 47

A seller provides sales incentives to a customer when entering into a contract. Examples of such customer incentives include:

- **Cash incentives**
- **Non-cash incentives in the three scenarios as described below:**
  - **Scenario 1: Loyalty points to purchase goods from the seller at a lower price;**
  - **Scenario 2: A coupon redeemable for free products from a third party;**
  - **Scenario 3: Free goods or services that the seller normally sells or provides as part of its business (eg, on purchase of two products, third product is free),**

How should an entity account for cash and non-cash based sales incentives when entering into a contract for supply of goods or services?

SOLUTION : 47

Cash Incentives

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).

An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange. for a distinct good or service that the customer transfers to the entity.

Therefore, cash incentives (payments given to the customer) would be included in the measurement of revenue when the goods are delivered, Revenue would be recognised at a reduced amount taking into account such an incentive.

Scenario 1:

An entity shall account for loyalty points as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the loyalty points and the other components of the sale.

If in a contract, an entity grants a customer the option to acquire additional goods, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that he would not receive without entering into that contract. In this case the customer does get a material right since he can purchase future additional goods at a discount. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred

Therefore for such non-cash incentives, a portion of the total consideration receivable is allocated to the incentive and is reduced from the revenue of initial sale. These incentives are recognised as revenue when the incentive is redeemed and the entity fulfils its obligations to supply the incentive. Non-Cash Incentives

An entity to allocate the transaction price to performance obligations on a relative standalone basis. If the stand alone selling price is not directly observable, an entity shall estimate is on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

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).

An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Scenario 2:

In the given scenario, as the discount or free item is provided by a third-party, for such non-cash incentives, the portion of the total consideration receivable is to be allocated to the incentive. Further, an entity shall assess whether it is acting as a principal or agent, to determine the 'deliverable' within the arrangement and the amount to allocate to that item.

Acting as a principal: If the entity has collected the consideration allocated to the points on its own account, (ie, as the principal in the transaction), the accounting treatment is the same as in scenario 1 above, that is, the entity allocates the consideration to all the elements of the transaction, including the free good or services it provides as an incentive to its customers and recognises revenue when those free goods or services are delivered / provided.

Acting as an agent : If the entity is collecting the consideration on behalf of the third party (ie, as an agent for the third party), the entity measures revenue at the net amount it retains on its own account (the consideration allocated to the incentive less the amount paid to the third party supplying the incentive). The entity recognises the net revenue when it provides the incentive to the customer.

Scenario 3:

An entity grants "free" goods to a customer as part of the sale transaction, which it sells separately as part of its operations. The transaction price is allocated to the each separate component based on IFRS 15 which requires that revenue from sale of goods shall be recognised when the entity satisfies a performance obligation by transferring a promised good or service to a customer.

IFRS 15 further states that at the contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance oblig}ion each promise to transfer to the customer either: A good or service that is distinct and separately identifiable.

Accordingly, in the given scenario, an entity grants free goods to a customer as part of the sale transaction, which it sells separately as part of its operations, the transaction price is allocated to each separate identifiable promised good or service.

In the current transaction, the total consideration received will be allocated to all elements in the sale, including the free goods. sitution:

QUESTION : 48

A Ltd owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every Rs 100. As per the past experience of A Ltd, the likelihood of exercise of the points is 100% and the stand alone price of each such point is Rs 5. Customer X spends Rs 10,000 in one of the resorts of A Ltd and earns 100 points. What is the accounting treatment for the points granted by A Ltd?

SOLUTION : 48

IFRS 15 states that, "if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that he would not receive without entering into that contract."

Additionally, if a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those 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.

In this case the customer does get a material right since the customer can get a discount of Rs 500 for every 100 points that he would not receive without the previous stay in that resort. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

IFRS 15 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone basis. If the stand alone selling price is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised. As per para B40-41, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone price of the 100 points is Rs 500. A Ltd should allocate the fair value of the consideration (ie, Rs 10,000) between the points and the other components of the sale as Rs 476 (500 / 10,500 * 10,000) and Rs 9,524 (10,000 / 10,500 * 10,000) respectively in proportion of their standalone values. Since A Ltd supplies the awards itself, it should recognise Rs 476 as revenue when points are redeemed.

IFRS 16 — LEASE ACCOUNTING

1. GENERAL PRINCIPLES

1.1 Objective of IFRS 16 and general application

The objective of IFRS 16 is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents their lease transactions in their financial statements. This information provides a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity. [IFRS 16:1]

When applying IFRS 16, an entity is required to consider:

- all relevant facts and circumstances; and
- the terms and conditions of contracts.

A contract is defined as "an agreement between two or more parties that creates enforceable rights and obligations"

[IFRS 16:Appendix A]

Note that the application of IFRS 16 is not restricted to contracts, or portions of contracts, that are specifically described or labelled as leases (see section 3).

1.2 Requirement to apply IFRS 16 consistently

IFRS 16 should be applied consistently to contracts with similar characteristics and in similar circumstances. [IFRS 16:2]

1.3 Practical expedient - application to a portfolio of leases

Although IFRS 16 specifies the accounting for an individual lease, as a practical expedient the Standard can be applied to a portfolio of leases with similar characteristics provided that it is reasonably expected that the effects on the financial statements of applying a portfolio approach will not differ materially from applying IFRS 16 to the individual leases within that portfolio. When accounting for a portfolio, estimates and assumptions that reflect the size and composition of the portfolio should be used. [IFRS 16:B1]

Falling within the scope of this practical expedient are circumstances when an entity enters into a single contract to lease a number of identical assets. Take, for example, a contract to lease 20 printers (assumed for the purposes of this example to be high-volume commercial printers that do not qualify as low-value assets (see 7.2.3)).

As discussed at 4.1, if the printers can be operated on a stand-alone basis, the right to use each printer is required to be accounted for as a separate lease component. The practical expedient helps to reduce that complexity by permitting the entity to account for the leases as one portfolio, rather than recognising and accounting for 20 leases separately.

The following example, which is reproduced from the illustrative examples accompanying IFRS 16, illustrates how an entity might identify portfolios of leases for the purpose of applying this practical expedient. It also illustrates the accounting for leases of low-value assets (see 7.2 for explanation and detailed requirements).

Example 1.3 Portfolio application

[IFRS 16: Illustrative example 11]

A lessee in the pharmaceutical manufacturing and distribution industry (Lessee) has the following leases:

a) leases of real estate (both office buildings and warehouses).
b) leases of manufacturing equipment.
c) leases of company cars, both for sales personnel and senior management and of varying quality, specification and value.
d) leases of trucks and vans used for delivery purposes, of varying size and value.
e) leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).
f) leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers overtime as Lessee has needed to increase the storage capacity of the servers.
g) leases of office equipment:
   i) office furniture (such as chairs, desks and office partitions):
   ii) water dispensers; and
   iii) high-capacity multifunction photocopier devices.

Leases of low-value assets see 7.2 for explanation and detailed requirements!

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

a) leases of IT equipment for use by individual employees; and

b) leases of office furniture and water dispensers.

Lessee elects to apply the requirements in [IFRS 16:6] in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers [(see **7.2.3.5** for further discussion)].

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in IFRS 16 to its leases of real estate, manufacturing equipment, company cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its company cars, trucks and vans into portfolios.

Lessee's company cars are leased under a series of master lease agreements. Lessee uses eight different types of company car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of company car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of IFRS 16 to each master lease agreement would not result in a materially different effect than applying the requirements of IFRS 16 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of IFRS 16 to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of company cars in similar territories. Lessee reasonably expects that the effect of applying IFRS 16 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying IFRS 16 to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of IFRS 16 to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van lease. Consequently, Lessee applies the requirements of IFRS 16 to different portfolios of truck and van leases, rather than to 6,500 individual leases.

1.4 Combining contracts

Two or more contracts that are interdependent should be combined and accounted for as a single contract. This requirement applies

[IFRS 16:B2]

- the contracts are entered into at or near the same time; and
- the contracts are with the same counterparty (or related parties of the counterparty); and
- one or more of the following criteria are met:
  - the contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together; or
  - the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
  - the rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in IFRS 16:BB2 (see **4.1.2).**

The requirements of IFRS 16:B2 are intended to capture circumstances in which an entity enters into a number of contracts in contemplation of one another such that the transactions, in substance, form a single arrangement that achieves an overall commercial objective that cannot be understood without considering the contracts together.

For example, assume that a lessee enters into a one-year lease of an asset with particular characteristics. The lessee also enters into a one-year lease for an asset with those same characteristics starting in one year's time and a similar forward contract starting in two years'time and in three years'time. The terms and conditions of all four contracts are negotiated in contemplation of each other such that the overall economic effect cannot be understood without reference to the series of transactions as a whole. In effect, the lessee has entered into a four-year lease. In such situations, accounting for the contracts independently of each other might not result in a faithful representation of the combined transaction. [IFRS 16:BC130]

2 SCOPE

2.1 Scope - general

IFRS 16 should be applied to all leases except the following:

[IFRS 16:3]

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;

IFRS 6 Exploration for and Evaluation of Mineral Resources specifies the accounting for rights to explore for and evaluate mineral resources.

(b) leases of biological assets within the scope of IAS 41 Agriculture held by a lessee;

Biological assets that are bearer plants are within the scope of IAS 16 Property, Plant and Equipment rather than IAS 41 and, consequently, are within the scope of IFRS 16. Therefore, for example, leases of bearer plants such as orchards and vineyards held by a lessee are within the scope of IFRS 16. [IFRS 16:BC68(b)]

(c) service concession arrangements within the scope of IFRIC12 Service Concession Arrangements;

(d) licences of intellectual property granted by a lessor within the scope of IFRS 15 Revenue from Contracts with Customers; and

(e) rights held by a lessee under licensing agreements within the scope of IAS 38 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

A lessee is permitted, but not required, to apply IFRS 16 to leases of intangible assets other than those described in IFRS 16:3(e). [IFRS 16:4]

Leases of'other' intangible assets in the context of IFRS 16:4 might include, for example, exclusive licences for brands or trademarks held by a lessee. Such leases were previously considered to fall within the scope of IAS 17. The IASB decided to permit, but not require, entities to account for these leases in accordance with IFRS 16. Although there is no conceptual basis for excluding them from the scope of IFRS 16, the Board considered that a more comprehensive review of the accounting for intangible assets is required before requiring leases of intangible assets to be accounted for under the new Standard. [IFRS 16:BC71]

2.2 Long-term leases of land

The IASB considered, but decided against, a scope exclusion for long-term leases of land (see IFRS 16:BC78). Therefore, such leases should be accounted for in accordance with IFRS 16.

2.3 Leases of investment property

Unlike IAS 17, IFRS 16 contains no scope exclusions in relation to investment property. Therefore, all aspects of leases of investment property are accounted for under IFRS 16.

Consequential amendments arising from IFRS 16 have amended the definition of investment property in IAS 40 **Investment Property** to include both owned investment property and investment property held by a lessee as a right-of-use asset. Under IFRS 16:34 (see **7.5.1.5),** if a lessee applies IAS 40's fair value model to its owned investment property, it is also required to apply that fair value model to right-of-use assets that meet the definition of investment property.

2.4 Subleases

Leases of right-of-use assets in a sublease are within the scope of IFRS 16, subject to the exclusions set out at **2.1.** [IFRS 16:3]

Subleases are required to be accounted for in the same way as other leases (see **8.6)** and, accordingly, are within the scope of IFRS 16. [IFRS 16:BC73]

2.5 Leases of inventories

IFRS 16 does not specifically exclude leases of inventories from its scope. However, the IASB believes that few such transactions would meet the definition of a lease under IFRS 16 because a lessee is unlikely to be able to hold an asset that it leases (and that is owned by another party) for sale in the ordinary course of business, or for consumption in the process of production for sale in the ordinary course of business. [IFRS 16:BC74]

2.6 Derivatives embedded in a lease

The IASB decided to require an entity to separate from a lease any derivatives embedded in the lease (as defined in IFRS 9 **Financial Instruments**), and account for the derivatives applying IFRS 9. Nonetheless, IFRS 16 includes specific requirements for features of a lease such as options and residual value guarantees that may meet the definition of a derivative. The IASB noted that the lease accounting model in IFRS 16 was not developed with derivatives in mind and, consequently, IFRS 16 would not provide an appropriate basis on which to account for derivatives. Accordingly, if derivatives embedded in leases were not accounted for separately, unrelated derivative contracts could be bundled with leases to avoid measuring the derivatives atfairvalue. [IFRS16:BC81]

2.7 Short-term leases and leases of low-value items

IFRS 16 applies to all leases except those specifically excluded under IFRS 16:3 (see 2.1). However, the Standard includes recognition exemptions available to lessees for short-term leases and leases of low-value items and specifies alternative requirements (see 7.2).

3. IDENTIFYING A LEASE

3.1 Definition of a lease

A lease is defined as "[a] contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration". [IFRS 16:AppendixA]

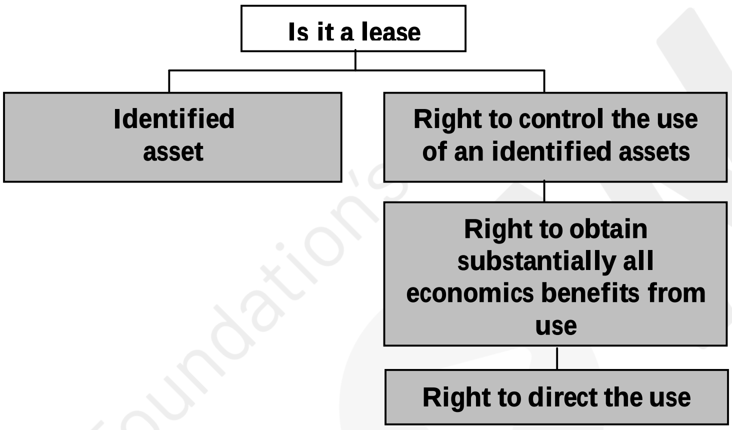
3.2 Determination as to whether a contract is, or contains, a lease

3.2.1 Requirement to assess whether a contract is, or contains, a lease

At inception of a contract, an entity is required to assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. [IFRS 16:9]

Key aspects of this definition are that:

- the asset that is the subject of a lease must be specifically identified (see 3.3); and
- a lease must convey the right to control the use (see 3.4) of that identified asset for a period of time.



For the purposes of IFRS 16:9, a 'period of time' may be described in terms of the amount of use of an identified asset (e.g. the number of production units that an item of equipment will be used to produce). [IFRS 16:10]

An entity is required to assess whether a contract contains a lease at inception of the contract, rather than at commencement of the lease term (see 5.3 for an explanation of these terms). This is necessary because a lessor is required to classify a lease as either a finance lease or an operating lease at the inception date (see 8.1). In addition, a lessee is required to disclose information about leases not yet commenced to which the lessee is committed if that information is relevant to users of financial statements. [IFRS 16:BC110]

Examples 1 to 10 of the illustrative examples accompanying IFRS 16 (summarised in Appendix 1) illustrate how an entity determines whether a contract is or contains a lease. Although the IASB believes that, in most cases, the assessment as to whether a contract is or contains a lease should be straightforward, it acknowledges that significant judgement will be required to make this assessment in some cases. [IFRS 16:BC109]

3.2.2 Lease vs 'in-substance' sale or purchase

When assessing the nature of a contract, an entity should consider whether the contract transfers control of the underlying asset itself (as opposed to conveying the right to control the use of the underlying asset for a period of time). If so, the transaction is a sale or purchase within the scope of other Standards (e.g. IFRS 15 Revenue from Contracts with Customers or IAS 16 Property, Plant and Equipment). [IFRS 16:BC140]

3.2.3 Leases vs service contracts

IFRS 16 aims to distinguish a lease from a service contract on the basis of whether a customer is able to control the use of the asset being leased. If the customer controls the use of an identified asset (see 3.3) for a period of time, then the contract contains a lease.

This will be the case if the customer can make the important decisions about the use of the asset in a similar way to that in which it makes decisions about owned assets that it uses (see 3.4). In contrast, in a service contract, the supplier controls the use of any assets used to deliver the service. [IFRS 16:BC105]

3.2.4. Customer has control for only a portion of the term of a contract

If the customer has the right to control the use of an identified asset for only a portion of the term of a contract, the contract contains a lease for that portion of the lease term. [IFRS 16:B10]

3.2.5. Assessment required for each potential separate lease component

The assessment as to whether a contract contains a lease should be made for each potential separate lease component (see section 4). [IFRS 16: B12]

3.2.6. Assessing whether a contract contains a lease when the customer is a joint arrangement

When a contract to receive goods or services is entered into by, or on behalf of, a joint arrangement (as defined in IFRS 11 Joint Arrangements), the joint arrangement is considered to be the customer in the contract. Accordingly, when assessing whether such a contract contains a lease, an entity should assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use. [IFRS 16:B11]

IFRS 16:B11 clarifies that when a contract is entered into by, or on behalf of, a joint arrangement, it is the joint arrangement (rather than the parties to the joint arrangement) that should be considered to be the customer when assessing whether the contract contains a lease, irrespective of which entity signed the contract. Accordingly, if the parties to the joint arrangement collectively have the right to control the use of an identified asset throughout the period of use through their joint control of the arrangement, the contract contains a lease. It is not appropriate to conclude that a contract does not contain a lease on the grounds that each of the parties to the joint arrangement either obtains only a portion of the economic benefits from use of the underlying asset or does not unilaterally direct the use of the underlying asset. [IFRS 16:BC126]

This guidance is particularly relevant for joint operations where each of the parties has direct rights and obligations for the lease and for which, in the absence of this guidance, it might not have been clear whether control should be viewed from the perspective of the joint operation.

3.2.7 Reassessment as to whether a contract is, or contains, a lease

An entity should reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed. [IFRS 16:11]

3.3 Identified asset

3.3.1. Identification of an asset - general

The asset that is the subject of a lease must be specifically identified. This will be case if either of the following applies: [IFRS 16:B13]

- the asset is explicitly specified in the contract (e.g. a specific serial number); or
- the asset is implicitly specified at the time that it is made available for use by the customer (e.g. when there is only one asset that is capable of being used to meet the contract terms).

3.3.2 Substantive substitution rights

Right to use an identified asset is undermined by substantive substitution right

Even if an asset is specified as discussed in 3.3.1, a customer is not considered to have the right to use an identified asset (and, therefore, the contract is not a lease) if the supplier has a substantive right to substitute the asset throughout the period of use. [IFRS 16:B14]

The'period of use' is "the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)11. [IFRS 16:AppendixA]

If a supplier has a substantive right to substitute the asset throughout the period of use, there is no identified asset and the contract does not contain a lease. This is because the supplier, and not the customer, controls the use of the asset in such circumstances.

[IFRS 16:BC112]

The illustrative examples accompanying IFRS 16 (as summarised in Appendix 1) include a number of scenarios in which substitution rights are considered.

3.3.2.2. Substantive substitution right - definition

A supplier's right to substitute an asset is substantive only if both of the following conditions are met: [IFRS 16:B14]

- the supplier has the practical ability to substitute alternative assets throughout the period of use (e.g. the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- the supplier would benefit economically from exercising its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

Substitution rights are not substantive if it is not likely, or practically or economically feasible, for the supplier to exercise those rights.

The IASB believes that, in many cases, it will be clear that the supplier would not benefit from the exercise of a substitution right because of the costs associated with substituting the asset. [IFRS 16:BC113]

3.3.2.3. Substitution on or after a specified future date or dependent on the occurrence of a specified event

If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use. [IFRS 16:B15]

3.3.2.4. Evaluation to be based on circumstances at inception and to exclude consideration of future events not considered likely to occur

An entity's evaluation of whether a supplier's substitution right is substantive should be based on facts and circumstances at inception of the contract. [IFRS 16:B16]

Future events that, at inception of the contract, are not considered likely to occur should be excluded from the evaluation. Examples of such future events include:

[IFRS 16: B16]

- an agreement by a future customer to pay an above market rate for use of the asset;
- the introduction of new technology that is not substantially developed at inception of the contract;
- a substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and
- a substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.

If a supplier would benefit from substitution only in circumstances that are not likely to occur, such as those listed in IFRS 16:B16, those substitution rights are not substantive, regardless of whether the circumstances are specified in the contract. [IFRS 16:BC114]

3.3.2.5. Substitution costs generally higher when the asset is located at the customer's premises or elsewhere

If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset. [IFRS 16: B17]

3.3.2.6. Substitution for repairs or technical upgrade

A supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available, does not preclude the customer from having the right to use an identified asset. [IFRS 16:B18]

3.3.2.7. Customer cannot readily determine whether the supplier has substantive substitution rights

If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer should presume that any substitution right is not substantive. [IFRS 16:B19]

The IASB believes that it should generally be relatively clear from the facts and circumstances whether substitution rights are substantive, and the Board intends that customers should assess whether substitution rights are substantive if they are reasonably able to do so. However, the requirement in IFRS 16:B19 is intended to clarify that a customer is not expected to exert undue effort in order to provide evidence that a substitution right is not substantive. [IFRS 16:BC115]

3.3.3. Portions of assets

A capacity portion of an asset is an identified asset if it is physically distinct (e.g. a floor of a building). [IFRS 16:B20]

A capacity or other portion of an asset that is not physically distinct (e.g. a capacity portion of a fibre optic cable or a pipeline) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. [IFRS 16:B20]

Thinking it through

The determination as to whether an asset is physically distinct may not be difficult for items such as buildings, where it is clearly accepted and acknowledged in IFRS 16 that a floor of a building can be distinct, even though the ability to use it depends on having access through common areas used or controlled by others. However, it may be more difficult to conceptualise for assets such as technology assets (e.g, a satellite), whether there is a distinct portion that can be controlled, when the ability to use that portion may require access or power, say, from a portion that is not controlled.

3.4 The right to control the use of an identified asset

3.4.1. Elements of'control'

To assess whether a contract conveys the right to control the use of an identified asset for a period of time (as required under IFRS 16:9 - see 3.2.1), an entity is required to assess whether, throughout the period of use, the customer has both of the following:

- the right to obtain substantially all of the economic benefits from use of the identified asset (see 3.4.2); and
- the right to direct the use of the identified asset (see 3.4.3).

The'period of use' is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)". [IFRS 16:AppendixA]

As discussed in the following sections, the IASB decided that to control the use of an asset, a customer is required to have not only the right to obtain substantially all of the economic benefits from use of an asset throughout the period of use (a 'benefits'element) but also the ability to direct the use of that asset (a 'power' element). The shift in focus from 'risks and rewards'to 'control' is consistent with other recent Standards (e.g. IFRS 10 **Consolidated Financial Statements** and IFRS 15 **Revenue from Contracts with Customers**),

3.4.2. Right to economic benefits from use

3.4.2.1 Customer must have the right to obtain substantially all of the economic benefits from use of the asset

To control the use of an identified asset, a customer must have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (e.g. by having exclusive use of the asset throughout that period). [IFRS 16:B21]

Therefore, in circumstances when an asset might be considered to be implicitly identified (e.g. the supplier has only one machine capable of delivering the customer's requirements), if the supplier can regularly use the machine for other purposes during the course of the contract (e.g. to supply other customers), the customer does not have the right to obtain substantially all of the economic benefits from the use of that asset and there is no lease.

3.4.2.2. Nature of economic benefits from use of the asset

Economic benefits from use of an asset can be obtained by the customer in many ways (e.g. by using, holding or sub-leasing the asset); they include the primary output and by-products generated from use of the asset, and other economic benefits from using the asset that could be realised from a commercial transaction with a third party. [IFRS 16:B21] All of these benefits should be considered in the assessment of whether the contract conveys the right to substantially all of the economic benefits from the use of the asset.

The assessment as to whether a contract contains a lease should not consider economic benefits relating to ownership of an asset (e.g. tax benefits as a result of owning an asset). This is because a lease does not convey ownership of the underlying asset. [IFRS 16:BC118]

3.4.2.3. Restrictions on economic benefits available to the customer

The economic benefits to be considered are those that are available within the defined scope of the customer's right to use the asset. For example:

[IFRS 16:B22]

- if a contract limits the use of a motor vehicle to only one particular territory during the period of use, only the economic benefits from use of the motor vehicle within that territory should be considered; and
- if a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, only the economic benefits from use of the motor vehicle for the permitted mileage should be considered.

Therefore, potential additional economic benefits outside the scope of the customer's rights (e.g. in the second bullet point above, beyond the specified mileage for the motor vehicle) are not relevant to the determination as to whether the customer has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use.

Thinking it through

Sometimes it may be difficult to make the assessment of the economic benefits within the defined scope of the right-of-use asset, in which case it may be helpful to consider the arrangement not just from the customer's perspective but also from the perspective of whether another party can use the asset for its own benefit during the period of the contract. In the examples above it can be seen that another party could not, during the contract, use the motor vehicle to drive in other territories, or drive additional mileage.

3.4.2.4. Customer required to pay a portion of the cash flows derived from use of the asset as consideration

If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration should be considered to be part of the economic benefits that the customer obtains from use of the asset. [IFRS 16:B23]

For example, if the customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. This is because the total cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the supplier as consideration for the right to use that space.

[IFRS 16:B23]

3.4.3. Right to direct the use

3.4.3.1. Circumstances when the customer has the right to direct the use of an identified asset

A customer has the right to direct the use of an identified asset throughout the period of use only if either:

[IFRS 16:B24]

(a) the customer has the right to direct how and for what purpose the asset is used throughout the period of use (see 3.4.3.2); or

(b) the relevant decisions about how and for what purpose the asset is used are predetermined and specified conditions are met (see 3.4.3.3).

If neither of the conditions in IFRS 16:B24 is met, the supplier directs how and for what purpose the asset is used and, consequently, the contract does not contain a lease.

3.4.3.2. How and for what purpose the asset is used

Note that, as explained in IFRS 16:BC120, 'how and for what purpose'an asset is used is a single concept (i.e. 'how'an asset is used is not assessed separately from 'for what purpose' an asset is used).

A customer has the right to direct how and for what purpose the asset is used if it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, the focus is on whether the customer has decision-making rights that affect the economic benefits to be derived from use of the asset. [IFRS 16: B25]

The decision-making rights that are most relevant for this purpose are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract. Depending on the circumstances, these could include rights to change:

[IFRS 16:B25 & B26]

- the type of output that is produced by the asset (e.g. to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from retail space);
- when the output is produced (e.g. to decide when an item of machinery or a power plant will be used);
- where the output is produced (e.g. to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used);
- whether the output is produced, and the quantity of that output (e.g. to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

Rights that are limited to operating or maintaining the asset are examples of rights that do not grant the right to change how and for what purpose the asset is used. Although such rights are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used.

[IFRS 16:B27]

Therefore, for example, if a contract covers the use of a fleet of trucks for an agreed period and the customer has the right to decide how and when the trucks are used, the fact that the supplier continues to operate and maintain the trucks does not undermine the customer's ability to direct the use of the trucks.

In the IASB's view, the decisions about how and for what purpose an asset is used are more important in determining control of the use of an asset than other decisions to be made about use, including decisions about operating and maintaining the asset. This is because decisions about how and for what purpose an asset is used determine how, and what, economic benefits are derived from use.

[IFRS 16:BC120]

However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined as contemplated in IFRS 16:B24(b)(i) (see **3.4.3.3).**

3.4.3.3. Relevant decisions are predetermined

The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset. [IFRS 16:B28]

When decisions about how and for what purpose an asset is used are predetermined, they cannot be changed by either the customer or the supplier during the period of use. The IASB noted that it would expect these circumstances to arise in relatively few cases. [IFRS 16:BC121]

When the relevant decisions about how and for what purpose the asset is used are predetermined, a customer has the right to direct the use of an identified asset throughout the period of use only if either:

[IFRS 16:B24(b)]

i) the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or

ii) the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

The approach to determining whether a customer has the right to direct the use of an identified asset changes if the decisions about how and for what purpose an asset is used are predetermined. IFRS 16 clarifies that, in such circumstances, a customer can still direct the use of an asset if it has the right to operate the asset, or if it designed the asset in a way that predetermines how and for what purpose the asset will be used. In either of these cases, the customer controls rights of use that extend beyond the rights of a customer in a typical supply or service contract (i.e. the customer has rights that extend beyond solely ordering and receiving output from the asset). In these cases, the customer has the right to make (or, in the case of design, has already made) decisions that affect the economic benefits to be derived from use of the asset throughout the period of use. [IFRS 16:BC122]

For example, consider a contract for the use of a fleet of trucks for an agreed period where the contract specifies how and for what purpose the trucks are to be used (e.g. to carry rock from a specified quarry site to crushing facilities); these matters have been agreed between the parties prior to the commencement date and they cannot be changed. In such circumstances, if the customer has the right to operate the trucks throughout the period of use, under IFRS 16:B24(b)(i) it has the right to direct the use of the trucks, notwithstanding its inability to change how and for what purpose the trucks are used. In contrast, if the supplier is the operator, then the customer does not have the right to direct the use of the trucks, and there is no lease.

The concept of directing use through design (as contemplated in IFRS 16:B24(b)(ii)) is explored in Example 9A of the illustrative examples accompanying IFRS 16 (see Appendix 1 for summary). In the situation described, the customer purchases all of the output of a solar farm with predetermined activities. Although the customer makes no decisions during the life of the farm, it has the right to direct the use of the farm as a result of having designed the asset before it was constructed.

3.4.3.4. Decisions determined during and before the period of use

In assessing whether a customer has the right to direct the use of an asset, an entity should consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in IFRS 16:B24(b)(ii) (see 3.4.3.3). Consequently, unless the conditions in IFRS 16:B24(b)(ii) exist, an entity should not consider decisions that are predetermined before the period of use. [IFRS 16:B29]

For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services. [IFRS 16:B29]

It will not be unusual for a customer to specify its requirements prior to the commencement of a contract and to reach an agreement with the supplier as to how those requirements will be met. For example, a customer requires a supply of iron over an extended period. It agrees with the supplier prior to the commencement of supply that this requirement will be met by utilising all of the capacity of a specifically identified smelting plant operating for an agreed number of hours over that period. Assuming that the customer was not involved in the design of the smelting plant, the fact that it is able to specify the output of the smelting plant before the period of use does not mean that it has the right to direct the use of the plant. In this scenario:

- if the customer has the right to change how and for what purpose the smelting plant is used during the period of use, the customer has the right to direct the use of the smelting plant and, subject to other conditions, there may be a lease;
- if the supplier has the right to change how and for what purpose the smelting plant is used during the period of use, the supplier has the right to direct the use of the smelting plant and there is no lease; and
- if neither party has the right to change how and for what purpose the smelting plant is used, its activities are predetermined, and the right to direct its use will be determined by which entity is operating the smelting plant during the period of use (see 3.4.3.3),

3.4.3.5. Protective rights

A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may:

[IFRS 16:B30]

- specify the maximum amount of use of an asset or limit where or when the customer can use the asset; or
- require a customer to follow particular operating practices; or
- require a customer to inform the supplier of changes in how an asset will be used.

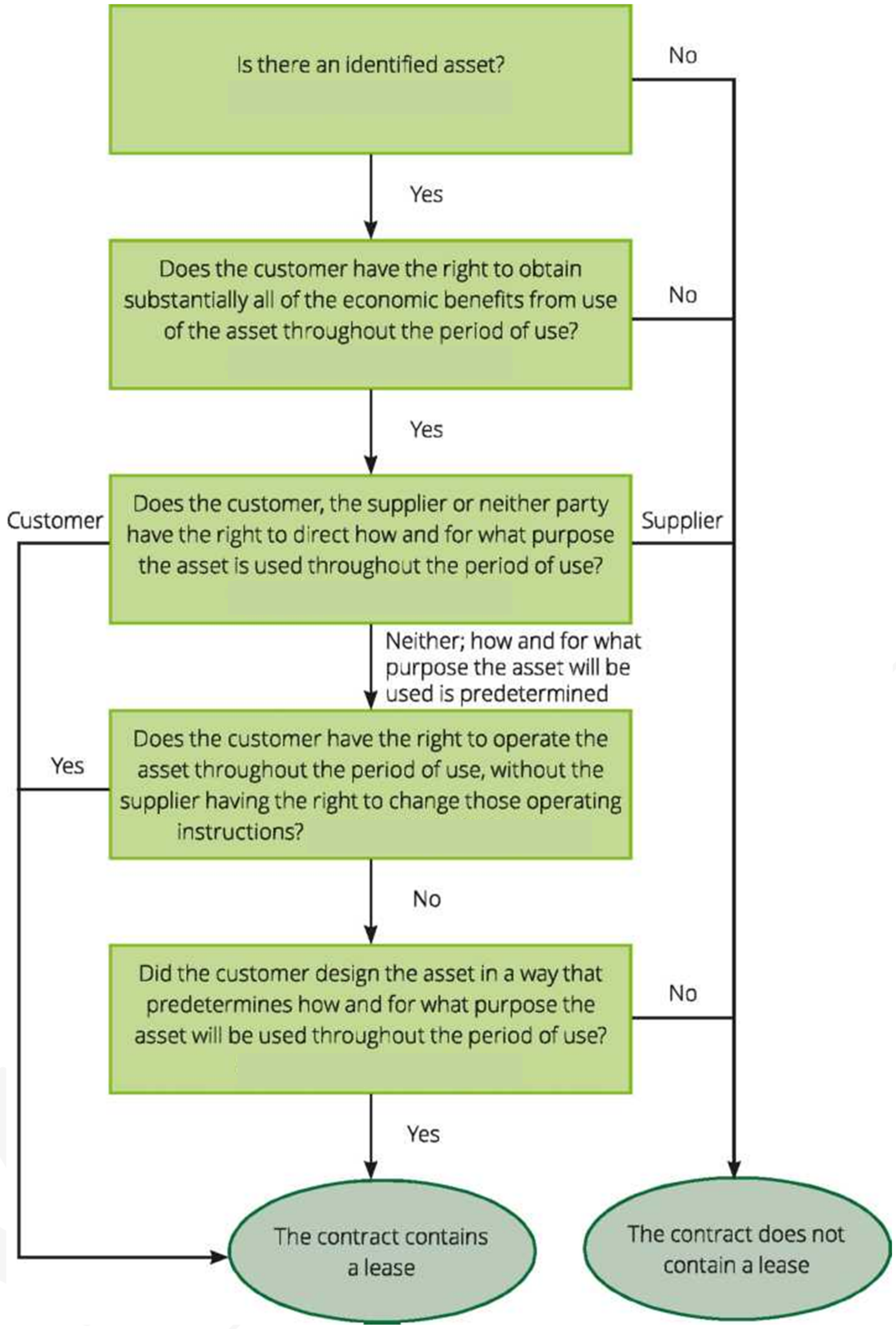
Rights of this nature typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset. [IFRS 16:B30]

The illustrative examples accompanying IFRS 16 cite examples of protective rights, including the following.

- Example 1 describes a situation in which the customer generally determines when, where and how rail cars are used, but subject to restrictions on the types of cargo (e.g. explosives) that can be carried. These restrictions are considered to be protective rights of the supplier and to define the scope of the customer's right to use the rail cars, but not to limit the customer's right to direct the use of the rail cars within that defined scope.
- Example 6B describes a situation in which the customer generally determines whether, where and when a ship sails, as well as the cargo it will carry, but contractual restrictions prevent the customer from sailing the ship into waters at a high risk of piracy or carrying hazardous material as cargo. Again, these restrictions are considered to be protective rights that protect the supplier's investment in the ship and the supplier's personnel. They define the scope of the customer's right to use the ship but they do not limit the customer's right to direct the use of the ship within that defined scope.

3.5. Summary flowchart

The following flowchart, which is reproduced from IFRS 16, summarises the steps involved in the assessment as to whether a contract is, or contains, a lease. [IFRS 16:B31]



4. SEPARATING COMPONENTS OF A CONTRACT

4.1 Separating components of a contract - requirements applicable for both lessees and lessors

4.1.1 Requirement to separate components of a contract

If a contract is, or contains, a lease, an entity is required to account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in IFRS 16:15 (see 4.2.3).

Some contracts contain both lease and non-lease (service) components. For example, a contract for a car may combine a lease with maintenance services. Other contracts contain two or more lease components. For example, a single contract may include leases of land, buildings and equipment. [IFRS 16:BC133]

The IASB considers that the identification of separate lease components in a lease contract is similar to the identification of performance obligations in a revenue contract - in both circumstances, an entity is trying to identify whether a customer or a lessee is contracting for a number of separate deliverables or contracting for one deliverable that may incorporate a number of different assets. Accordingly, rather than developing new requirements addressing how to identify separate lease components, the IASB decided to include in IFRS 16 requirements similar to those in IFRS 15 Revenue from Contracts with Customers on the identification of performance obligations.

The IASB intends that those requirements in IFRS 16 are applied in a similar way to their application within the context of a revenue contract in IFRS 15. [IFRS 16:BC134]

Note that the effect of the practical expedient described in 4.2.3 is that lessees have a choice as to whether to separate the non-lease components of a contract.

4.1.2 Identification of separate lease components

The right to use an underlying asset is a separate lease component if both:

[IFRS 16:B32]

- the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
- the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

Take, for example, a contract for the hire of a pneumatic hammer and an air-compressor for breaking up concrete (assume that the contract meets the definition of a lease). The hammer only works with an air-compressor. However, the hammer is not linked to the specific air-compressor and could be used with a different compressor purchased or hired elsewhere. In this example, having regard to the conditions in IFRS 16:B32, the contract is considered to have two separate lease components.

In contrast, consider a contract for the hire of two interdependent items of equipment that have been specifically configured to work in unison so that neither item can be readily substituted. In this case, the contract is likely to be considered to consist of only one lease.

Note that, even when separate lease components are identified, if the lease components have similar characteristics, it may be possible to account for them as a single portfolio under IFRS 16:B1 (see 1.3).

The following example, which is reproduced from the illustrative examples accompanying IFRS 16, illustrates the application of IFRS 16:B32.

Example 4.1.2

Identification of lease components

Lessor leases a bulldozer, a truck and a long-reach excavator to Lessee to be used In Lessee's mining operations for four years. Lessor also agrees to maintain each item of equipment throughout the lease term. The total consideration In the contract is CU600,000, payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. The variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. The consideration includes the cost of maintenance services for each Item of equipment.

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying [IFRS 16:12], Lessee does not elect the practical expedient in [IFRS 16:15 - see 4.2.3], Lessee considers the requirements in [IFRS 16:B32] and concludes that the lease of the bulldozer, the lease of the truck and the lease of the long-reach excavator are each separate lease components. This is because:

Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative truck or excavator to use in its operations); and

although Lessee is leasing all three items of equipment for one purpose (ie to engage in mining operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract.

continued at example 4.2.1

4.1.3. Activities and costs that do not transfer a good or service to the lessee

A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

[IFRS 16:B33]

For example, a contract includes a lease component (hire of a machine) and a non-lease component (maintenance of the machine over the lease term). The contract also provides for an additional charge for administrative tasks of 2 per cent of the amounts otherwise payable under the contract. Because these administrative tasks do not transfer a good or service to the lessee, the additional charge is not considered to be a separate component of the contract. Rather, assuming that the lessee does not elect to use the practical expedient in IFRS 16:15 (see 4.2.3), both the lessee and the lessor account for the hire and maintenance components separately and the administration charge is included in the total consideration to be allocated between those components.

4.2. Separating components of a contract - lessees

4.2.1. Consideration to be allocated based on relative stand-alone prices

For lessees, the consideration in a contract should be allocated between lease and non-lease components (if any) on the basis of the relative stand-alone price of each lease component and the aggregate stand-alone price of the non-lease components. [IFRS 16:13]

The relative stand-alone price of lease and non-lease components should be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee should estimate the stand-alone price, maximising the use of observable information. [IFRS 16:14]

IFRS 16:14 permits a lessee to estimate the stand-alone prices of lease components because it may not have the necessary information to determine the lessor's stand-alone prices. The Standard requires the lessee to maximise the use of observable information - for example, the price charged by other suppliers or the price charged by the supplier to other customers.

In addition, having regard to the likelihood that a lessee may not have complete information on the lessor's pricing model, the IASB has granted relief from the requirement to separate non-lease components (see 4.2.3).

The following example, which is reproduced from the illustrative examples accompanying IFRS 16, illustrates the application of IFRS 16:13 and 14.

Example 4.2.1

Allocation of consideration between lease and non-lease components

... continued from example 4.1.2

Lessee applies the guidance in [IFRS 16:3 and 14] to allocate the consideration in the contract to the three lease components and the non-lease components.

Several suppliers provide maintenance services for a similar bulldozer and a similar truck. Accordingly, there are observable stand-alone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the maintenance of the bulldozer and the truck of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The long-reach excavator is highly specialised and, accordingly, other suppliers do not lease or provide maintenance services for similar excavators. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar long-reach excavators from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount ofCU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. That variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. Consequently, Lessee estimates the stand-alone price of the maintenance services for the long-reach excavator to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the bulldozer, the truck and the long-reach excavator ofCU170,000, CU102,000 and CU224,000, respectively.

Lessee allocates the fixed consideration in the contract (CU600.000) to the lease and non-lease components as follows:

CU	Bulldozer	Truck	excavator	Total
Lease	170,000	102,000	224,000	496.000
Non-lease				104,000
Total fixed consideration				**600,000**

Lessee allocates all of the variable consideration to the maintenance of the long-reach excavator, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in IFRS 16, treating the allocated consideration as the lease payments for each lease component.

4.2.2. Accounting for non-lease components

Unless the practical expedient in IFRS 16:15 (see 4.2.3) is applied, a lessee should account for non-lease components in a contract in accordance with other applicable Standards. [IFRS 16:16]

IFRS 16 only deals with the accounting for lease components of a contract - not the accounting for services. The IASB considers that the accounting for services (or the service components of a contract) should not be affected, regardless of whether the contract is only for services or includes the purchase, or lease, of an asset as well as services. [IFRS 16:BC135]

Consequently, although IFRS 16 requires entities to separate non-lease components (unless the practical expedient in IFRS 16:15 is used) and to allocate consideration to those non-lease components in aggregate, it does not specify how the aggregate allocation should be apportioned between separate non-lease components nor the subsequent accounting for such consideration. These matters will be determined under other applicable Standards.

4.2.3. Relief from requirement to separate non-lease components from lease components - practical expedient

As a practical expedient, a lessee may elect not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. This election should be made by class of underlying asset. [IFRS 16:15]

Note that, if the practical expedient is adopted, an entity accounts for the combined lease and non-lease component as a single lease component - it is not permitted to account for the combined lease and non-lease component as a service.

4.2.4. No relief from requirement to separate embedded derivatives

The relief from the requirement to separate non-lease components described in 4.2.3 is not available in respect of embedded derivatives that meet the criteria for separation from a host contract as set out in paragraph 4.3.3 of IFRS 9 Financial Instruments (or, for entities that have not yet adopted IFRS 9, paragraph 11 of IAS 39 Financial Instruments: Recognition and Measurement) - see also 2.6). [IFRS 16:15]

4.3. Separating components of a contract - lessors

If a contract contains a lease component and one or more additional lease or non-lease components, a lessor should allocate the consideration in the contract by applying paragraphs 73 to 90 of IFRS 15 Revenue from Contracts with Customers.

Lessors are therefore required to allocate the consideration in a contract between lease and non-lease components using the requirements in IFRS 15 regarding the allocation of the transaction price to performance obligations. This approach is designed to ensure consistency for entities that are both a lessor and a seller of goods or services in the same contract. [IFRS 16:BC136]

Although IFRS 16 includes a practical expedient permitting lessees not to separate non-lease components from lease components (see 4.2.3), there is no equivalent practical expedient for lessors. The IASB believes that a lessor should be able to separate payments for lease and non-lease components. This is because the lessor would need to have information about the value of each component, or a reasonable estimate of it, when pricing the contract. [IFRS 16:BC135(a)]

5. LEASE TERM

5.1. Definition of lease term

The lease term is defined as "the non-cancellable period for which a lessee has the right to use an underlying asset, together with both: [IFRS 16:18]

- periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option".

See 5.5 to 5.7 for a discussion of lessor and lessee termination and extension options.

5.2 Consideration of enforceability

As part of its assessment of the lease term and the length of the non-cancellable period of a lease, an entity should consider the definition of a contract ("[a]n agreement between two or more parties that creates enforceable right and obligations") and determine the period for which the contract is enforceable. [IFRS 16:B34]

For the purposes of IFRS 16, a contract is considered to exist only when it creates rights and obligations that are enforceable. Any non- cancellable period or notice period in a lease meets the definition of a contract and, therefore, should be included as part of the lease term. Any options to extend or terminate the lease that are included in the lease term must also be enforceable.

In assessing the enforceability of a contract, an entity should consider whether the lessor can refuse a request from the lessee to extend the lease. If optional periods are not enforceable (e.g. if the lessee cannot enforce the extension of the lease without the agreement of the lessor), the lessee does not have the right to use the asset beyond the non-cancellable period. By definition, there is no contract beyond the non-cancellable period (plus any notice period) if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term. [IFRS 16:BC127]

A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty. [IFRS 16:B34]

5.3 Beginning of lease term

The lease term begins on the'commencement date'of the lease. [IFRS 16:B36] This is defined as the date on which the lessor makes an underlying asset available for use by a lessee. [IFRS 16:AppendixA] It is the date on which the lessee initially recognises and measures right-of-use assets and lease liabilities (see section 7). It is also the date on which the lessor recognises assets held under a finance lease in its statement of financial position (see 9.1.1).

IFRS 16 makes an important distinction between the 'inception date' and the 'commencement date' of a lease. The inception date of the lease is defined as the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. [IFRS 16:Appendix A] This is the date on which an entity evaluates a contract to determine whether it is, or contains, a lease (see section 3). For lessors, it is also the date at which the classification of a lease is determined (see section 8).

Therefore, although important assessments are made at the inception date, the assets, liabilities, income and expenses resulting from a lease are not recognised in the financial statements or measured until the commencement date

A lessee does not obtain and control its right to use the underlying asset until the commencement date. Before that date, the lessor has not yet performed under the contract. Although a lessee may have a right and an obligation to exchange lease payments for a right- of-use asset from the date of inception, the lessee is unlikely to have an obligation to make lease payments before the asset is made available for its use. [IFRS 16:BC142], If such circumstances do arise (i.e. if the entity is required to make payments for the right to use the underlying asset before the commencement date), IFRS 16:B44 explicitly requires that they be included in lease payments (see 7.3.2).

Example 5.3

Lease payments on assets not in use

Company X is planning a major expansion of its oil production capacity beginning in 20X2. In order to ensure sufficient shipping capacity is available when production increases, Company X enters into a lease contract on 1 January 20X1 for rail cars to ship the oil. The rail cars will be made available to Company X from 1 July 20X1. Company X does not expect to use the rail cars for its own shipping purposes until 20X2, but it may consider other options (e.g. to rent out the cars to other producers) in the second half of 20X1. The sole reason for entering into the lease contract in 20X1 is to ensure that the rail cars will be available to Company X in 20X2.

The inception date of the lease is 1 January 20X1 (or any earlier date on which the parties committed to the principal provisions of the lease). This is the date on which Company X evaluates the contract to determine whether it is, or contains, a lease. Assume that, having regard to the requirements set out in 3.3 (identified assets, no substantive substitution rights and, from 1 July 20X1, the right to control the use of the rail cars), Company X determines that the contract is a lease. [In fact, each of the rail cars may be considered a separate lease component-see section 4. However, it is assumed that Company X applies the practical expedient in IFRS 16:B1 (see 1.3) and accounts for the portfolio of leases together.]

The lessor makes the rail cars available for use by Company X on 1 July 20X1. Company X has the right to control the use of the rail cars from that date. Although Company X does not intend to use the rail cars until 20X2, it has the right to determine how and for what purpose the rail cars are used from 1 July 20X1. If Company X chooses to store the rail cars rather than use them for a period of time, this is a demonstration of its control over those cars. Therefore, 1 July 20X1 is the commencement date of the lease and the assets, liabilities, income and expenses resulting from the lease are recognised and measured from that date.

The depreciation of the right-of-use asset should commence from 1 July 20X1 (i.e. the commencement date - see 7.5.1.3) even if the rail cars are not used until 20X2.

5.4 Rent-free periods

The lease term includes any rent-free periods provided to the lessee by the lessor. [IFRS 16:B36]

5.5. Lessor termination options

If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease. [IFRS 16:B35]

A lessor's right to terminate a lease is ignored when determining the lease term because, in that case, the lessee has an unconditional obligation to pay for the right to use the asset for the period of the lease, unless and until the lessor decides to terminate the lease.

[IFRS 16:BC128]

This principle applies for the determination of the lease term for the lessor as well as for the lessee - there is no assessment regarding whether the lessor is reasonably certain not to terminate, as is the case with lessee termination options (see 5.6).

5.6 Assessment of lessee extension and termination options

In contrast to lessor termination options, if the lessee has the right to extend or terminate the lease, there are enforceable rights and obligations beyond the initial non-cancellable period and the parties to the lease are required to consider those optional periods in their assessment of the lease term. [IFRS 16:BC128]

In accordance with IFRS 16:18 (see 5.1), the lease term will be considered to extend beyond the non-cancellable period if the lessee has an extension option that it is considered to be reasonable certain to exercise, or a termination option that it is considered to be reasonably certain not to exercise.

At the commencement date, the entity should assess whether the lessee is reasonably certain:

[IFRS 16: B37]

- to exercise an option to extend the lease; or
- to exercise an option to purchase the underlying asset; or
- not to exercise an option to terminate the lease.

In making these assessments, the entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. [IFRS 16:19 & B37]

Examples of factors to consider when making these assessments include, but are not limited to:

[IFRS 16: B37]

- contractual terms and conditions for the optional periods compared with market rates, such as:
  - the amount of payments for the lease in any optional period;
  - the amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
  - the terms and conditions of any options that are exercisable after initial optional periods (e.g. a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates);
- significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- costs relating to the termination of the lease, such as:
  - negotiation costs;
  - relocation costs;
  - costs of identifying another underlying asset suitable for the lessee's needs;
  - costs of integrating a new asset into the lessee's operations; and
  - termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
- the importance of that underlying asset to the lessee's operations (considering, for example, whether the underlying asset is a specialised asset, the location of the underlying asset and the availability of suitable alternatives); and
- conditionality associated with exercising the option (i.e. when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.

An option to extend or terminate a lease may be combined with one or more other contractual features (e.g. a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in IFRS 16:B42 (see 6.3), an entity should assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease. [IFRS 16:B38]

The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period. [IFRS 16:B39]

A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time, or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee should consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.

[IFRS 16:B40]

5.7 Reassessment of extension and termination options

A lessee should reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:

[IFRS 16:20]

- is within the control of the lessee; and
- affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term.

In principle, the IASB is of the view that users of financial statements receive more relevant information if lessees reassess extension, termination and purchase options on a regular basis. However, requiring reassessment at each reporting date would be costly for an entity with many leases that include options. In order to address that concern, while still providing useful information to users of financial statements, the Board decided that an appropriate balance would be achieved by requiring reassessment only if both of the criteria in IFRS 16:20 are met. Consequently reassessment is required only upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and that affects whether the lessee is reasonably certain to exercise, or not to exercise, an option to extend a lease, to terminate a lease or to purchase an underlying asset. Limiting the reassessment requirement to events within the control of the lessee means that a lessee is not required to reassess options in response to purely market-based events or changes in circumstances. To assist lessees, IFRS 16:B41 (see below) includes some examples of possible triggering events to help entities apply judgement in identifying significant events or significant changes in circumstances that trigger reassessment.

[IFRS 16:BC184 - BC186]

Examples of significant events or changes in circumstances as contemplated in IFRS 16:20 include:

[IFRS 16:B41]

- significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- a significant modification to, or customisation of, the underlying asset that was not anticipated at the commencement date;
- the inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and
- a business decision of the lessee that is directly relevant to exercising, or not exercising, an option (e.g. a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of a business unit within which the right-of-use asset is employed).

5.8 Revision of lease term

An entity should revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if one of the following occurs:

[IFRS 16:21]

- the lessee exercises an option not previously included in the entity's determination of the lease term;
- the lessee does not exercise an option previously included in the entity's determination of the lease term;
- an event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term; or
- an event occurs that contractually prohibits the lessee from exercising an option previously included in the entity's determination of the lease term.

The lease term may also be revised following a reassessment as to whether an extension option is reasonably certain to be exercised, or a termination option is reasonably certain not to be exercised (see 5.7). Although such a reassessment does not affect the non- cancellable period, it affects the total lease term comprised of the non-cancellable period and reasonably certain extension periods (see 5.1).

6. LEASE PAYMENTS

6.1 Lease payments-definition

A number of the measurement requirements in IFRS 16 are determined by reference to the'lease payments'. Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

[IFRS 16:Appendix A]

- fixed payments (including in-substance fixed payments - see 6.3), less any lease incentives (see 6.4);
- variable lease payments that depend on an index or a rate (see 6.5.2);
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (see 6.6);
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease; and
- residual value guarantees as set out in 6.7.

In accordance with IFRS 16:18 (see 5.1), the lease term will be considered to extend beyond the non-cancellable period if the lessee has an extension option that it is considered to be reasonably certain to exercise, or a termination option that it is considered to be reasonably certain not to exercise. Therefore, lease payments include optional payments payable after the non-cancellable period if it is considered reasonably certain that the lease will extend beyond that period.

Lease payments exclude (1) variable lease payments linked to future performance or use of the underlying asset (see 6.5.3), and (2) optional payments payable afterthe non-cancellable period if it is not considered reasonably certain that the lessee will extend the lease beyond that period.

6.2 Exclusion of payments allocated to non-lease components

Entities are generally required to separate lease and non-lease components of a contract (see section 4).

For a lessee, lease payments do not include payments allocated to non-lease components of a contract, unless the lessee has elected to combine lease and non-lease components under the practical expedient permitted under IFRS 16:15 (see 4.2.3). [IFRS 16:AppendixA]

For a lessor, lease payments do not include payments allocated to non-lease components. [IFRS 16:AppendixA]

For a lessor, there is no practical expedient permitting lease and non-lease components to be combined (see 4.3).

6.3 Fixed payments

Fixed payments are defined as "[payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments". [IFRS 16:AppendixA]

See 6.5 for a discussion of variable lease payments.

'In-substance' fixed lease payments, which are specifically required to be included in lease payments (see 6.1), are payments that may, in form, contain variability but that, in substance, are unavoidable. [IFRS 16:B42]

In-substance fixed lease payments exist, for example, if:

[IFRS 16:B42]

- payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. **Examples of those types of payments include:**
  - payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or
  - payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved;
- there is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity should include within lease payments the realistic set of payments; and
- there is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity should include within lease payments the set of payments that aggregates to the lowest amount (on a discounted basis).

IFRS 16 requires a lessee to include in-substance fixed lease payments in the measurement of lease liabilities because those payments are unavoidable and, therefore, are economically indistinguishable from fixed lease payments. [IFRS 16:BC164]

6.4 Lease incentives

Lease incentives are defined as "payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee". [IFRS 16:AppendixA]

Such incentives may take the form, for example, of an up-front cash payment to the lessee or a reimbursement or assumption by the lessor of costs of the lessee (e.g. relocation costs and costs associated with a pre-existing lease commitment of the lessee).

Such payments are offset against lease payments made by the lessee to the lessor (see 6.1). When any incentives are paid to the lessee, even if they are not part of the formal lease agreement, they should be offset against lease payments.

6.5 Variable lease payments

6.5.1 Variable lease payments - definition

Variable lease payments are defined as the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time". [IFRS 16:Appendix A]

Variability arises if lease payments are linked to:

[IFRS 16:BC163]

- price changes due to changes in a market rate or the value of an index. For example, lease payments might be adjusted for changes in a benchmark interest rate or a consumer price index (see 6.5.2);
- the lessee's performance derived from the underlying asset. For example, a lease of retail property may specify that lease payments are based on a specified percentage of sales made from that property (see 6.5.3); or
- the use of the underlying asset. For example, a vehicle lease may require the lessee to make additional lease payments if the lessee exceeds a specified mileage (see 6.5.3).

6.5.2. Variable lease payments that depend on an index or a rate

6.5.2.1. Lease liability initially measured using the index or rate as at the commencement date

Variable lease payments that depend on an index or a rate (which, as indicated in 6.1, should be included within lease payments) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.[IFRS 16:28]

When measuring a lessee's lease liability (see 7.4.2.1) ora lessor's net investment in a lease (see 9.1.1), such payments should initially be measured using the index or rate as at the commencement date (see 5.3).

Variable lease payments that depend on an index or a rate are included in lease payments. They meet the definition of liabilities for the lessee because they are unavoidable and do not depend on any future activity of the lessee. Any uncertainty, therefore, relates to the measurement of the liability that arises from those payments and not to the existence of that liability. [IFRS 16:BC165]

At initial recognition, such payments are measured using the index or rate at the commencement date (without estimating changes in the index or rate over the remainder of the lease term). The IASB considered that using forecasting techniques or forward rates to estimate changes in the index or rate would be costly, and might introduce measurement uncertainty and reduce comparability between entities. [IFRS 16:BC166]

6.5.2.2. Variable lease payments that depend on an index - example

The following example, which is reproduced from the illustrative examples accompanying IFRS 16, illustrates how a lessee accounts for variable lease payments that depend on an index.

Example 6.5.2.2

Variable lease payments that depend on an index [IFRS 16:Illustrative example 14A]

Example 14A - Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 percent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the

During the first two years of the lease, Lessee recognises in aggregate the following related to the lease.

Interest expense	CU33,928	
Lease liability		CU33,928
Depreciation charge (CU405,391 ÷ 10 x 2 years)	CU81,078	
Right-of-use asset		CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognises the following.

Lease liability	CU50,000	
Cash		CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 percent per annum = CU355,391 + CU33,928 - CU50,000).

At the beginning of the third year of the lease the Consumer Price index is 135.

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 (CU50,000 x 135 ÷ 125). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, ie the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 percent per annum, which is CU366,464. Lessee increases the lease liability by CU27,I45, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognised as follows.

Right-of-use asset	CU27,145	
Lease liability		CU27,145

At the beginning of the third year, Lessee makes the lease payment for the third year and recognises the following.

Lease liability	CU54,000	
Cash		CU54.000

6.5.2.3 Variable lease payments that depend on a rate - example

When variable payments depend on a rate, the accounting is a little different, as illustrated in the following example.

Example 6.5.2.3

Variable lease payment that depend on a rate

Entity B enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is CU1,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 percent. Assume that the interest rate implicit in the lease is 5 per cent.

In accordance with IFRS 16:27{b), the lease payments should initially be measured using the rate (i.e. LIBOR) as at the commencement date. LIBOR at that date is 2 percent; therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows.

Year	Lease payment	Discount factor	Present value of lease payment
	CU		CU
1	1000	1	1,000
2	1020	0.952	971
3	1040	0.907	943
4	1061	0.863	916
5	1082	0.822	889
6	1104	0.784	866
7	1126	0.746	840
8	1149	0.711	817
9	1172	0.677	793
10	1195	0.645	771
Therefore, the lease liability is initially measured at CU8,806.			

6.5.2.4. Rent reviews to market rates or upward-only

When a lease contract includes the potential for rent reviews (whether to market rates or upward only), the lease payments included in the measurement of the lessee's lease liability and the lessor's net investment in the lease at the commencement date will be the payments agreed at inception, without consideration of future rent reviews.

Whether a lease specifies a rent of CU100 annually plus market increases, or CU100 annually resetting up or down to market every five years, the lease payments recognised at the commencement date are CU100 annually. Any increase or decrease as a result of subsequent rent reviews will be recognised when the adjustment to the lease payments takes effect (see 8.5.2.7).

The basis of any rent review under a lease should be evaluated carefully to determine whether the rent review resets the lease payments to market at the date of the review or whether, in substance, the amount of change in the lease payments at the date of the review was fixed at inception. In the latter case, the changes in rent would represent in-substance fixed payments (see 7.3) and would therefore be included in lease payments from the commencement date.

6.5.3 Variable lease payments linked to future performance or use of an underlying asset

Variable lease payments linked to future performance or use of an underlying asset are excluded from the measurement of lease liabilities

Such payments are required to be recognised in profit or loss in the period in which the event or condition that triggers those payments occurs (see 7.5.2.3).

The following example, which is reproduced from the illustrative examples accompanying IFRS 16, illustrates how a lessee accounts for variable lease payments not included in the measurement of the lease liability.

Example 6.5.3

Variable lease payments linked to sales

[IFRS 16:Illustrative example 14B]

Assume the same facts as [example 6.5.2.2J except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee's sales generated from the leased property.

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognised at the same amounts as in [example 6.5.2.2], This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000from the leased property.

Lessee incurs an additional expense related to the lease of CU8,000 (CU800,000 x 1 per cent), which Lessee recognises in profit or loss in the first year of the lease [see 6.5.2.3],

6.6. Options to purchase the underlying asset

Purchase options are required to be included in the measurement of a lessee's lease liability and a lessor's lease receivable in the same way as options to extend the term of a lease (i.e. the exercise price of a purchase option is included in the measurement of a lease liability/receivable if the lessee is reasonably certain to exercise that option). The IASB views a purchase option as effectively the ultimate option to extend the lease term. A lessee that has an option to extend a lease for all of the remaining economic life of the underlying asset is, economically, in a similar position to a lessee that has an option to purchase the underlying asset. [IFRS 16:BC173]

6.7. Residual value guarantees

A residual value guarantee is defined as "[a] guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount". [IFRS 16:Appendix A]

For a lessee, lease payments include amounts expected to be payable by the lessee under residual value guarantees. [IFRS 16:AppendixA]

For a lessor, lease payments include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

7. ACCOUNTING BY LESSEES

7.1 Recognition - general

At the commencement date of a lease, a lessee is required to recognise both:

- a right-of-use asset; and
- a lease liability.

7.2. Recognition exemptions

7.2.1 Recognition exemptions-general

A lessee may elect not to apply the requirements in IFRS 16

- short-term leases (see 7.2.2); and
- leases for which the underlying asset is of low value (see 7.2.3 and subject to the exception in 7.2.3.5).

For short-term leases or leases of low-value items to which this exemption is applied, lease payments are recognised as an expense over the lease term (see 7.2.4).

> **Thinking it through**
>
> **Some entities may decide that they do not wish to take advantage of these exemptions, perhaps because recognising lease assets and liabilities and presenting the lease expense as interest and depreciation is considered preferable to an off-balance sheet treatment with an operating expense. Or, for some lessees, while they may see benefit to having such leases off-balance sheet, that benefit may not be sufficient to justify the additional cost or complexity of having two lease accounting systems.**

7.2.2 Short-term leases

7.2.2.1 Short-term lease - definition

A short-term lease is defined as a lease that, at the commencement date, has a lease term of 12 months or less". [IFRS 16:AppendixA]

A lease that contains a purchase option cannot be classified as a short-term lease. [IFRS 16:Appendix A]

For the purposes of the definition of a short-term lease, the lease term should be determined under the general requirements of IFRS 16 (see section 5). Consequently, lessees will need to assess the effect of extension and termination options.

Note that the prohibition on a lease containing a purchase option being classified as a short-term lease applies for any lease containing a purchase option, irrespective of the probability that the option will be exercised.

Note also that there is no restriction on qualification as a short-term lease based on the value of the underlying asset or the amount of the consideration paid. This exemption is available for high-value items that are leased for the short term.

7.2.2.2 Election to be made on a class-by-class basis

The election to take the recognition exemption for short-term leases is required to be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations. [IFRS 16:8]

For example, consider an entity that has leased several items of office equipment - some for less than 12 months and some for longer than 12 months, with none containing purchase options. Assuming that the items of office equipment are all considered to be of the same class, if the entity wishes to use the short-term lease exemption it must apply that exemption for all of the leases with terms of 12 months or less. The leases with terms longer than 12 months will be accounted for in accordance with the general recognition and measurement requirements for lessees.

7.2.2.3 Impact of lease modifications

If a lessee accounts for short-term leases applying IFRS 16:6 (see 7.2.4), it should consider the lease to be a new lease for the purposes of IFRS 16 if:

[IFRS 16:7]

- there is a lease modification; or
- there is any change in the lease term (e.g. the lessee exercises an option not previously included in its determination of the lease term).

7.2.3. Leases of low-value assets

7.2.3.1. Low-value assets - definition and examples

IFRS 16 does not provide an explicit definition for what is meant by low-value assets. However, the Basis of Conclusions states that at the time of reaching decisions about the exemption in 2015, the IASB had in mind leases of underlying assets with a value, when new, in the order of magnitude of US$5,000 or less". [IFRS 16:BC100]

Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

[IFRS 16:B8]

7.2.3.2. Assessment independent of the size or nature of the lessee

The assessment as to whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in IFRS 16:6 (see 7.2.4) regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value. [IFRS 16:B4]

7.2.3.3. Assessment to be based on the value of the asset when new

The value of an underlying asset should be assessed based on the value of the asset when it is new, regardless of the age of the asset being leased. [IFRS 16:B3]

A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value. [IFRS 16:B6]

7.2.3.4. Election available on lease-by-lease basis

The exemption for leases of low-value assets is available on a lease-by-lease basis. [IFRS 16:8]

Subject to IFRS 16's general requirements regarding the combination of interdependent contracts (see 1.4), and the specific requirements in IFRS 16:B5 regarding assets that are highly interdependent or highly interrelated (see 7.2.3.5), each lease is assessed separately.

For example, a hospital enters into a rental contract for a large number of hospital beds. Each bed within the contract constitutes an identified underlying asset and the other conditions for identification of a lease are met. The value of an individual hospital bed would be considered to be 'low', even though the contract for all of the beds is not. The conditions of IFRS 16:B5 are met (the hospital can benefit from the use of an individual bed together with other resources that are already available, and each individual bed does not need other assets to make it functional for patients). Consequently each bed qualifies as a low-value asset and the entity can elect to apply the low- value asset exemption to all of the beds under the contract.

7.2.3.5. Assets that are highly dependent on, or highly interrelated with, other assets do not qualify as low-value assets

A lease will qualify for this exemption only if:

[IFRS 16: B5]

- the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
- the underlying asset is not highly dependent on, or highly interrelated with, other assets.

Therefore, if either (1) the lessee cannot benefit from the underlying asset on its own or together with other readily available resources, or (2) the underlying asset is highly dependent on, or highly interrelated with, other underlying assets, the recognition exemption for low-value assets cannot be applied to that individual asset (unless the overall asset, combining the highly dependent or highly interrelated assets, is itself low value). In this context, the IASB had in mind large assets made up of a number of individual leases of low- value assets (such as IT equipment made up of individually low-value component parts).

See example 1.3 which sets out a scenario in which some items of IT equipment (laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones) qualify for the low-value asset exemption but others (individual modules that increase the storage capacity of mainframe servers) do not. Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers.

7.2.3.6. Head leases do not qualify as low-value assets

If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset. [IFRS 16:B7]

7.2.3.7. Recognition of lease payments for short-term leases and leases of low-value assets

If a lessee elects to apply the exemption in IFRS 16:5 to either short-term leases or leases of low-value assets, it should recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term, or on another systematic basis if that basis is more representative of the pattern of the lessee's benefit. [IFRS 16:6]

For example, if the lease payments for an asset are based on the actual usage of that asset, or are revised periodically to reflect the efficiency of the asset or current market rates, the amounts actually payable may be an appropriate measure.

The lease payments to be spread on a straight-line (or other systematic) basis are after deduction of any lease incentives (see 6.4).

The lease term includes any rent-free periods (see 5.4). The following examples illustrate the recognition of lease payments under IFRS 16:6 when such features are present.

Example 7.2.4A

Recognition of lease payments (including lease incentives) for low-value assets

Entity A leases office equipment for 5 years. The total value of the equipment when new is CU5,000 (determined by Entity A to be 'low value'). EntityA elects to apply the low-value asset exemption.

Lease payments are payable as follows.

Year 1	CUnil (rent-free period)
Years 2 and 3:	CU1,750 per year
Years 4 and 5:	CU1,500 per year

In addition, the lessor provides a lease incentive with a value of CU500. The lessee's benefit under the lease arises on a straight-line basis over the full lease term.

Applying IFRS 16:6 to the lease payments:

Total payments: (CU1,750 x 2) + (CU1,500 x 2) - CU500 = CU6,000

Length of lease: 5 years

Lease expense recognised each year: CU1,200 (CU6,000 / 5)

Example 7.2.4B

Period over which lease incentives should be recognised

Entity B leases office equipment for 5 years. The total value of the equipment when new is CU5,000 (determined by Entity B to be 'low value'). Entity B elects to apply the low-value asset exemption.

The lease includes a clause requiring lease payments to be repriced to market rates part-way through the lease term. The lessor grants an incentive to Entity B to enter into the lease arrangement.

Over what period should the lease incentive be recognised (i.e. over the whole of the lease term or over the period up to the repricing of lease payments to market rates)?

The lease incentive should be recognised over the lease term. It should be recognised on a straight-line basis, unless another systematic basis is more representative of the time pattern of Entity B's benefit from use of the leased asset.

The IFRIC (now the IFRS Interpretations Committee) was asked to considerthis issue in 2005 (in the context of SIC-15 Operating Leases- Incentives, but equally applicable for entities applying the low-value asset exemption under IFRS 16). Specifically, the IFRIC was asked to consider whether the lease incentive should be recognised over the shorter period ending when the lease payments are adjusted to market rates on the basis that the lease expense of a lessee after a lease is repriced to market ought to be comparable with the lease expense of an entity entering into a new lease at that same time at market rates. The IFRIC did not accept this argument and confirmed that the general requirements for spreading lease incentives over the entire lease term should apply.

7.3 Lessee involvement with the underlying asset before the commencement date

7.3.1. Costs of the lessee relating to the construction or design of the underlying asset

Parties may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee maybe required to make payments relating to the construction or design of the asset. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee should account for those costs applying other applicable Standards (e.g. IAS 16 Property, Plant and Equipment). [IFRS 16:B43 & B44]

Such costs (e.g. amounts payable by an entity to construct a bespoke property that it will ultimately lease from another entity - sometimes referred to as 'build-to-suit' leases) do not qualify as initial direct costs (as discussed at 7.4.1.2); they are not included within the carrying amount of the right-of-use asset under IFRS 16, but rather are accounted for as a separate asset (assuming the recognition criteria of the relevant Standard are met).

7.3.2. Payments for the right to use the underlying asset made before the commencement date

Costs relating to the construction or design of an underlying asset (as described in 7.3.1) do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments. [IFRS 16:B44] They are included within the initial measurement of the right-of-use asset (see 7.4.1)

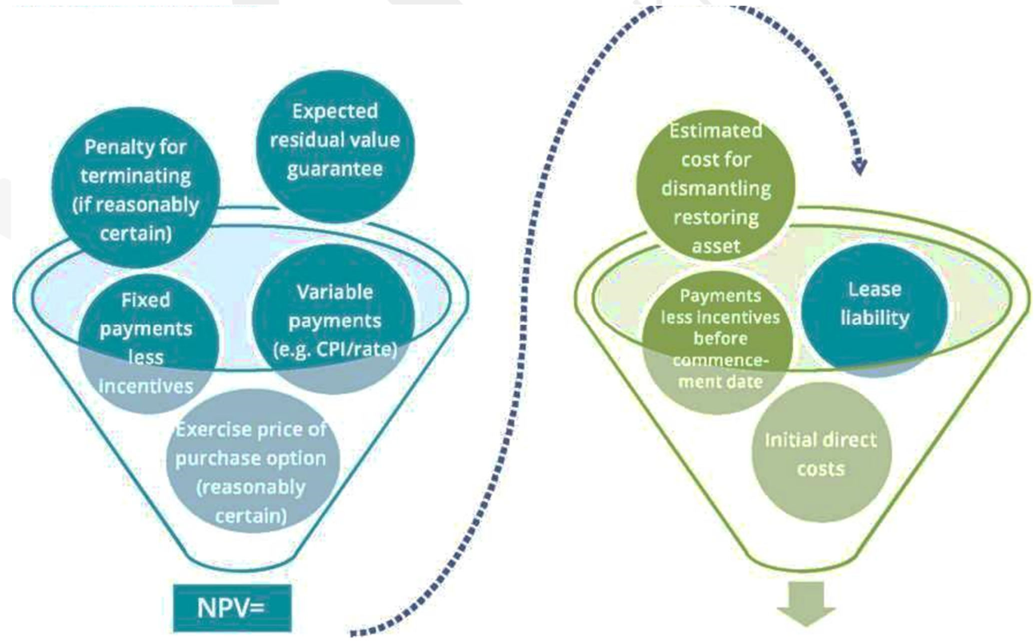
7.3.3. Legal title to the underlying asset

A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction. [IFRS 16:B45]

If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction accounted for by applying IFRS 16:98 to 103 (see section 10). [IFRS 16:B46]

However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. For example, this may be the case if a manufacturer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the manufacturer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease. [IFRS 16:B47]

7.4 Initial Measurement



Lease Liability **Right of use asset**

7.4.1. Initial measurement of the right-of-use asset

7.4.1.1. Right-of-use asset to be measured initially at cost

At the commencement date, the right-of-use asset should be measured at cost. [IFRS 16:23]

For this purpose, cost comprises:

[IFRS 16:24]

the amount of the initial measurement of the lease liability, as described in IFRS 16:26 (see 7.4.2);

a) any lease payments made at or before the commencement date (see 7.3.2), less any lease incentives received (see 6.4 for a definition of lease incentives);
b) any initial direct costs incurred by the lessee (see 7.4.1.2); and
c) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the asset during a particular period (see 7.4.1.3).

See example 7.6 for an illustration of the initial and subsequent measurement of a lessee's right-of-use asset and lease liability.

7.4.1.2. Initial direct costs

Initial direct costs are the "[i]ncremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease". [IFRS 16:AppendixA]

Initial direct costs are, typically, costs incurred in negotiating and securing lease arrangements. They exclude costs incurred by a lessee relating to the construction or design of an underlying asset (see 7.3.1).

7.4.1.3. Restoration costs

Under IFRS 16:24(d), the initial cost of a right-of-use asset includes an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. [IFRS 16:24(d)]

The costs described in IFRS 16:24(d) should be recognised as part of the cost of the right-of-use asset when the lessee incurs an obligation for those costs. The lessee should apply IAS 2 Inventories to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying IFRS 16 or IAS 2 are recognised and measured applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets. [IFRS 16:25]

At initial recognition, the estimated liability for such restoration costs is recognised as a provision under IAS 37 Provisions, Contingent Liabilities and Contingent Assets if an obligating event has already occurred. It is not included as part of the lease liability.

As a consequential amendment arising from IFRS 16, the scope of IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities has been amended to include restoration costs of this nature that are recognised as part of the cost of a right-of-use asset under IFRS 16:24(d). Therefore, any change in the entity's estimate of such costs after initial recognition should be accounted for in accordance with that Interpretation which, for right-of-use assets measured subsequent to initial recognition using a cost model, will result in such changes being added to, or deducted from, the cost of the right-of-use asset.

Sometimes lease contracts stipulate that the underlying asset must be returned to the lessor in the same condition as when originally leased. The appropriate accounting in such circumstances depends on the particular lease clause. For example, the underlying asset may suffer general wear and tear that is merely a result of being used. In such circumstances, it may be necessary gradually to build up a provision to repair or maintain the asset over the lease term, so that it can be returned to the lessor in its original condition. Generally, in these circumstances, it would be inappropriate to recognise a provision for all of the estimated maintenance costs at the outset of the lease. Conversely, other contracts may require specific work to be performed; for example, the contract may stipulate that the asset must be painted at the end of the lease before being returned to the lessor. In such circumstances, it may be appropriate to recognise a provision at the outset of the lease because, by signing the lease contract, the entity has committed itself to painting the asset, irrespective of any wear and tear suffered.

7.4.2. Initial measurement of the lease liability

7.4.2.1. Lease liability to be measured initially at the present value of unpaid lease payments

At the commencement date, the lease liability should be measured at the present value of the lease payments that are not paid at that date. [IFRS 16:26]

See section 6 for a discussion of the components of'lease payments'for the purposes of this measurement.

The liability may also be treated as 'debt' for some purposes, although this will depend on the particular circumstances.

7.4.2.2. Discount rate

The lease payments should be discounted using:

- the interest rate implicit in the lease; or
- if the interest rate implicit in the lease cannot be readily determined, the lessee's incremental borrowing rate.

The interest rate implicit in the lease is defined as the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor". [IFRS 16:Appendix A] The unguaranteed residual value is defined as"[t]hat portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor". [IFRS 16:Appendix A]

The lessee's incremental borrowing rate is defined as"[t]he rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment". [IFRS 16:Appendix A]

Thinking it through

In attempting to arrive at an appropriate discount rate, some lessees may decide to approach lessors in order to obtain greater insight into the pricing of contracts and returns being made by lessors. In some industries and for some lessors, this may not be sensitive information and the lessors may readily provide it. In other cases, lessors may be reluctant to divulge such information for commercial reasons and lessees will need to consider whether the implicit rate is readily determinable by other means, before resorting to the incremental borrowing rate.

7.5 Subsequent measurement

7.5.1. Subsequent measurement of the right-of-use asset

7.5.1.1. Subsequent measurement of the right-of-use asset - general

After the commencement date, the right-of-use asset should be measured using a cost model (see 7.5.1.2), unless it applies either of the measurement models described in IFRS 16:34 and 35 (see 7.5.1.5 and 7.5.1.6, respectively). [IFRS 16:29]

7.5.1.2. Cost model for right-of-use assets

Under the cost model, the right-of-use asset is measured at cost:

less any accumulated depreciation and any accumulated impairment losses (see 7.5.1.3 and 7.5.1.4, respectively); and

adjusted for any remeasurement of the lease liability specified in IFRS 16:36(c)(see 7.5.2.1).

7.5.1.3. Depreciation for right-of-use assets

Right-of-use assets measured under the cost model should be depreciated in accordance with the depreciation requirements in IAS 16, subject to the following:

- if the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the right-of-use asset should be depreciated from the commencement date to the end of the useful life of the underlying asset;
- otherwise, the right-of-use asset should be depreciated from the commencement date to the earlier of the end of the useful life of the right-of-use asset and the end of the lease term.

The useful life of an asset is defined as"[t]he period over which an asset is expected to be available for use by an entity; or the number of production or similar units expected to be obtained from an asset by an entity". [IFRS 16:AppendixA]

Therefore, if the ownership of the underlying asset transfers to the lessee at the end of the lease term, or it is reasonably certain that the lessee will exercise a purchase option, depreciation is based on the useful life of the underlying asset. Otherwise, depreciation is determined by reference to the useful life of the right-of-use asset (provided that is not longer than the lease term).

7.5.1.4. Impairment for right-of-use assets

A lessee should apply IAS 36 Impairment of Assets to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

7.5.1.5. Right-of-use assets that meet the definition of investment property

If a lessee applies the fair value model in IAS 40 Investment Property to its investment property, it is also required to apply that fair value model to right-of-use assets that meet the definition of investment property in IAS 40.

IFRS 16 has amended the scope of IAS 40 by defining investment property to include both owned investment property and investment property held by a lessee as a right-of-use asset. A lessee is required to account for right-of-use assets that meet the definition of investment property in a manner consistent with its policy for owned investment property - i.e. using either the cost model and disclosing fair value, or using the fair value model.

7.5.1.6. Right-of-use assets that relate to a class of revalued property, plant and equipment

If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Therefore, for property, plant and equipment:

- if the class of owned assets to which right-of-assets relate is measured using the cost model, the right-of-use assets should also be accounted for using the cost model; but
- if the class of assets to which right-of-use assets relate is measured using IAS 16's revaluation model, a lessee can chose whether to measure right-of-use assets at fair value. This choice is made on a class-by-class basis. This is in contrast to right-of-use assets that meet the definition of investment property for which the accounting model to be followed is determined by the lessee's accounting policy for owned investment property (see 7.5.1.5).

7.5.2. Subsequent measurement of the right-of-use liability

7.5.2.1. Subsequent measurement of the lease liability-general

After the commencement date, the lease liability should be measured by:

a) increasing the carrying amount to reflect interest on the lease liability;
b) reducing the carrying amount to reflect the lease payments made; and
c) remeasuring the carrying amount to reflect any reassessment or lease modifications specified in IFRS 16:39 to 46 (see 7.5.2.4), or to reflect revised in-substance fixed lease payments (see 6.3).

Lease liabilities are measured on an ongoing basis similarly to other financial liabilities, using an effective interest method, so that the carrying amount of the lease liability is measured on an amortised cost basis and the interest expense is allocated over the lease term. IFRS 16 does not require or permit a lessee to measure lease liabilities at fair value after initial measurement.

7.5.2.2. Recognising interest on the lease liability

Interest on the lease liability in each period during the lease term should be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. For this purposes, the periodic rate of interest is the discount rate used in the initial measurement of the lease liability (see 7.4.2.2) or, if applicable, the revised discount rate described in IFRS 16:41 or 43 (see 7.5.2.5 to 7.5.2.7) or IFRS 16:45(c) (see 7.7.3). [IFRS 16:37]

7.5.2.3. Amounts to be recognised in profit or loss

After the commencement date, a lessee should recognise in profit or loss (unless the costs are included in the carrying amount of another asset under other applicable IFRSs), both:

- interest on the lease liability; and
- variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs (see also 6.5.3).

Recognising an interest and depreciation expense under IFRS 16, rather than an operating expense for rentals paid under IAS 17, means that metrics such as EBITDA will increase compared to amounts reported when IAS 17 is applied. This may have a knock-on effect on an entity's KPIs, bonus targets, contingent consideration arrangements, lending covenants and more.

7.5.2.4. Remeasurement of the lease liability-general

After the commencement date, if changes to the lease payments occur, the lease liability should be remeasured in accordance with IFRS 16:40 to 43 (see 7.5.2.5 to 7.5.2.7J. The amount of the remeasurement of the lease liability should generally be recognised as an adjustment to the right-of-use asset (see 7.5.1.2). However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, the remaining remeasurement should be recognised in profit or loss.

7.5.2.5. Remeasurements arising from a change in the lease term or reassessment of purchase option

The lease liability should be remeasured by discounting the revised lease payments using a revised discount rate, if either:

- there is a change in the lease term (see 5.7 and 5.8), in which case the revised lease payments should be determined on the basis of the revised lease term; or
- there is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in IFRS 16:20 and 21 (see 5.7 and 5.8) in the context of a purchase option, in which case the revised lease payments should be determined to reflect the change in amounts payable under the purchase option.

In most cases, an entity should not reassess the discount rate during the lease term. However, IFRS 16 requires a lessee to remeasure the lease liability using revised payments and a revised discount rate when there is a change in the lease term or a change in the assessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset. In the IASB's view, in those circumstances, the economics of the lease have changed and it is appropriate to reassess the discount rate to be consistent with the change in the lease payments included in the measurement of the lease liability (and right-of-use asset).

In applying IFRS 16:40, the revised discount rate used should be:

- the interest rate implicit in the lease for the remainder of the lease term; or
- if the interest rate implicit in the lease cannot be readily determined, the lessee's incremental borrowing rate at the date of reassessment.

7.5.2.6. Remeasurements arising from a change in the amounts expected to be payable under a residual value guarantee

The lease liability should be remeasured by discounting the revised lease payments (i.e. reflecting the change in the residual value guarantee) using an unchanged discount rate, unless the change in the residual value guarantee results from a change in floating interest rates, in which case the lessee should use a revised discount rate that reflects changes in the interest rate.

7.5.2.7 Remeasurements arising from a change in future lease payments resulting from a change in an index or a rate

These requirements apply when there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments (including, for example, a change to reflect changes in market rental rates following a market rent review). In such circumstances, the lease liability should be remeasured to reflect those revised lease payments only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect - see example 7.5.2.7).

The IASB decided that a lessee should reassess variable lease payments that are determined by reference to an index or a rate only when there is a change in the cash flows resulting from a change in the reference index or rate. This approach is considered to be less complex and costly to apply than requiring a lessee to reassess variable lease payments at each reporting date.

The revised lease payments for the remainder of the lease term should be determined based on the revised contractual payments. They should be discounted using an unchanged discount rate, unless the change in the lease payments results from a change in floating interest rates, in which case the lessee should use a revised discount rate that reflects changes in the interest rate.

IFRS 16 generally does not permit an entity to reassess the discount rate during the lease term. An exception is made when there is a change in the lease term or a change in the assessment regarding a purchase option (see 7.5.2.5). The IASB also decided that, in a floating interest rate lease, a lessee should use a revised discount rate to remeasure the lease liability when there is a change in lease payments resulting from changes in the floating interest rate. This approach is consistent with the requirements in IFRS 9 Financial Instruments for the measurement of floating-rate financial liabilities subsequently measured at amortised cost.

Example 7.5.2.7

Remeasurements arising from a change in future lease payments resulting from a change in an index

On 1 January 20X1, Entity A leases a property for a lease term of 8 years. The lease payments for the first three years have been agreed at CU100 per year. The lease payments will be reset on 1 January 20X4 (and, subsequently, on 1 January 20X7) on the basis of the increase in the Retail Price Index (RPI) for the preceding three years. All lease payments are made at the end of the relevant year.

At 1 January 20X1 (the commencement date), the RPI is 100 and Entity A measures its lease liability at CU646(8 payments of CU100 payable in arrears, discounted at the interest rate implicit in the lease of 5 per cent).

On 1 January 20X2,20X3 and 20X4, respectively, the RPI is 103,107 and 108. On 1 January 20X7, the RPI is 113.

In its financial statements for the years ended 31 December 20X1,31 December 20X2 and 31 December 20X3, Entity A makes no adjustment for increases in RPI because there is no change in cash flows in those years. In its financial statements for year ended 31 December 20X4 (and subsequently 20X7), Entity A recalculates its liability based on the increased RPI. These adjustments are added to the carrying amount of the lease liability and the related right-of-use asset, subject to the requirements of IFRS 16:39 (see 7.5.2.4).

Year	Opening lease liability	Adjustment	Interest	Repayment	Closing lease liability
	cu	CU	CU	CU	CU
20X1	646	-	32	-100	578
20X2	578	-	29	-100	507
20X3	507	-	25	-100	432
20X4	432	35s	22	-108	381
20X5	381	-	19	-108	292
20X6	292	-	16	-108	200
20X7	200	9b	11	-113	107
20X8	107	-	6	-113	0

a) Difference between five remaining payments of CU100 discounted at 5 percent and five remaining payments of CU108 discounted at 5 per cent.

b) Difference between two remaining payments of CU108 discounted at 5 percent and two remaining payments of CU113 discounted at 5 per cent.

7.5.2.8. Foreign currency exchange

IFRS 16 does not provide specific requirements as to how a lessee should account for the effects of foreign currency exchange differences relating to lease liabilities that are denominated in a foreign currency. In line with other financial liabilities, a lessee's lease liability is a monetary item and consequently, if denominated in a foreign currency, is required to be remeasured using closing rates at the end of each reporting period applying IAS 21 The Effects of Changes in Foreign Exchange Rates. Such foreign exchange differences are recognised in profit in loss and not as an adjustment to the carrying amount of the right-of-use asset.

7.6 Illustrative example - lessee measurement

The following example, reproduced from the illustrative examples accompanying IFRS 16, illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 7.6

Measurement by a lessee and accounting for a change in the lease term

[IFRS 16:Illustrative example 13]

Part 1 - Initial measurement of the right-of-use asset and the lease liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000 and Lessee's leasehold improvements of CU7,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease Is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives lease incentives from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying IFRS 16. This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right-of-use asset.

Part 2 - Subsequent measurement and accounting for a change in the lease term

In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimise costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period - Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

		Lease liability				Right-of-use asset	
	Beginning balance	Lease payment	5% interest expense	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	CU	CU	CU	CU	CU	CU
1	355,391	-	17,770	373,161	420,391	(42,039)	378,352
2	373,161	(50,000)	16,158	339,319	378,352	(42,039)	336,313
3	339,319	(50,000)	14,466	303,785	336,313	(42,039)	294,274
4	303,785	(50,000)	12,689	266,474	294,274	(42,039)	252,235
5	266,474	(50,000)	10,823	227,297	252,235	(42,039)	210,196
6	227,297	(50,000)	8,865	186,162	210,196	(42,039)	168,157

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,I62 (the present value of four remaining payments of CU50.000, discounted at the original interest rate of 5 percent per annum). Interest expense of CU8,865 is recognised in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,I74. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognised as follows.

Right-of-use asset	CU192,012	
Lease liability		CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,I69 (ie CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

		Lease liability				Right-of-use asset	
	Beginning balance	Lease payment	5% interest expense	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	cu	CU	cu	cu	cu	cu
7	378,174	(50,000)	19,690	347,864	360,169	(40,019)	320,150
8	347,864	(50,000)	17,872	315,736	320,150	(40,019)	280,131
9	315,736	(50,000)	15,944	281,680	280,131	(40,019)	240,112
10	281,680	(50,000)	13,901	245,581	240,112	(40,019)	200,093
11	245,581	(55,000)	11,435	202,016	200,093	(40,019)	160,074
12	202,016	(55,000)	8,821	155,837	160,074	(40,019)	120,055
13	155,837	(55,000)	6,050	106,887	120,055	(40,019)	80,036
14	106,887	(55,000)	3,113	55,000	80,036	(40,018)	40,018
15	55,000	(55,000)	-	-	40,018	(40,018)	-

7.7. Lease modifications

7.7.1 Lease modification - definition

A'lease modification' is defined as “a change in the scope of a lease, or the consideration fora lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term)".

The 'effective date of the modification is “the date when both parties agree to a lease modification".

7.7.2 Conditions for treating a lease modification as a separate lease

A lease modification should be accounted for as a separate lease if both of the following apply:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and

- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

When the conditions in IFRS 16:44 are met, the modification is considered to result in the creation of a new lease that is separate from the original lease. [IFRS 16:BC202] The agreement for the right to use one or more additional assets is accounted for as a separate lease (or leases) to which the requirements of IFRS 16 are applied independently of the original lease.

The following example, reproduced from the illustrative examples accompanying IFRS 16, illustrates a modification that should be accounted for as a separate lease.

Example 7.7.2

Measurement by a lessee and accounting for a change in the lease term

[IFRS 16:Illustrative example 15]

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

7.7.3 Lease modifications that are not accounted for as a separate lease

For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification, the lessee should:

[IFRS 16:45]

a) allocate the consideration in the modified contract applying the requirements of IFRS 16:13 to 16 (see 4.2);
b) determine the lease term of the modified lease applying the requirements of IFRS 16:18 and 19 (see section 5); and
c) remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as:
   (i) the interest rate implicit in the lease for the remainder of the lease term; or
   (ii) if the interest rate implicit in the lease cannot be readily determined, the lessee's incremental borrowing rate at the effective date of the modification.

The lessee should account for the remeasurement of the lease liability as follows:

[IFRS 16:46]

a) for lease modifications that decrease the scope of the lease, by decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease. Any gain or loss relating to the partial or full termination of the lease should be recognised in profit or loss; and
b) for all other lease modifications, making a corresponding adjustment to the right-of-use asset.

For the lease modifications dealt with under IFRS 16:46(b), the original lease is not terminated because there is no decrease in scope. The lessee continues to have the right to use the underlying asset identified in the original lease. For lease modifications that increase the scope of a lease, the adjustment to the carrying amount of the right-of-use asset effectively represents the cost of the additional right of use acquired as a result of the modification. For lease modifications that change the consideration paid for a lease, the adjustment to the carrying amount of the right-of-use asset effectively represents a change in the cost of the right-of-use asset as a result of the modification. The use of a revised discount rate in remeasuring the lease liability reflects that, in modifying the lease, there is a change in the interest rate implicit in the lease (which the discount rate is intended to approximate).

Example 7.7.3A

Modification that increases the scope of the lease by extending the contractual lease term

[IFRS 16: Illustrative example 16]

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (ie CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's Incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 percent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of- use asset.

Example 7.7.3B

Modification that decreases the scope of the lease

[IFRS 16:Illustrative example 17]

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 percent per annum.

This equals CU129,884. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (ie 2,500 square metres corresponding to 50 per cent of the original right-of-use asset).

50 percent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309.

Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 - CU92,001 = CU13,308) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Example 7.7.3C

Modification that both increases and decreases the scope of the lease

[IFRS 16:Illustrative example 18]

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is CU150,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 percent per annum.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

		Lease liability				Right-of-use asset	
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
Year	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206
4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 percent per annum.

The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

Decrease in the lease term

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square metres of office space (ie a remaining three-year lease term rather than the original five-year lease term).

The remaining right-of-use asset for the original 2,000 square metres of office space is CU220,802 (ie CU368,004 ÷ 5 x 3 years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square metres of office space is CU267,301 (ie present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 (CU368,004 - CU220,802), and the carrying amount of the lease liability by CU153,935 (CU421,236 - CU267,301). Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU153,935 - CU147,202 = CU6,733) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease liability	CU153,935	
Right-of-use asset		CU147,202
Gain		CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 percent per annum, which is CU4,870 (CU267,301 - CU262,431), as an adjustment to the right-of-use asset.

Lease liability	CU4,870	
Right-of-use asset		CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in scope of CU131,216 (ie present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216	
Lease liability		CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

	Lease liability				Right-of-use asset		
	Beginning balance	**7% interest expense**	**Lease payment**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
Year	CU	CU	CU	CU	CU	CU	CU
6	393,647	27,556	(150,000)	271,203	347,148	(115,716)	231,432
7	271,203	18,984	(150,000)	140,187	231,432	(115,716)	115,716
8	140,187	9,813	(150,000)	-	115,716	(115,716)	-

Example 7.7.3D

Modification that is a change in consideration only

[IFRS 16:Illustrative example 19]

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's Incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

8. CLASSIFICATION OF LEASES BY LESSORS

8.1 Classification of leases - general

8.1.1. Each lease to be classified as either an operating lease or a finance lease

A lessor is required to classify each of its leases as either an operating lease or a finance lease.

The key distinction to be made by lessors in accounting for leases under IFRS 16 is whether the lease in question is either:

- a simple short-term hire arrangement (an operating lease), whereby rentals are dealt with in profit or loss with the only impact on the statement of financial position relating to the timing of payments; or
- in the nature of an arrangement for financing the acquisition of an asset (a finance lease), when the presentation in the financial statements will depart from the legal form of the transaction and be based on the economic substance (i.e. as if the underlying asset had been sold to the lessee).

8.1.2. Lease classification determined at the inception date

Lease classification is determined at the inception date and is reassessed only if there is a lease modification. [IFRS 16:66]

Changes in estimates (e.g. changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (e.g. default by the lessee), do not give rise to a new lease classification.

If a lease contract includes terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (e.g. a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease), for the purposes of classifying the lease, the effect of any such changes is deemed to have taken place at inception.

There may be a time lag between the inception date and the commencement date (see 5.3 for an explanation of both terms), and the amounts involved in the lease arrangement may change between the two - most commonly when the asset is being constructed and the final cost is not known at inception.

8.1.3. Classification of leases acquired in a business combination

When a group acquires a new subsidiary in a business combination, the classification of the subsidiary's leases in which it is the lessor is not reassessed at the date of the business combination for the purposes of the consolidated financial statements. The subsidiary's leases will be classified in the consolidated financial statements on the basis of their terms at original inception, and without regard to the remaining lease term from the acquisition date. Thus, in particular, if the acquiree has appropriately treated a lease as a finance lease, that lease will also be treated as a finance lease in the consolidated financial statements, even if the majority of the lease term has expired before the acquisition date.

8.2 Distinction between a finance lease and an operating lease

8.2.1. Finance lease - definition

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset to the lessee.

8.2.2. Operating lease - definition

An operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Nature of risks and rewards incidental to ownership

Based on the definitions in 8.2.1 and 8.2.2, the classification of leases for lessors under IFRS 16 is determined according to the extent to which the risks and rewards incidental to ownership of the underlying asset lie with the lessor or the lessee.

- The risks incidental to ownership include, but are not limited to, the possibility of losses from idle capacity or technological obsolescence, and of variations in the future economic benefits expected to flow to the entity due to changing economic conditions.
- The rewards incidental to ownership include, but are not limited to, an expectation of profitable operation over the underlying asset's economic life and of gain from appreciation in value or realisation of a residual value.

8.2.4. Classification to be determined based on the substance of the transaction

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.

8.3. Situations that will generally lead to finance lease classification

IFRS 16 gives examples of situations that, individually or in combination, would normally lead to a lease being classified as a finance lease. The indicators in IFRS 16:63 relate to transfer of title and other factors in the primary period of the lease and should be regarded as the primary indicators. IFRS 16:64 sets out additional indicators, which will sometimes be relevant. Primary indicators of a finance lease are:

[IFRS 16:63]

- the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;

A lease can be considered to transfer ownership of the underlying asset when transfer of legal title, and thus continued ownership of risks and rewards, is automatic either under the lease agreement or under a side agreement that forms part of the overall lease arrangement (e.g. when the lessor has entered into a separate forward sale agreement with the lessee). This condition will also be met, in substance, when the lessor has a put option requiring the lessee to acquire legal title, and the option is structured in such a manner that it is reasonably certain to be exercised by the lessor.

- the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception date, it is reasonably certain that the option will be exercised;

This condition extends that referred to in the previous bullet point to a lessee call option at a price that makes its exercise commercially likely to occur. An option to purchase at a low or nominal amount is a typical example of this type of arrangement.

- the lease term is for the major part of the economic life of the underlying asset, even if title is not transferred;

This condition covers the circumstances when substantially all the economic benefits of the underlying asset are consumed over the lease term during which the lessee controls the underlying asset. There is no specific threshold in IFRS 16 delineating the 'major part' of an asset's economic life and thresholds established by other GAAPs should not be considered definitive. Instead, it is necessary to consider the substance of a lease and to classify it according to whether the agreement transfers substantially all of the risks and rewards of ownership as discussed at 8.2.3.

Note that when renewal or purchase options exist, these should be assessed at the inception date (see 5.3) to determine whether it is reasonably certain that the option will be exercised. The lease term will include the further term when, at the inception date, exercise of the option is assessed to be reasonably certain.

- at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset;

This condition tests whether the lessor receives a full return of its initial investment. As with economic life, there is no specific threshold in IFRS 16 delineating what constitutes 'substantially all1 of the fair value of an underlying asset and thresholds established by other GAAPs should not be considered definitive. Instead, as discussed above, it is necessary to consider the substance of a lease and determine its classification based on whether the agreement transfers substantially all of the risks and rewards of ownership.

When the lease term has been extended by renewal or purchase options (as discussed in the previous point), the lease payments will include payments due with respect to this further term.

- the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.

When this condition is met, it is likely that the underlying asset will have been constructed to the lessee's specifications such that its market value is limited. It follows that the lessor will seek to recover its investment from the primary lease term.

Other indicators that, individually or in combination, could also lead to a lease being classified as a finance lease are:

- if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from fluctuations in the fair value of the residual accrue to the lessee (e.g. in the form of a rent rebate equalling most of the sales proceeds at the end of the lease);

If the lessee does not acquire legal title by the end of the lease, it may nevertheless bear the risk of variation in the residual value of the underlying asset; leases will commonly provide for a substantial fixed final rental (a 'balloon rental') followed by a repayment equal to all or substantially all of the sales proceeds from disposal of the underlying asset.

- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

A bargain renewal option exists when a lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent. The rent for a secondary period would be considered substantially lower than market rent if it would be economically rational for the lessee to continue the lease at that lower rent.

Rental for a secondary period either at a nominal amount or substantially below market rates suggests both that (1) the lessor has received the required return from its initial investment, and (2) that the lessee is likely to choose to enter into such a secondary period.

Although the factors set out above are intended to identify the key characteristics of a finance lease, they are not always conclusive.

IFRS 16 underlines the requirement to consider the whole of the arrangement, and the extent to which the risks and rewards incidental to ownership are transferred. Although a lease may appear to fall within the definition of a finance lease, having regard to the characteristics referred to above, there may be other features that demonstrate that the lease does not transfer substantially all of the risks and rewards incidental to ownership of the underlying asset. Byway of example, the Standard cites circumstances in which ownership of the asset transfers at the end of the lease, but in exchange for a variable payment equal to its then fair value. Similarly, if there are variable lease payments, as a result of which the lessee does not have substantially all of the risks and rewards incidental to ownership of the underlying asset, the lease will not be classified as a finance lease.

8.5 Leases of land and buildings

8.5.1. Requirement to assess the classification of land and buildings elements separately

When a lease includes both land and buildings elements, a lessor should assess the classification of each element as a finance or an operating lease separately. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.

Leases of land are assessed in the same way as all other leases. Land normally has an indefinite economic life, so it is unlikely that the lease term will be for the major part of the economic life of the asset. Nevertheless, some of the other characteristics described at maybe met, in which case a lease of land may be a finance lease. In particular, if, at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset, it is possible that a lease of land will be a finance lease. Note, however, that leases of land (and buildings) for long periods will often be subject to rent reviews, which may mean that the lessor has not transferred substantially all the risks and rewards incidental to ownership.

8.5.2. Splitting leases of land and buildings

Whenever necessary in order to classify and account for a lease of land and buildings, a lessor should allocate the lease payments (including any lump-sum up-front payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date.

If the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

One of the most common applications of the previous paragraphs is likely to be in legal jurisdictions where the ownership of property is held only via leasehold interests. Typically, the government retains ownership of all land, and leasehold interests in land and buildings are the only means of purchasing such assets. In these circumstances, because similar land and buildings are not sold or leased separately, it may not be possible to arrive at a meaningful allocation of the lease payments.

For a lease of land and buildings under which the amount for the land element is immaterial to the lease, IFRS 16 allows that the land and buildings may be treated as a single unit for the purpose of lease classification. In such cases, the economic life of the buildings is regarded as the economic life of the entire underlying asset. [IFRS 16:B57 & BCZ249]

8.6 Subleases

8.6.1. Subleases - classification

IFRS 16 requires an intermediate lessor to account for a head lease and a sublease as two separate contracts, applying both the lessee and lessor accounting requirements. This approach is considered to be appropriate because, in general each contract is negotiated separately, with the counterparty to the sublease being a different entity from the counterparty to the head lease. Accordingly, for an intermediate lessor, the obligations that arise from the head lease are generally not extinguished by the terms and conditions of the sublease. [IFRS 16:BC232]

In classifying a sublease, an intermediate lessor should classify the sublease as a finance lease or an operating lease as follows:

- if the head lease is a short-term lease that the entity, as a lessee, has accounted for applying IFRS 16:6 (see 7.2), the sublease should be classified as an operating lease;
- otherwise, the sublease should be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (e.g. the item of property, plant or equipment that is the subject of the lease).

In classifying a sublease by reference to the right-of-use asset arising from the head lease, an intermediate lessor will classify more subleases as finance leases than it would have done if those same subleases were classified by reference to the underlying asset.

The intermediate lessor only has a right to use the underlying asset for a period of time. If the sublease is for all of the remaining term of the head lease, the intermediate lessor has in effect transferred that right to another party. [IFRS 16:BC234]

The following examples, reproduced from the illustrative examples accompanying IFRS 16, illustrate the application of the requirements in IFRS 16 for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 8.6.1A

Sublease classified as a finance lease

[IFRS 16:Illustrative example 20]

Head lease - An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).

Sublease - At the beginning of Year 3, the intermediate lessor subleases the 5,000 square metres of office space for the remaining three years of the head lease to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in [IFRS 16:61 to 66],

When the intermediate lessor enters into the sublease, the intermediate lessor:

a) derecognises the right-of-use asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;
b) recognises any difference between the right-of-use asset and the net investment in the sublease in profit or loss; and
c) retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognises both finance income on the sublease and interest expense on the head lease.

Example 8.6.1 B

Sublease classified as an operating lease

[IFRS 16:Illustrative example 21]

Head lease - An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).

Sublease - At commencement of the head lease, the intermediate lessor subleases the 5,000 square metres of office space for two years to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in [IFRS 16:61 to 66],

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

During the term of the sublease, the intermediate lessor:

a) recognises a depreciation charge for the right-of-use asset and interest on the lease liability; and
b) recognises lease income from the sublease.

8.6.2. Subleases - presentation

IFRS 16 does not include requirements relating to the presentation of subleases. An intermediate lessor should not offset lease income and lease expenses relating to a head lease and a sublease of the same underlying asset, unless the requirements for offsetting in IAS 1 are met.

9. ACCOUNTING BY LESSORS

9.1 Accounting for finance leases by lessors

9.1.1. Recognition and measurement at the commencement date - general

9.1.1.1. Recognition and measurement-general

At the commencement date, a lessor should recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease.

Initially, the lessor will recognise a finance lease receivable under IFRS 16:67, at the amount equal to the net investment in the lease. Subsequently, finance income will be recognised at a constant rate on the net investment under IFRS 16:75 (see 11.3). During any'rent- free' period, this will result in the accrued finance income increasing the finance lease receivable.

9.1.1.2. Net investment in the lease - definition

The net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the sum of (1) lease payments receivable by the lessor under a finance lease, and (2) any unguaranteed residual value accruing to the lessor.

The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments, and (b)the unguaranteed residual to equal to the sum of (i) the fair value of the underlying asset, and (ii) any initial direct costs of the lessor.

If the lessor grants any incentives to the lessee, such as an initial rent-free period, then, at the inception of the lease, the calculation of the minimum lease payments and determination of the interest rate implicit in the lease will factor in nil payments by the lessee during such a rent-free period.

9.1.1.3. Initial direct costs

Initial direct costs are the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease".

For lessors (other than a manufacturer or dealer lessor), initial direct costs should be included in the initial measurement of the investment in the lease, and reduce the amount of income recognised over the lease term. The definition of the interest rate implicit in the lease set out at 9.1.1.2 results in such costs being included automatically in the finance lease receivable; there is no need to add them separately.

These costs should include only costs that are incremental, and that are directly attributable to negotiating and arranging a lease (e.g. commissions, legal fees and incremental internal costs). General overheads, such as costs of sales and marketing, are excluded.

If a lessor employs permanent staff to negotiate and arrange new leases, it is not appropriate for the salary costs of those staff to be included within the initial measurement of finance lease receivables.

Internal fixed costs do not qualify as incremental costs. Only those costs that would not have been incurred if the lease had not been obtained should be included in the initial measurement of the finance lease receivable.

9.1.1.4. Initial measurement of the lease payments included in the net investment in the lease

At the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

[IFRS 16:70]

- fixed payments (including in-substance fixed payments as described in IFRS 16:B42 - see 6.3), less any lease incentives payable;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (see 6.5.2);
- any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in IFRS 16:B37-see 6.6); and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

9.1.2. Recognition and measurement at the commencement date - manufacturer and dealer lessors

At the commencement date, a manufacturer or dealer lessor should recognise the following for each of its finance leases:

- revenue, which is the fair value of the underlying asset, or, if lower, the present value of the lease payments accruing to the lessor, discounted using a market rate of interest;
- the cost of sale, which is the cost (or carrying amount if different) of the underlying asset less the present value of the unguaranteed residual value; and
- selling profit or loss (which is the difference between revenue and the cost of sale) in accordance with its policy for outright sales to which IFRS 15 Revenue from Contracts with Customers applies. The selling profit or loss on a finance lease should be recognised at the commencement date, regardless of whether the lessor transfers the underlying asset as described in IFRS 15.

Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to profit or loss equivalent to the profit or loss resulting from an outright sale of the underlying asset, at normal selling prices, reflecting any applicable volume or trade discounts. [IFRS 16:72]

Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in a lessor recognising an excessive portion of the total income from the transaction at the commencement date. If artificially low rates of interest are quoted, the selling profit should be restricted to that which would apply if a market rate of interest were charged. [IFRS 16:73]

Costs incurred by a manufacturer or dealer lessor in connection with obtaining a finance lease should be recognised as an expense at the commencement date because they are mainly related to earning the manufacturer or dealer's selling profit. Such costs are excluded from the definition of initial direct costs (see 9.1.1.3) and, accordingly, are excluded from the net investment in the lease. [IFRS 16:74]

9.1.3 Subsequent measurement

9.1.3.1. Finance lease income recognised at a constant periodic rate of return on the net investment

The lessor recognises finance income over the lease term so as to reflect a constant periodic rate of return on its net investment in the finance lease. [IFRS 16:75] This is achieved by allocating the rentals (net of any charges for services etc.) received by the lessor between finance income to the lessor and repayment of the debtor balance.

9.1.3.2. Derecognition and impairment

The derecognition and impairment requirements of IFRS 9 Financial Instruments apply to a lessor's net investment in a lease. [IFRS 16:77]

Changes in unguaranteed residual values

9.1.3.4. Asset under a finance lease classified as held for sale

When an asset under a finance lease is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, it is accounted for in accordance with that Standard, [IFRS 16:78]

9.2 Accounting for operating leases by lessors

9.2.1. Recognition of lease income

Lease payments from operating leases should be recognised as income on a straight-line basis unless another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished. [IFRS 16:81]

Therefore, variable lease payments under operating leases, other than those that are dependent on an index or a rate, should not be estimated and included in the total lease payments to be recognised on a straight-line basis over the lease term; instead, they should be recognised as income in the period in which they are earned.

9.2.2 Costs incurred in earning lease income

Costs incurred in earning the lease income, including depreciation, are recognised as an expense. [IFRS 16:82]

9.2.3. Initial direct costs

When initial direct costs are incurred by lessors in obtaining an operating lease, these should be added to the carrying amount of the underlying asset and recognised as an expense over the lease term on the same basis as the lease income. [IFRS 16:83]

9.2.4. Depreciation of assets subject to operating leases

The depreciation of leased assets should be on a basis consistent with the lessor's normal depreciation policy for similar assets, and the depreciation expense should be calculated on the basis set out in IAS 16 Property Plant and Equipment or IAS 38 Intangible Assets, as appropriate.

9.2.5. Impairment of assets subject to operating leases

IAS 36 Impairment of Assets should be applied to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.

9.2.6. Accounting by manufacturer and dealer lessors

A manufacturer or dealer lessor should not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

9.2.7. Assets cease to be rented and become held for sale

Entities that, in the course of their ordinary activities, routinely sell items that they have held for rental to others are required to transfer those assets to inventories at their carrying amount when they cease to be rented and become held for sale.

9.2.9 Presentation of assets subject to operating leases

Lessors should present assets subject to operating leases in their statements of financial position according to the nature of the underlying asset.

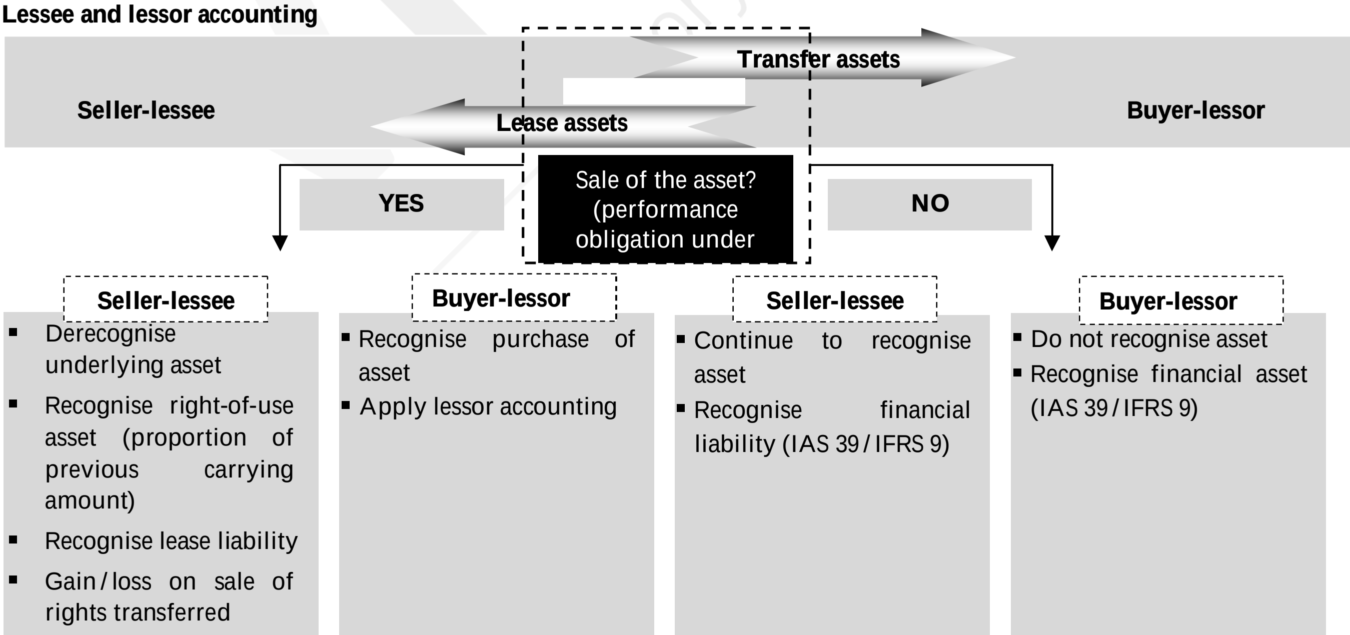
10 SALE AND LEASEBACK TRANSACTIONS

10.1 Sale and leaseback transactions - general

If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor are required to account for the transfer contract and the lease applying IFRS 16

Sale and leaseback

Lessee and lessor accounting



10.2 Assessing whether the transfer of the asset is a sale

An entity should apply the requirements for determining when a performance obligation is satisfied in IFRS 15 Revenue from Contracts with Customers to determine whether the transfer of an asset is accounted for as a sale of that asset.

10.3 Transfer of the asset is a sale

If the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset:

- the seller-lessee should measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee should recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor; and
- the buyer-lessor should account for the purchase of the asset applying applicable IFRSs, and for the lease applying the lessor accounting requirements in IFRS 16.

If either (1) the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or (2) the payments for the lease are not at market rates, the following adjustments are required to measure the sale proceeds at fair value:

[IFRS 16:101]

- any below-market terms should be accounted for as a prepayment of lease payments; and
- any above-market terms should be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

The following example, reproduced from the illustrative examples accompanying IFRS 16, illustrates the application forthe requirements in IFRS 16:99 to 102 for a seller-lessee and a buyer-lessor.

Example 10.3

Sale and leaseback transaction

[IFRS 16:Illustrative example 24]

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15 Revenue from Contracts with Customers. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 - CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Buyer-lessor classifies the lease of the building as an operating lease.

<u>Seller-lessee</u>

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) x CU1,259,200 (the discounted lease payments forthe 18-year right-of-use asset).

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 - CU1,000,000), of which:

a) CU559,645 (CU800,000 ÷ CU1,800,000 x CU1,259,200) relates to the right to use the building retained by Seller-lessee; and
b) CU240,355 (CU800,000 ÷ CU 1,800,000 x (CU1,800,000 - CU1,259,200)) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Financial liability		CU1,459,200
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset (18 payments of CU16,447, discounted at 4.5 per cent per annum)	CU200,000	
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue,

10.4 Transfer of the asset is not a sale

If the transfer of an asset by the seller-lessee does not satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset:

- the seller-lessee should continue to recognise the transferred asset and should recognise a financial liability equal to the transfer proceeds. It should account for the financial liability applying IFRS 9 Financial Instruments and
- the buyer-lessor should not recognise the transferred asset and should recognise a financial asset equal to the transfer proceeds.
  It should account for the financial asset applying IFRS 9.

In such circumstances, no sale is recognised by the seller-lessee and no purchase is recognised by the buyer-lessor. Instead, the seller- lessee and buyer-lessor are required to account for any amounts received or paid relating to the leaseback as a financial asset or a financial liability applying IFRS 9 (or IAS 39). This is because such a transaction represents, in substance, a financing arrangement.

APPENDIX 1

ILLUSTRATIVE EXAMPLES - IDENTIFICATION OF A LEASE

The illustrative examples accompanying IFRS 16 include 10 examples of how an entity determines whether a contract is, or contains, a lease. These examples are summarised in a tabular format below, in each case highlighting the key determinants as to whether the contract is, or contains, a lease. Please refer to the full text of the illustrative examples accompanying IFRS 16 for complete details in each case.

Example	Identified asset?	Substantive substitution rights?	Customer has a right to control the use of the identified asset?	Lease?
1A - Contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years.	Yes. Specific rails cars identified in contract.	No. Can only be substituted for repairs or maintenance.	Yes. Customer has exclusive use of rails cars during the contract period so that it has the right to substantially all of the economic benefits from use of the rail cars. Customer has the right to change how and for what purpose the cars are used - it directs when and where the ca rs are used, and which goods are transported. Supplier's rights (restrictions on specified types of cargo) are protective only. Supplier's control of engines required to transport the rail cars does not give it the right to control the use of the cars.	Yes - lease of rail cars (not engines).
1B - Contract between Customer and Supplier requires Supplier to transporta specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for five years.	No. Supplier has large pool of similar items and none are specified in the contract.	Yes. Alternatives are readily available at minimal cost. Supplier benefits economically by using its pool of available rolling stock in the most efficient manner.	No. Supplier selects which are used for each delivery and obtains substantially all of the economic benefits from use of the rail cars.	No. Customer is purchasing freight capacity (service).

2-Coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period.	No. Many areas available for Customer to locate its kiosk and none specified in the contract.	Yes. Alternatives are readily available at minimal cost. Supplier benefits economically by using its retail space in the most efficient manner.	No. Supplier selects which space is allocated to Customer and obtains substantially all of the economic benefits from use of the concession space.	No. Customer is purchasing space, which can be changed at the discretion of the supplier, and is a service.
3A - Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo.	Yes. Fibres are specifically identified in the contract and are physically distinct from other fibres within the cable.	No. Can only be substituted for repairs or maintenance.	Yes. Customer has exclusive use of fibres during the contract period so that it has the right to substantially all of the economic benefits from use. Customer has the right to change how and for what purpose the fibres are used - it decides when and whether the fibres are connected and the type and volume of data transported.	Yes - lease of specified fibres.
3B - Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo.	No. Customer is purchasing capacity, equivalent to its having the use of three fibres, but specific fibres are not identified. Capacity purchased is not physically distinct and does not represent substantially all the capacity of the cable.	Yes. Alternatives are readily available Supplier benefits economically by using fibres in the most efficient manner.	No. Supplier makes all of the relevant decisions and has the right to substantially all of the economic benefits from use of the fibres.	No. Customer is purchasing transmission capacity (service).
4 - Customer enters into a contract with a property owner (Supplier) to use Retail Unit A for a five-year period. Retail Unit A is part of a larger retail space with many retail units.	Yes. Specific retail unit identified in the contract.	No. Although Supplier has the practical ability to substitute another retail unit, it would be required to pay relocation expenses and the circumstances in which it would benefit economically (major new tenant) are, at the inception date, not considered likely to arise.	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the retail unit during the contract period (notwithstanding the requirement to make variable payments based on retail sales to the Supplier). Customer makes all of the relevant decisions regarding what to sell and prices. Supplier's inputs (cleaning, security, advertising) do not give it the right to decide how and for what purpose the retail space is used.	Yes - lease of specific retail unit.
5 - Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco.	Yes. Specific truck identified in the contract.	No.	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the truck during the contract period. Although how and for what purpose the truck is used is predetermined, Customer operates the truck and, therefore, has the right to direct the use of the truck (see 3.4.3.3).	Yes - lease of truck. Because the duration of the lease is one week, it is a short-term lease (see 7.2.2).

6A - Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship	Yes. Specific ship identified in the contract.	No	No. Customer occupies substantially all of the capacity of the ship and therefore has the right to substantially all of the economic benefits from use of the ship during the contract period. However, how and for what purpose the ship is used is predetermined and Supplier operates the ship. Therefore, Customer does not have the right to direct the use of the ship (see 3.4.3.3).	No. Customer is purchasing transport service.
6B - Customer enters into a contract with Supplier for the use of a specified ship for a five-year period.	Yes. Specific ship identified in the contract.	No	Yes. Customer occupies substantially all of the capacity of the ship and therefore has the right to substantially all of the economic benefits from use of the ship during the contract period. Customer makes the relevant decisions about whether, where and when the ship sails (subject to contractual restrictions designed to protect Supplier's investment and personnel). Although Supplier operates the ship, it is in accordance with Customer's decisions regarding how and for what purpose the ship is used.	Yes - lease of ship forthe contract period.
7 - Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.	Yes. Specific aircraft identified in the contract.	No. Although Supplier has the right to su bstitute another aircraft, the costs of outfitting any substitute to the standard specified in the contract mean that Supplier would not be expected to benefit economically from substitution.	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the aircraft during the contract period. Contractual and legal restrictions define the scope of Customer's right of use. Within that defined scope. Customer makes the relevant decisions about how and for what purpose the aircraft is used. Although Supplier operates the aircraft, it is in accordance with Customer's decisions regarding whether, where and when the aircraft travels.	Yes - lease of aircraft for the contract period.
- Customer enters into a contract with a manufacturer (Supplier) to purchase a particulartype, quality and quantity of shirts for a three-year period.	Yes. Factory implicitly specified because Supplier can fulfil the contract only through the use of its one factory.	No. No alternative factory available.	No. Customer does not have the right to obtain all of the economic benefits from use of the factory during the contract period because its output does not represent substantially all of the output of the factory and Supplier can use spare capacity to supply other customers. Also, Supplier directs the use of the factory (Customer has the same rights as other customers).	No. Customer is purchasing shirts (goods).
9A - A utility company (Customer) enters into a contract with a power company (Supplier) to purchase all of the	Yes. Specific solar farm identified in the contract.	No	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the solar farm during the contract period (Supplier's benefits in the form of tax	Yes - lease of solar farm for the contract period.

electricity produced by a new solar farm for 20 years.			credits are economic benefits from ownership rather than use). Although how and for what purpose the solar farm is used is predetermined. Customer's design of the farm has given it the right to direct the use of the farm (see 3.4.3.3).	
9B - Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years.	Yes. Specific power plant identified in the contract.	No	No. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the power plant during the contract period. However, how and for what purpose the plant is used is predetermined and Customer did not design the plant and Supplier operates the plant. Therefore, Customer does not have the right to direct the use of the plant (see 3.4.3.3).	No. Customer is purchasing a power supply (service).
9C - Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years.	Yes. Specific power plant identified in the contract.	No	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the power plant during the contract period. Customer makes the relevant decisions about how and for what purpose the plant is used. Although Supplier operates the plant, it is in accordance with Customer's decisions regarding the timing and quantity of power produced.	Yes - lease of power plant for the contract period.
10A - Customer enters into a contract with a tele-communications company (Supplier) for network services for two years.	Not considered	Not considered	No. Customer does not control the use of the servers. Supplier is the only party that can make relevant decisions about the servers during the period of use - it decides how data is transported using the services, whether to reconfigure the servers and whether to use the servers for another purpose.	No. Customer is purchasing network services.
10B - Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years.	Yes. Specific server identified in the contract.	No. Server can only be substituted if it malfunctions.	Yes. Customer has exclusive use and has the right to obtain all of the economic benefits from use of the server during the contract period. Customer makes the relevant decisions about how and for what purpose the server is used.	Yes - lease of the server for the contract period.

APPENDIX 2 - COMPARISON WITH US GAAP

The FASB issued its new leasing standard, ASU 2016-02, in February 2016. Although the IASB and the FASB started the initiative to improve the accounting for leases as a joint project, with the aim of producing a fully converged standard, in the end there are a number of differences in approach between IFRS 16 and ASU 2016-02, the most significant of which are highlighted in the table below.

	Key provision IFRS 16	ASU 2016-02
Scope	Scope includes leases of all assets (with specified exceptions. Also, lessees can elect to apply the guidance to leases of intangible assets	Scope includes leases of all property, plant, and equipment and excludes: ▪ leases of intangible assets; ▪ leases to explore for or use non-regenerative resources;

		▪ leases of biological assets; ▪ leases of inventory; and ▪ leases of assets under construction.
Leases of low- value assets	A lessee may recognise the payments on leases of low- value assets on a straight-line basis over the lease term. When the exemption is applied, such leases are not reflected on the lessee's balance sheet.	No equivalent exemption under US GAAP. However, the FASB believes that an entity will be able to adopt a reasonable capitalisation policy under which the entity will not recognise lease assets and liabilities that are below a certain threshold.
Lessee accounting model	All leases are 'on-balance sheet' (subject to exemptions for short-term leases and leases of low-value assets. No distinction between finance and operating leases. As of the lease commencement date, a lessee recognises: • a liability for its lease obligation (initially measured at the present value of the future lease payments not yet paid over the lease term) and • an asset for its right to use the underlying asset (equal to the lease liability, adjusted for lease payments made at or before lease commencement, lease incentives, and any initial direct costs). The lessee uses the effective interest rate method to subsequently account for the lease liability, and the right-of-use asset is generally amortised on a straight-line basis.	All leases are 'on-balance sheet' (subject to exemption for short-term leases). Distinction between finance (capital) and operating leases is retained. The accounting for finance leases is similar to the IFRS 16 approach. The right-of-use asset is generally amortised on a straight-line basis. This amortisation, when combined with the interest on the lease liability, results in a front-loaded expense profile in which interest and amortisation are presented separately in the income statement. For operating leases: • the lease liability is measured as under IFRS 16 but without a requirement to reassess variable lease payments; and • the lease expense is generally recognised on a straight- line basis and is presented as a single line item in the income statement.
Lessor accounting	Retains the current lessor accounting approach for operating and finance leases. A dealer's profit for a finance lease is recognised up-front without regard to the revenue guidance in IFRS 15.	Retains the current lessor accounting approach for operating and capital (direct financing and sales-type) leases. However, the lease classification criteria will change, and the treatment of dealer's profit, if any, will be affected as follows: • a dealer's profit is recognised up-front if the arrangement is a sales-type lease; and • a dealer's profit resulting from a direct financing lease, if any, is deferred and recognised as interest income over the lease term.
Subleases	The intermediate lessor is required to classify a sublease as either an operating lease or a finance lease by reference to the right-of-use asset arising from the head lease. ***(For example, classification may be affected by lease term)***	The intermediate lessor is required to classify a sublease by reference to the underlying asset of the head lease. ***(Classification may be affected by economic life of asset)***
Sale-and-leaseback arrangements	For transactions that qualify as a sale, the gain or loss recognised by a seller-lessee is limited to the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.	If the transaction qualifies as a sale, the entire gain on the transaction is recognised.

APPENDIX 3 - TRANSITION PROVISIONS

Lessees are permitted to choose between two transition approaches applied consistently to all leases, either the full retrospective approach or the modified retrospective approach.

RETROSPECTIVE APPLICATION OR MODIFIED APPROACH?

Option 1 - Retrospective

- Restate comparatives as if Ind IFRS 16 always applied

Option 2 — Modified (Do not change comparative FS)

- Difference between asset and liability recognized in opening RE at transition date.
- Operating leases:
  - ✓ Calculate present value of remaining lease payments for existing operating leases using incremental borrowing rate at date of transition
  - ✓ Choose how to measure ROU asset on lease-by lease basis:

Option 2 A –

- Measure asset as if IFRS 16 had been applied from lease commencement (but using incremental borrowing rate at date of transition)

Option 2B -

- Measure asset at amount equal to liability (adjusted for accruals and prepayments)

A lessor is not requited to make any adjustments on transition for leases in which it is a lessor and Shall account for those leases applying this Standard from the date of initial application except in the case of subleases.

APPENDIX 4 - KEY DISCLOSURES

In the books of lessees

All leases

Statement of financial position	• Carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset • Additions to right-of-use asset
Statement of profit and loss	• Depreciation charge for right-of-use assets by class of underlying asset, • Interest expense on lease liabilities • Variable lease payment not included in the lease liability measurement • Short-term lease expense for such leases with a lease term greater than one month • Low-value asset lease expense (except for portions related to short-term leases) • Income from subleasing right-of-use assets • Gains and losses arising from sale and leaseback transactions
Statement of cash flow	• Total cash out flow for teases
Other quantitative and qualitative information	▪ Maturity analysis of lease liabilities ▪ Amount of its lease commitments for short-term leases when short-term lease commitments at the end of the reporting period are dissimilar to same period's short-term lease expense ▪ The nature of the lessee's leasing activities ▪ Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities: ➢ Variable lease payments ➢ Extension options and termination options ➢ Residual value guarantees ➢ Leases not yet commenced to which the lessee is committed ▪ Restrictions or covenants imposed by leases ▪ Sale and leaseback transactions ▪ Facts of short term leases or teases of low- value assets

In the books of lessors

Finance Leases

SOFP	Significant changes in the carrying amount of the net investment in finance leases
Statement of profit and loss	• Finance income on the net investment in the lease • Income relating to variable lease payments not included in the measurement of the net investment in the lease • Selling profit or loss at the time of sale of assets under finance lease
Statement of cash flow	Total cash out flow for lease
Other quantitative and qualitative information	• Maturity analysis of lease payments receivable showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years • Reconciliation of the undiscounted lease payments to the net investment in the lease • The nature of the lessor's leasing activities • Risk management strategy for the rights it retains in the underlying assets. E.g., buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits
Operating leases	
Statement of profit and loss	Lease income Income relating to variable lease payments that do not depend on an index or a rate
Other quantitative and qualitative information	• Maturity analysis of lease payments receivable showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years • The nature of the lessor's leasing activities • Risk management strategy for the rights it retains in the underlying assets. E.g., buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits

APPENDIX 5 - SIGNIFICANT AREAS OF DIFFERENCES BETWEEN IFRS AND IND AS

S. No.	IFRS 16	IND AS 116
1. Investment property	If a lessee applies the fair value model for Investment properties in accordance with IAS 40, Investment properties, it shall apply the fair value model for right-of-use assets that meet the definition of investment property.	The option to subsequently carry right-of-use assets at fair value is not available.
2. Presentation in balance sheet	Right-of-use assets may be presented either separately or within the same line item within which the corresponding owned assets would be presented. Similar option is available for presentation of lease liability.	Right-of-use assets and lease liabilities shall be presented on the balance sheet or disclosed in the notes separately from other assets and other liabilities.
3. Presentation in statement of cash flows	Repayment of interest may be classified as either an operation or financing activity.	Interest payments are to be presented as a financing activity.

IFRS 6 — EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

1. INTRODUCTION

There can be three stages through which an entity may incur expenditures that are related to exploration for and evaluation of mineral resources.

This IFRS does not address accounting issues relatable to

(i) expenditures incurred before the exploration for and evaluation of mineral resources, or

(ii) other expenditures incurred after the technical feasibility and commercial viability of extracting a mineral resource is found to be demonstrable.

This IFRS recognises that a variety of accounting practices are being followed by entities in respect of expenditures that would fall under these two categories, and that, such accounting practices can be continued.

Consider the following table:

Stage 1 **Not covered by IFRS 6**	**Stage 2** **IFRS 6 should be applied**	**Stage 3** **Not covered by IFRS 6**
Expenditure prior to exploration and evaluation of mineral resources	Expenditure for exploration and evaluation of mineral resources	Expenditure incurred after technical feasibility and commercial viability of extracting mineral resources are demonstrable

Applicability of this IFRS is confined to Stage 2, that is, **expenditures exploration and evaluation expenditures that it incurs after the legal rights to explore a specific area has been obtained.**

The scope of coverage also includes expenditures incurred for evaluating the technical feasibility and commercial viability of extracting mineral resources.

The IFRS describes the scope of activity that can be construed as exploration for and evaluation of mineral resources. These are expenditures pertaining to Stage 2. These include,among others,

- **the search for mineral resource including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained**
- **legal rights to explore in a specific area,**
- **as well as the evaluation of the technical feasibility and commercial viability of extracting the mineral resource.**

2. DEFINITIONS

a. **EXPLORATION AND EVALUATION ASSETS** are exploration and evaluation expenditures recognised as assets in accordance with the entity's accounting policy.

b. **EXPLORATION AND EVALUATION EXPENDITURES** are expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

3. ACCOUNTING POLICY

It is mandatory for entities engaged in the exploration for and evaluation of mineral resources to develop and establish appropriate accounting policies in strict compliance with the requirements in Paragraph 10 of IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors), subject to compliance of all other provisions of IFRS 6 (e.g. recognition, measurement, etc explained later), the principles of selecting appropriate policies laid out in paragraphs 11 and 12 of IAS 8 are not applicable

In other words, in making judgements, it is not necessary for management to refer to the requirements and guidance in IFRSs dealing with similar and related issues, or to the definition, recognition criteria, etc. laid out in Framework, or to the most recent pronouncements of other standard setting bodies.

Other principles such as consistency in selection and application of accounting policies, and those governing changes in accounting policies as spelt out in the aforementioned IAS 8, shall nevertheless apply.

4. MEASUREMENT AT RECOGNITION

Exploration and Evaluation assets should be measured **at cost**

The accounting policy framed by an entity should address the criteria for differentiating between expenditures that can be recognised as assets, and other expenditures that are to be written off, or may be deferred.

The degree to which the expenditures can be associated finding specific mineral resources is the determining factor for recognition of expenditures as assets and others,

Examples indude

- acquisition of rights to explore
- exploratory drilling
- trenching
- sampling
- topographical, geological, geochemical and geophysical studies and
- activities in relation to evaluating the technical feasibilityand commercial viability of extracting a mineral resource.

5. RELEVANCE OF IAS 37 AND IAS 38 IN MEASUREMENT AT RECOGNITION

When an entity incurs expenditure that is attributable to development of mineral resources, it shall apply the principles laid out in IAS 38 (Intangible Assets), and those contained in the Framework.

As a corollary to undertaking exploration for and evaluation of mineral resources, when an entity is required to recognize the associated obligations for removal and restoration, principles laid down in IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' shall apply.

6. MEASUREMENT AFTER RECOGNITION

After recognition, an entity shall apply either the cost model or the revaluation model to the exploration and evaluation assets. If revaluation model is applied, it shall be consistent with the classification of assets as tangible or intangible.

7. PRESENTATION – CLASSIFICATION AND RECLASSIFICATION

The classification of exploration and evaluation assets shall be according to the nature of assets, either tangible (drilling rigs) or intangible (drilling rights) and shall be applied consistently.

Once the technical feasibility and commercial viability of extracting mineral resource are demonstrable, the exploration and evaluation assets cannot be classified as per this IFRS.

Therefore such assets shall be reclassified suitably and prior to such reclassification, the assets shall be assessed for impairment and any impairment loss is to recognized.

8. ACCOUNTING FOR EXPLORATION AND EVALUATION ASSETS AT A GLANCE

Recognise E&E Assets and measure at cost. Various items of costs are illustrated in Paragraph 9 of IFRS 6

↓

Classify E&E assets as tangible or intangible according to the nature.

↓

E&E assets are measured applying cost model or revaluation model. Revaluation model applicable to tangible asset should be consistent with IAS 16 and for intangible assets with IAS 38.

↓

E&E Assets are tested for impairment under Para-graphs 18-22 of IFRS 6

↓

Reclassification: E&E assets for which commercially-viable reserves have been identified are re-classified out of the Exploration and Evaluation category to Development Assets.

9. IMPAIRMENT

If the facts and circumstances indicate that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount, the assets shall be tested for impairment.

IAS 36 (Impairment of Assets) incorporates a few indicators (internal and external) that may point to the need for impairment testing.

IFRS 6 clarifies that in so far as exploration and evaluation assets are concerned, (rather than relying on IAS 36), reliance should be placed on the under-noted circumstances that indicate that an entity should test exploration and evaluation assets for impairment:

- The expiration of the life of right to explore.
- Substantive expenditures on further exploration for and evaluation of mineral sources exceeding the budget or plan.
- Discontinuance of exploration activities in the absence of commercial viability.
- The carrying amount of the asset is unlikely be recovered from successful development or by sale.

The entity shall measure, present and disclose any impairment loss in accordance with IAS 36.

The allocation of exploration and evaluation assets to cash generating units or group of units for impairment testing shall be as per entity's accounting policy. The CGU and group of units shall not be larger than an operating segment as per IFRS 8 'Operating Segments'.

10. DISCLOSURES

In the financial statements

- An entity shall treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either IAS 16 or IAS 38 consistent with how the assets are classified.

In the notes to accounts

- Its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets.
- The amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

PROBLEMS:

PROBLEM 1 :

CR Ltd. incurred legal expenditure of Rs 2 crores for acquiring land before obtaining the legal rights for exploration. What is appropriate accounting treatment of such legal expenditure?

SOLUTION : 1

PROBLEM 2 :

XYZ Ltd. has completed the activity of exploration and drilling of coal mine. It has also established the commercial viability of extracting coal. Can the subsequent expenditure be accounted for E&E asset under IFRS 6?

SOLUTION : 2

PROBLEM 3 :

Tactful Ltd. has incurred Rs 1.5 crores to increase the grade of coal which they have extracted from the mine. Can the expenditure to increase the grade be treated as E&E expenditure?

SOLUTION : 3

PROBLEM 4 :

ASF Ltd ventures into discovery of oil for which they took a land to explore the possibility of extracting oil:
It applied for acquiring rights and paid fees Rs. 40,000. Alia Bhat an expert in topography was hired at Rs. 75,000

- **Travelling expenses of Alia Bhat Rs 1,300 borne by the company**
- **Drilling work with machines paid Rs 30,000**
- **Digging trenches paid Rs 17,000**
- **Sampling: Rs 18,000**

After the first block of oil was extracted it was send to another site for evaluating the technical feasibility and commercial visibility of oil purity. Fees Rs. 50,000 and transport cost Rs. 2,000.

Calculate cost of exploration and evaluation costs of assets.

SOLUTION : 4

PROBLEM 5 :

ASF Ltd entity purchased a vehicle costing Rs 7,00,000 engaged in exploratory drilling of the mine.

- **Depreciation of vehicle Rs 40,000.**
- **Fuel consumed by vehicle Rs. 6,000.**
- **Drilling rig Rs. 5,00,000.**
- **Depreciation on rig Rs 75,000.**
- **Other drilling expenses Rs 1,15,000.**

Calculate TANGIBLE and intangible assets.

SOLUTION : 5

PROBLEM 6 :

PQ Gas Ltd. is engaged in exploration, production and refining of crude oil. The company has two exploration sites- Site A and Site B; the two sites form part of a single operating segment in accordance with Ind AS 108, Operating Segments.

The company has recently acquired rights to explore the two sites and has paid Rs 1 crore for permission from authorities, legal expense to acquire the land were Rs 20 crores. Consultation fee paid to a topographical expert was Rs 10 crores. Other expenses incurred by the company are digging trenches Rs 2 crores, sample testing Rs 30 crores, drilling expenses Rs 70 crores, present value of cost of dismantling the test drilling rig is Rs 30 crores, materials and fuel used Rs 3 crores, employee costs Rs 1.1 crores, administrative overheads Rs 0.5 crore, payments made to contractors Rs 2 crores, expenses paid to a consultant to determine the commercial viability of the extraction is Rs 1.5 crores.

Company has purchased two vehicles - Vehicle A and Vehicle B for each of the two sites, to transport persons engaged in exploratory drilling of mine amounting to Rs 4 crores.

During the year, there is a change in taxation rules, which has adversely affected the management estimate of future prices. The recoverable amount of the each site is as follows:

Site A: 60 crores

Site B : 40 crores

How should the above expenses incurred be accounted for in the books of PQ Gas Ltd. (including classification, measurement and recognition) assuming that the company accounts for evaluation and development expenditure is accounted for using the successful efforts method of accounting, and follows the cost model for subsequent measurement of E&E assets?

SOLUTION : 6

IFRS 1	FIRST-TIME ADOPTION OF IFRS

1. INTRODUCTION

This standard contains provisions for entities which comply with IFRS for the first time.

The transition should be facilitated from the existing standards through a smooth process where costs of complying should not exceed benefits. To facilitate this process, this standard is given.

2. SCOPE

An entity shall apply this IFRS in:

(a) its first IFRS financial statements; and

(b) each interim financial report, if any, that it presents in accordance with IAS 34 Interim Financial Reporting for part of the period covered by its first IFRS financial statements.

3. DEFINITIONS

Date of transition to IFRS: The beginning of the earliest comparative period for which an entity presents financial information under IFRSs in its first IFRS financial statements.

Deemed Cost: An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortization assumes that the entity had initially recognised an asset or a liability at the given date and that its cost was equal to the deemed cost.

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.

First IFRS financial statements: The first annual financial statements in which an entity adopts IFRS by an explicit and unreserved statement of compliance with IFRS.

First IFRS reporting period: The latest reporting period covered by an entity's first IFRS financial statements.

First-time adopter: An entity that presents its first IFRS financial statements

IFRS: Standards and Interpretations issued by the International Accounting Standards Board (IASB). They comprise:

(a) International Financial Reporting Standards;

(b) International Accounting Standards;

(c) IFRIC Interpretations; and

(d) SIC Interpretations.

Opening IFRS statement of financial position**:** An entity's statement of financial position at the date of transition to IFRS.

Previous GAAP: The basis of accounting that a first-time adopter used immediately before adopting IFRS.

4. OPENING STATEMENT OF FINANCIAL POSITION

The desired output out of the first-time adoption exercise is Opening Statement of financial position. The following paragraphs lead towards preparing such Statement of financial position:

An entity shall use the same accounting policies in its opening IFRS Statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the end of its first IFRS reporting period.

EXAMPLE:

Suppose. period ending 31.03.2021 is first IFRS reporting period.

An entity decides to adopt IFRS from this period and consequently prepares comparative financials and transition date statement of financial position.

Hence while preparing financial statements under IFRS 1 (first reporting period, comparatives and transition date), IFRS effective at the end i.e., 31.03.2021 should be applied for all transactions and balances.

Applying consistent accounting policies an entity in its opening financial statements:

- Recognises all assets and liabilities whose recognition is required by IFRS (example, derivative assets, etc).
- De-recognises items as assets or liabilities if IFRS do not permit such recognition (example, goodwill, discount on issue of shares, etc).
- Reclassifies items that are recognised in accordance with previous GAAPs (example, Investments, etc)
- Applies IFRSs in measuring all recognised assets and liabilities (fair value model for investment property, fair value of Share based payments, etc).

These resulting adjustments are treated as those arising from events and transactions before the date of transition to IFRS and are recognised as adjustments directly in retained earnings or any other appropriate category of equity.

5. MANDATORY EXCEPTIONS TO THE RETROSPECTIVE APPLICATION OF IFRSs

IFRS prohibits retrospective application of IFRSs in the following areas, i.e., should be applied only from the transition date:

1. Estimates
2. Derecognition of financial assets and financial liabilities
3. Hedge accounting

4. Non-controlling interests
5. Classification and measurement of financial assets and financial liabilities
6. Impairment of financial assets
7. Embedded derivatives
8. Government loans

6. ESTIMATES

Items involving estimates at the date of transition should be consistent with the estimates that were made under previous GAAP.

No hindsight information can be used for changing such estimates.

For example, an estimate for provision for expenses of Rs. 673,521 was made on the date of transition (assuming 31st March 2019/ 1st April 2019) to IFRSs under previous GAAP. Later (during year 2020-21) it was ascertained that such provision amounts only to Rs. 573,641 and the rest was reversed.

The provision under IFRS for the opening statement of financial position (as at 1st April 2019) should remain at Rs. 673,521 and the reversal should be in the subsequent period as in the previous GAAP.

However, if an estimate has to be made due to the application of IFRSs, such estimate should reflect the conditions that prevailed on the date of transition to IFRS.

7. DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

If a first time adopter derecognizes financial assets and liabilities in accordance with its previous GAAP, it shall not recognise those assets and liabilities in accordance with IFRSs unless they qualify for recognition as a result of a later transaction or event.

Derecognition principles should be applied prospectively from the date of transition to IFRS.

8. HEDGE ACCOUNTING

The Standard on Financial Instruments (Recognition and Measurement) stipulates conditions arid criteria to be met, for designating a hedged item and a hedging instrument in a hedge- relationship. Three important requirements are as under.

- The transactions entered into prior to transition date shall not be retrospectively designated as hedges.
- Where the transaction does not qualify for hedge accounting, in accordance with IFRS 9, it shall not be reflected in opening IFRS statement.
- If a net position had been designated as a hedged item under previous GAAP an entity may apply hedge accounting principles in accordance with IFRS to an individual item within that net position on the **date of transition.**
- In addition, as on transition date, an entity is required to measure all derivatives at fair value and all deferred losses and gains reported under previous GAAP as if they were assets and liabilities, should be eliminated.

9. NON-CONTROLLING INTERESTS

Certain requirements prescribed in the Standard on Consolidated and Separate Financial Statements are required to be applied prospectively from the transition-date.

These relate to presenting a statement of changes in equity, disclosing therein the share of changes in owner's equity also showing the share of non-controlling interests.

The following two requirements, if not done under previous GAAP, **should not be done on retrospective basis,**

(i) disclose non-controlling interest even if the share of non-controlling interest were to show a deficit balance, (ii) changes in ownership interests that do not result in loss of control (also that leads to loss of control).

These requirements of prospective application will not apply where an entity applies the principles of accounting for Business Combinations on a retrospective basis (prior to transition date). In such cases, entities shall follow retrospective application principles for presenting information in the statement of changes in equity.

10. CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Classification based on business purpose model and cash flow characteristic shall be done based on facts and circumstances on the date of transition.

Fair value of financial asset or financial liability to be carried at amortised cost shall be the amount determined on date of transition to IFRS.

11. IMPAIRMENT OF FINANCIAL ASSETS

At the date of transition to IFRSs, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised (or for loan commitments and financial guarantee contracts the date that the entity became a party to the irrevocable commitment) and compare that to the credit risk at the date of transition to IFRSs

If, at the date of transition to IFRSs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized.

12. EMBEDDED DERIVATIVES

Embedded derivatives is to be separated from host contract based on reassessment on the date of transition.

13. GOVERNMENT LOANS

If a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with IFRS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to IFRSs as the carrying amount of the loan in the opening IFRS statement of financial position.

An entity shall apply IFRS 9 to the measurement of such loans after the date of transition to IFRSs.

Only Government loans received after the date of transition shall be assessed to determine if it is liability or equity in accordance with IAS 32.

14. EXEMPTIONS FOR BUSINESS COMBINATIONS (IFRS 3)

A first time adopter need not (may or may not) apply the relevant principles, in respect of business combinations that took place prior to transition date. If the entity opts to apply IFRS 3, following parameters will apply:

- The Standard will not be applied selectively to some combinations. Nevertheless the entity can exercise a choice and select a cut-off date and apply uniformly and consistently the principles under IFRS 3 to the Business Combinations that occurred on and from the chosen cut-off date and shall also apply IFRS 10 from that same date. This prescription implies that, for Business Combinations that occurred before the date chosen by the entity, the Standard need not be applied.
- For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X6, it shall restate all business combinations that occurred between 30 June 20X6 and the date of transition to IFRSs, and it shall also apply IFRS 10 from 30 June 20X6.
- If under previous GAAP, goodwill is recognised as a deduction from equity, goodwill shall not be reinstated.
- The exemption for past business combinations also applies to past acquisitions of investments in associates, interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes a business, as defined in IFRS 3. Furthermore, the date selected for business combination applies equally for all such acquisitions.

15. EXEMPTIONS FROM OTHER IFRS

An entity may elect to use one or more of the following exemptions:

(a) share-based payment transactions;
(b) deemed cost;
(c) leases ;
(d) cumulative translation differences;
(e) investments in subsidiaries, joint ventures and associates;
(f) assets and liabilities of subsidiaries, associates and joint ventures;
(g) compound financial instruments;
(h) designation of previously recognised financial instruments;
(i) fair value measurement of financial assets or financial liabilities at initial recognition;
(j) decommissioning liabilities included in the cost of property, plant and equipment;
(k) financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements* ;
(l) borrowing costs;
(m) transfers of assets from customers ;
(n) extinguishing financial liabilities with equity instruments ;
(o) severe hyperinflation ;
(p) joint arrangements ;
(q) stripping costs in the production phase of a surface mine ;
(r) designation of contracts to buy or sell a non-financial item ;
(s) revenue ; and
(t) foreign currency transactions and advance consideration.

16. SHARE-BASED PAYMENTS

The Standard on Share-based payments requires that share options granted to, say employees, and should be accounted for by applying Fair Values to the instruments as on grant date.

A first-time adopter need not apply IFRS 2 for options that have vested prior to the date of transition. However disclosures required under IFRS 2 should be given for such grants

17. DEEMED COST - SURROGATE FOR COST

The standard provides two alternatives on the date of transition

(a)either the items of Property, Plant and Equipment shall be determined by applying IAS 16 'Property, Plant and Equipment' retrospectively, or

(b) to determine the fair value of assets and use such fair values as deemed cost on the date of transition.

Fair value should be determined on date of transition. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to IFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost in accordance with IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

If an entity has done any event-driven fair valuation at a previous date, fair value on that date can be taken as deemed cost and IAS 16 should be applied from that date to determine carrying amount on the date of transition.

This choice (and disclosure prescription) is also available for items classified as

- Investment Property measured under cost model in IAS 40,
- right-of-use assets (IFRS 16 *Leases*),
- Intangible Assets (IAS 38).

18. EXPLORATION AND EVALUATION ASSETS.

A first-time adopter may elect to measure oil and gas assets at the date of transition to IFRSs on the following basis:

(a) exploration and evaluation assets at the amount determined under the entity's previous GAAP; and

(b) assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP.

The entity shall test exploration and evaluation assets for impairment at the date of transition to IFRSs in accordance with IFRS 6 or IAS 36

19. EXCHANGE DIFFERENCES

In accounting for the effects of foreign exchange rates, the cumulative translation differences for all foreign operations can be deemed to be zero at the date of transition to IFRSs.

The gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRSs and shall include later translation differences.

20. COMPOUND FINANCIAL INSTRUMENTS

In accounting for financial instruments, it is a requirement under the corresponding standard that, where a financial instrument combines a liability element and an equity element (e.g. a debenture with convertible option in the hands of holder), the amounts of these two components (including tax-effect thereon) shall be presented separately.

However, in accordance with this IFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to IFRSs.

21. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JVs

When separate financial statements are prepared by an entity, investments are accounted either at

- cost or
- in accordance with IFRS 9
- using the equity method as described in IAS 28.

Cost may be cost as per IAS 27 or a deemed cost which can either be fair value on date of transition or previous GAAP carrying amount.

22. ASSETS AND LIABILITIES OF SUBSIDIARIES, ASSOCIATES AND JVs

The Standard envisages situations where the Subsidiary becomes first-time adopter later than the Parent (or where Parent becomes the first-time adopter later than the Subsidiary).

- **Parent transits to IFRS first:**

  In a situation where the Subsidiary becomes first-time adopter later than its Parent, the carrying amount of assets and liabilities would be either:

  ✓ carrying amounts that would be taken for the parent's Consolidated Financial Statements (CFS) duly adjusted for consolidation and effects of business combinations or

  ✓ carrying amount as required by other IFRSs, based on date of transition of the Subsidiary.

  This option is available in case of associate and joint venture also.

- **Subsidiary transits to IFRS first:**

  In case the Parent becomes first-time adopter later than its Subsidiary, the assets and liabilities of the Subsidiary shall be measured at the same carrying amounts as in Subsidiary's financials, except for adjustments required for consolidation and for business combination in which the parent had acquired the subsidiary.

23. SERVICE CONCESSION ARRANGEMENTS

A first-time adopter may apply the transitional provisions in IFRIC 12.

24. LEASES

A first-time adopter may assess whether a contract existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date.

25.DECOMMISSIONING LIABILITIES INCLUDED IN COST OF PROPERTY, PLANT AND EQUIPMENT

It is a requirement that in determining the cost of Property, Plant and Equipment, an entity is required to consider the obligations attributable to (i) decommissioning costs, (ii) restoration costs or (iii) similar costs, cash flow in respect of which is expected to occur at a subsequent date and not at the time of installation of the asset.

Where such costs are already included, it is also required to re-measure these costs, and changes in costs (liability) are to be accounted for by making adjustments to the cost of the relative asset, with a corollary prospective adjustment of depreciation charge.

A first-time adopter need not comply with this requirement of 'remeasurement of liability' that occurred before the date of transition.

If a first-time adopter uses this exemption, it shall measure the liability as at the date of transition to IFRSs in accordance with IAS 37;

26. INSURANCE CONTRACTS, TRANSFERS OF ASSETS FROM CUSTOMERS, EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY

These requirements shall be applied prospectively from the date of transition however, retrospective application is encouraged.

27. REVENUE FROM CONTRACT WITH CUSTOMERS

For completed contracts as on date of transition, IFRS 15 need not be applied. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with previous GAAP.

28. INTERIM FINANCIAL STATEMENTS

If an entity presents an interim financial report as per IAS 34 for part of the period covered by its first IFRS financial statements, it shall comply with the following requirements

a. A reconciliation of its equity in accordance with previous GAAP at the end of the interim comparable period under IFRS as on that date.

b. A reconciliation to its total comprehensive income in accordance with IFRS for that comparable interim period.

c. In addition, it shall also present the reconciliations required for its comparatives (As mentioned above)

29. PRESENTATION AND DISCLOSURE REQUIREMENTS IN THE FINANCIAL STATEMENTS

a. The first-time adopter is also required to present, statements of reconciliation, to disclose the movements in equity and comprehensive income. The disclosures would be in the nature of:

- Statement showing reconciliation of Equity as on transition date. This Statement should highlight each of the constituent elements that impact on equity due to transition from Previous GAAP to IFRS.
- A statement of reconciliation of total Comprehensive Income, specifying each of the constituent elements impacting income statement of the first reporting presented due to transition from Previous GAAP to IFRS (this is a disclosure relating to Profit and Loss).
- For interim financial reports, the above two reconciliations should be given for the part period and on a YTD basis

b. The first-time adopter's financial statements, should incorporate statement of financial position for three dates, i.e.,

- as on the Reporting Date,
- as on the comparative date on the immediately preceding reporting period, and
- as on the deemed transition date.

The transition date will be beginning of earliest comparative period.

The entity shall also present -

- two statements of profit or loss,
- two statements of cash flow, and
- related notes (reporting date and comparative period).

Also the comparative information should be given as per previous GAAP in addition to above requirements.

Example: An entity adopts IFRS for financial year ending 31st March 2021. Under this option, the entity will prepare opening statement of financial position as at 1st April 2019 (transition date), Statement of financial position, Statement of Profit or Loss, Cash flows and notes for year ending 31st March 2021 and 2020 as per IFRS and present comparative information for 31st March 2020 as per previous GAAP In addition, the first-time adopter is also required to present, statements of reconciliation, to disclose the movements in equity and comprehensive income.

- The above reconciliations should include explanations about the items forming part of reconciliation.

30. MAJOR CHANGES IN IND AS 101 VIS-A-VIS IFRS 1

RESULTING IN CARVE OUTS

(i) Definition of Previous GAAP under Ind AS 101

As per IFRS: IFRS 1 defines previous GAAP as the basis of accounting that a first-time adopter used immediately before adopting IFRS.

Carve out: Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its reporting requirement in India immediately before adopting IFRSs. The changes made it mandatory for Indian entities to consider the financial statements prepared in accordance with existing notified Accounting Standards as was applicable to them as previous GAAP when it transitions to IFRSs.

Reason: The change makes it mandatory for Indian companies to consider the financial statements prepared in accordance with existing Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 as previous GAAP when it transitions to IFRS as the law prevailing in India recognises the financial statements prepared in accordance with the Companies Act.

(ii) Allowing the use of Carrying Cost of Property, Plant and Equipment (PPE) on the Date of Transition of IFRS 101.

As per IFRS: IFRS 1 First time adoption of International Accounting Standards provides that on the date of transition either the items of Property, Plant and Equipment shall be determined by applying IAS 16 'Property, Plant and Equipment' retrospectively or the same should be recorded at fair value.

Carve out: Ind AS 101 provides an additional option to use carrying values of all items of property, plant and equipment on the date of transition in accordance with previous GAAP as an acceptable starting point under IFRS.

Reason: In case of old companies, retrospective application of Ind AS 16 or fair values at the date of transition to determine deemed cost may not be possible for old assets. Accordingly, Ind AS 101 provides relief to an entity to use carrying values of all items of property, plant and equipment on the date of transition in accordance with previous GAAP as an acceptable starting point under IFRS.

(iii) Long-term Foreign Currency Monetary Items As per IFRS: No provision in IFRS 1.

Carve out: Paragraph D13AA of Appendix D to IFRS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first IFRS financial reporting period as per the previous GAAP. Consequently, IFRS 21 also provides that it does not apply to long-term foreign currency monetary items for which an entity has opted for the exemption given in paragraph D13AA of Appendix D to IFRS 101. Such an entity may continue to apply the accounting policy so opted for such longterm foreign currency monetary items.

Reason: Para 46A of AS 11 provides an option to recognise long term foreign currency monetary items in the statement of profit and loss as a part of the cost of property, plant and equipment or to defer its recognition in the statement of profit and loss over the period of loan in case the loan is not related to acquisition of fixed assets. To provide transitional relief, such entities have been given an option to continue the capitalisation or deferment of exchange differences, as the case may be, on foreign currency borrowings obtained before the beginning of First IFRS reporting period.

(iv) Financial Assets or Intangible Assets accounted for in accordance with Appendix C, Service Concession Arrangements to IFRS 115, 'Revenue from Contracts with Customers'

As per IFRS: Paragraph D 22 of Appendix D to IFRS 1 provides that a first-time adopter may apply the transitional provisions in IFRIC 12 for account for financial assets or intangible assets.

Carve Out: Paragraph D 22 of Appendix D to Ind AS 101 provides that a first-time adopter may apply the following provisions while applying the Appendix C to Ind AS 115:

(a) Subject to paragraph (ii), changes in accounting policies are accounted for in accordance with IFRS 8, i.e. retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first IFRS financial reporting period as per the previous GAAP.

(b) If, for any particular service arrangement, it is impracticable for an operator to apply this Appendix retrospectively at the date of transition to IFRSs, it shall:

  (i) recognise financial assets and intangible assets that existed at the date of transition to IFRSs;

  (ii) use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and

  (iii) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.

(c) There are two aspects to retrospective determination: reclassification and remeasurement. It will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in an operator's Statement of financial position, but that retrospective re-measurement of service arrangement assets might not always be practicable. However, the fact should be disclosed.

As a consequence to the above, paragraph 7AA has been inserted in Ind AS 38 to scope out the entity, to apply amortisation method, that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in paragraph D22 of Appendix D to Ind AS 101.

Reason: Schedule II to the Companies Act, 2013, allows companies to use revenue based amortization of intangible assets arising from service concession arrangements related to toll roads while IAS 38, Intangible Assets, allows revenue based amortisation only in the circumstances in which the predominant limiting factor that is inherent in an intangible asset is the achievement of revenue threshold. In order to provide relief to such entities, IAS 38 and Ind AS 101 have been amended to allow the entities to continue to use the accounting policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first IFRS financial statements. In other words, IAS 38 would be applicable to the amortization of intangible assets arising from service concession arrangements related to toll roads entered into after the implementation of IFRS.

31. NOT RESULTING IN CARVE OUTS

1. **First Financial Statements:** Paragraph 3 of Ind AS 101 specifies that an entity's first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs in accordance with Ind ASs notified under the Companies Act, 2013 whereas IFRS 1 provides various examples of first IFRS financial statements.

2. **Examples when an Entity does not apply IFRS 1:** IFRS 1 provide various examples of instances when an entity does not apply this IFRS. IFRS 101 does not provide the same.
3. **Previous GAAP:** IFRS 1 requires the first-time adopter shall exclude from its opening IFRS Statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under IFRSs. The first-time adopter shall account for the resulting change in the retained earnings as at the transition date except in certain specific instances where it requires adjustment in the goodwill. In such specific instances where IFRS 1 allows adjustment in the goodwill, under Ind AS 101 it can be adjusted with the Capital Reserve to the extent such adjustment amount does not exceed the balance available in Capital Reserve.
4. **Optional Exemptions:** IFRS 1 provides for various optional exemptions that an entity can seek while an entity transitions to IFRS from its previous GAAP. Similar provisions have been retained under Ind AS 101. However, there are few changes that have been made, which can be broadly categorized as follows:
   (a) <u>Elimination of Effective Dates Prior to Transition Date to IFRSs:</u> IFRS 1 provides for various dates from which a standard could have been implemented. For example, Paragraph D2 of IFRS 1 provides that an entity is encouraged, but not required, to apply IFRS 2 'Share-based Payment' to equity instruments that were granted on or before 7 November 2002 or to instruments that were granted after 7 November 2002 and vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, for Ind AS 101 purposes, all these dates have been changed to coincide with the transition date elected by the entity adopting these converged standards i.e. Ind AS.
   (b) <u>Deletion of Borrowing Cost Exemptions not relevant for India:</u>Paragraph D23 of IFRS 1 provides for transitional adjustment requiring companies to apply the provisions of IAS 23 prospectively after the transition date to IFRS. IAS 23 provided an option to expense out such borrowing cost. However, this paragraph has not been included in Appendix D of Ind AS 101 since this was considered as not relevant in Indian situation as existing Accounting Standard 16 always required an entity to capitalize borrowing costs.
5. **Short-term Exemptions from IFRSs:** Appendix E of IFRS 1 provides for 'Short-term exemptions from IFRSs', however Ind AS 101 does not provide the above said short-term exemption.
6. **Optional Exemptions relating to the Long-term Foreign Currency Monetary Items and Service Concession Arrangements relating to Toll Roads:** Ind AS 101 in addition to exemptions provided under IFRS 1, also provides certain optional exemptions relating to the long-term foreign currency monetary items and service concession arrangements relating to toll roads.
7. **Business Combinations:** Under Ind AS 101, para C4(c) requires, the first-time adopter shall exclude from its opening IFRS Statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under Ind ASs. The first-time adopter shall account for the resulting change in the retained earnings as at the transition date except in certain specific instances where it requires adjustment in the goodwill.

In such specific instances where IFRS 1 allows adjustment in the goodwill, under Ind AS 101 it can be adjusted with the Capital reserve to the extent such adjustment amount does not exceed the balance available in Capital reserve.

CASE STUDY

QUESTION : 1

Case Study on Adjustments for opening SOFP Sheet as per IFRS

PARTICULARS	NOTES	PREVIOUS
PPE		13,450,000
Investment property		0
Investment in S Ltd		48,00,000
Total non-current assets		**1,82,50,000**
Debtors		2,00,000
Lease deposit		1,00,000
Advances for purchase of inventory		50,00,000
Inventory		7,00,000
Cash		49,000
Total current assets		60,49,000
Total assets		**2,42,99,000**
Equity and liabilities		
Share capital		1,30,00,000
Reserve:		2,99,000
Cumulative translation reserve	4	1,00,000
ESOP reserves	4	20,000
Retained earnings		1,79,000
Total equity		**1,32,99,000**
Sales tax deferral loan	3	60,00,000
Unearned government grant	3	0
Creditors		30,00,000
Short-term borrowing		8,00,000
Provisions		12,00,000
Total current liabilities		**1,10,00,000**
Total equity and liabilities		**2,42,99,000**

Notes:

1. **Fixed assets include** land held for the capital appreciation purposes Rs 4,50,000.
2. **Investment in subsidiary:** Fair value of the investment in subsidiary as on date of transition is Rs 68,00,000.
3. **Lease deposit :** The lease is a cancellable lease and the lease deposit is considered as repayable on demand.
4. **Sales tax deferral loan** of Rs 60,00,000 is payable at the end of the 5th year. The PV is Rs. 37,25,528
5. **ESOP :** As per previous GAAP 1,000 ESOPs were granted and 800 was already vested as on transition date and 200 options were not vested as on transition date.

   The fair value of such options not vested as on transition date in accordance with IFRS 2 will result in an additional ESOP charge of Rs 1,000.
6. **Cumulative exchange differences** recognised in FCTR as per previous GAAP is Rs 1,00,000 (Gain)

SOLUTION : 1

SOFP as per IFRS

PARTICULARS	NOTES	PREVIOUS GAAP	ADJUSTMENT	IFRS
Fixed assets	1			
Investment property				
Investment in S Ltd	2			
Total non-current assets				
Debtors				
Lease deposit	3			
Advances for purchase of inventory				
Inventory				
Cash				
Total CURRENT ASSETS				
Total assets				
Equity and liabilities				
Share capital				
Reserve:				
Cumulative translation reserve	6			
ESOP,reserves	5			
Retained earnings				
Total equity				
Sales tax deferral loan	4			
Unearned government grant	4			
Creditors				
Short-term borrowing				
Provisions				
Total current liabilities				
Total equity and liabilities				

Notes:

1. PPE :

As the land held for the capital appreciation purposes shall qualify as investment property, such investment property shall be reclassified from PPE and presented separately.

As the company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property shall be carried at its previous GAAP carrying values. As such, the past capitalised exchange differences require no adjustment in this case.

2. Investment in subsidiary:

On first time adoption of IFRS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the company can recognise such investment at a value of Rs 68,00,000.

3. Financial instruments:

As the lease is cancellable, the lease deposit is considered as repayable on demand. As such, no adjustment is required for discounting the deposit for the time value of money.

As the sales tax deferral loan is a financial liability under IFRS 9, that liability shall be recognised at its present value discounted at an appropriate discounting factor. Consequently, the sales tax deferral loan shall be recognised at Rs 37,25,528 and the remaining Rs 22,74,472 would be recognised as unearned government grant.

4. ESOP:

IFRS 1 provides an exemption of not restating the accounting as per previous GAAP in accordance with Ind IFRS 1 for all options that have vested by the transition date. Accordingly, out of 1,000 ESOPs granted, the first-time adoption exemption is available on 800 options that already vested. As such, its accounting need not be restated.

However, the 200 options that are not vested as at the transition date need to be vested in accordance with IFRS 2, As such, the additional impact of Rs 1,000 (ie, 9,000 less 8,000) would be recognised in the opening IFRS SOFP.

5. Cumulative transaction differences (CTR)

IFRS 1 provides an option to the first-time adopter to reset the carrying value of CTR as at the transition date to zero and transfer the balance in retained earnings. As such the balance of Rs 1,00,000 shall be transferred to retained earnings.

6. **Retained earnings as on date of transition to IFRS**

Retained earnings as per previous GAAP	179,000	
Increase in fair value of investments		20,00,000
Additional ESOP charge		(1,000)
Transfer of cumulative exchange differences opening balance		1,00,000
Closing balance of retained earnings		**22,78,000**

SIGNIFICANT DIFFERENCES BETWEEN IFRS AND US GAAP

1. INTRODUCTION

International Financial Reporting Standard (IFRS) is currently accepted worldwide as a global standard. More than 120 countries worldwide have either adopted IFRS or converged towards IFRS. These countries currently require or permit the use of IFRS in the preparation of financial statements of the entities.

Most of the world's more significant capital markets now require IFRS, or some form thereof, for financial statements of public-interest entities. Major capital markets without an IFRS mandate are:

- ✓ The US, with no current plans to change for domestic registrants (full IFRS allowed for non- US filers);
- ✓ Japan, where voluntary adoption is allowed, but no mandatory transition date has been established;
- ✓ India, which began its multi-year rollout of Indian Accounting Standards for domestic companies that are based on and significantly converged with IFRS (full IFRS allowed for non-Indian companies whose securities trade in a public market); and
- ✓ China, which has indicated that it intends to fully converge at some undefined future date.

While use of IFRS in the US by public companies will not be required in the foreseeable future, IFRS remains or is becoming increasingly relevant to many US businesses. Companies will be affected by IFRS at different times and to a different degree, depending on factors such as size, industry, geographic makeup, mergers and acquisition activity and global expansion plans.

There are currently approximately 500 non-US filers with market capitalization in the multiple of trillions of US dollars that use IFRS without reconciliation to US GAAP. Foreign private issuers operating in US, file their financial statements based on IFRS to the Securities and Exchange Commission (SEC) of the US. SEC accepts the same. However, public entities in the United States are required to apply U.S. GAAP in the preparation of their financial statements.

Before discussing the significant differences between IFRS and US GAAP, it is necessary to understand US GAAP and its issuing body.

2. FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)

The **Financial Accounting Standards Board** (FASB) is a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles in the United States (US GAAP). The FASB's mission for the private sector is similar to that of the Governmental Accounting Standards Board (GASB) for local and state governments in the United States. The FASB was created in 1973, replacing the Accounting Principles Board of the American Institute of Certified Public Accountants (AICPA). The FASB's mission is "to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information."

The US Securities and Exchange Commission (SEC) has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. The SEC designated the FASB as the organization responsible for setting accounting standards for public companies in the US.

3. US GAAP AND ITS HISTORY

Generally Accepted Accounting Principles (GAAP) refers to accounting policies and procedures that are widely used in practice. Unlike India where accounting has its basis in law, US GAAP has evolved to be a collection of pronouncements issued by various accounting organisations. US GAAP are the accounting rules used to prepare financial statements for publicly traded companies and many private companies in the United States. GAAP for local and state governments operate under a different set of assumptions, principles and constraints, as determined by the GASB.

In the United States as well as in other countries practicing under the English common law system, the government does not set accounting standards, in the belief that the private sector has better knowledge and resources. The SEC has the ultimate authority to set US accounting and financial reporting standards for public (listed) companies. The SEC has delegated this responsibility to the private sector led by the FASB. Other private sector bodies including the American Institute of Certified Public Accountants (AICPA) and the FASB's Emerging Issues Task Force (EITF) also establish authoritative accounting standards in the United States. Interpretations of the Financial Accounting Standard Board (FIN) also provide implementation and interpretation guidance. The SEC has the statutory authority to establish GAAP for filings made with it. While allowing most of the standard settings to be done in the private sector, the SEC is still very active in both its oversight responsibility as well as establishing guidance and interpretations, as it believes appropriate. USGAAP have the reputation around the world of being more descriptive and detailed than accounting standards in other countries. Earlier a GAAP hierarchy had been established which contained four categories of accounting principles. The sources in the higher category carried more weight and were followed when conflicts arise. The table given below summarises the previously followed (before mid-2009) GAAP hierarchy for financial statements of non- governmental entities.

PREVIOUSLY ESTABLISHED ACCOUNTING PRINCIPLES IN THE US

Category (a)	Financial Accounting Standards Board (FASB) Statements and Interpretations, American Institute of Certified Public Accountants (AICPA), Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins (ARB).

Category (b)	FASB Technical Bulletins, cleared AICPA Industry Audit and Accounting Guides, and cleared AICPA Statement of Position (SOPs).
Category (c)	Consensus positions of the FASB Emerging Issues Task Force (EITF) and cleared Accounting Standards Executive Committee of the AICPA (AcSEC) Practice Bulletins.
Category (d)	AICPA Accounting Interpretations, FASB Implementation Guides (QSAs), and widely recognised and prevalent industry practices.
Category Other Accounting Literature	Other accounting literature, including FASB concepts statements, APB Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; Pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles.

4. ACCOUNTING STANDARDS CODIFICATION (ASC)

FASB completed its project to codify GAAP in 2009. At that time, all existing GAAP literature was officially withdrawn. Beginning 1 July 2009, all codified GAAP was placed in a single level of the hierarchy (the second, lower level contains what formerly was defined as category e, consisting of scholarly writings, texts and guides by private-sector authors, guidance by other relevant bodies, and so forth), so the formerly important distinctions among categories a-d were eliminated.

According to FASB, this system should reduce the amount of time and effort required to solve an accounting research issue; mitigate the risk of non-compliance with standards through improved usability of the literature; provide accurate information with real-time updates as new standards are released; and assist the FASB with the research and convergence efforts required during the standard setting process.

Hence, effective from 1 July 2009, the FASB reorganised its standards into the FASB Accounting Standards Codification (ASC). ASC is an online research system representing the single source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB and applied by non-governmental entities. Rules and interpretive releases of the SEC under authority of Federal Securities laws are also sources of authoritative GAAP for SEC registrants. In addition to it, the SEC staff issues Staff Accounting Bulletins that represent practices followed by the staff in administering SEC disclosure requirements and it utilizes Staff Announcements and observer comments made at Emerging Issues Task Force meetings to publicly announce its views on certain accounting issues for SEC registrants.

Further, if the guidance for a transaction or event is not specified within a source of authoritative GAAP for that entity, an entity shall first consider accounting principles for similar transactions or events within a source of authoritative GAAP for that entity and then consider non-authoritative guidance from other sources. An entity shall not follow the accounting treatment specified in accounting guidance for similar transactions or events in cases in which those accounting principles either prohibit the application of the accounting treatment to the particular transaction or event or indicate that the accounting treatment should not be applied by analogy.

5. UNDERSTANDING OF GAAP CODIFICATION

To increase the utility of the Codification for public companies, relevant portions of authoritative content issued by the SEC and selected SEC staff interpretations and administrative guidance are being included for reference in the Codification. The sources include Regulation S-X, Financial Reporting Releases (FRR) / Accounting Series Releases (ASR), Interpretive Releases (IR), and SEC staff guidance in Staff Accounting Bulletins (SAB), EITF Topic D, and SEC Staff Observer comments. The Codification does not, however, incorporate the entire population of SEC rules, regulations, interpretive releases, and staff guidance, such as content related to matters outside of the basic financial statements, including Management's Discussion and Analysis (MD&A), or to auditing or independence matters.

Researching GAAP demands familiarity with, and access to, the ASC issued by FASB. Understanding the structure of the Codification is of great importance to all who have a need to understand GAAP and to research and apply GAAP to specific facts and circumstances.

The Codification content is arranged within Topics, Subtopics, Sections, and Subsections. All accountants should quickly develop a facility to navigate through this material.

Topics represent a collection of related guidance. Topics reside in four main areas as follows:

1. Presentation - Topics relating only to presentation matters; they do not address recognition, measurement, and derecognition matters. Examples of these topics are income statement, balance sheet, and earnings per share.
2. Financial Statement Accounts - The Codification organizes topics into a 'financial statement order, including assets, liabilities, equity, revenue, and expenses. Topics include, for example, receivables, revenue recognition, and inventory.
3. Broad Transactions - These topics relate to multiple financial statement accounts and are generally transaction-oriented. Topics include, for example, business combinations, derivatives, and non-monetary transactions.
4. Industries - These topics relate to accounting that is unique to an industry or type of activity. Topics include, for example, airlines, health care, and real estate.

Sub-topics represent subsets of a topic and are typically identified by type or by scope. For example, operating leases and capital leases are two separate subtopics of the leases topic, distinguished by type of lease. Each topic contains an overall subtopic that generally represents the pervasive guidance for the topic, which includes guidance that applies to all other subtopics. Each additional subtopic represents incremental or unique guidance not contained in the overall subtopic.

Sections represent the nature of the content in a subtopic - for example, recognition, measurement, and disclosure. The sectional organization for all subtopics is the same. In a manner similar to that used for topics, sections correlate closely with sections of individual International Accounting Standards.

Sections are further broken down into subsections, paragraphs, and subparagraphs, depending on the specific content of each section.

FASB has developed a classification system specifically for the Codification. The following is the structure of the classifications system: XXX-YY-ZZ-PP, where XXX = topic, YY = subtopic, ZZ = section and PP = paragraph. An "S" preceding the section number denotes SEC guidance.

Standards are composed of two items: the standard (similar to existing standards with a Basis for Conclusions) and an appendix of Codification Update instructions. The title of the combined set of standard and instructions will be Codification Update YYXX, where YY is the last two digits of the year and XX is the sequential number for each update.

6. COMPONENTS OF FINANCIAL STATEMENTS AS PER US GAAP

A full set of financial statements for a period shall comprise of the following:

a. Financial position at the end of the period
b. Earnings (net income) for the period, (which may be presented as a separate statement or within a continuous statement of comprehensive income)
c. Comprehensive income (total non-owner changes in equity) for the period in one statement or two separate but consecutive statements (if the reporting entity is required to report comprehensive income)
d. Cash flows during the period
e. Investments by and distributions to owners during the period.

In any one year it is ordinarily desirable that the statement of financial position, the income statement, and the statement of changes in equity be presented for one or more preceding years, as well as for the current year.

Prior-year figures shown for comparative purposes shall in fact be comparable with those shown for the most recent period. Any exceptions to comparability shall be clearly brought out.

Notes to financial statements, explanations, and accountants' reports containing qualifications that appeared on the statements for the preceding years shall be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance.

The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the entity. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period.

Hope the structure and hierarchy of the US GAAP is clear from the above paragraphs. Let us now discuss, the comparison between US GAAP and IFRS, which will help the students to grasp some of the major differences between IFRS and US GAAP.

More emphasis is placed on recognition, measurement, and presentation guidelines, and less emphasis is placed on disclosure requirements.

The comparison includes standards issued as of April 1, 2017. Further, this chapter list outs the differences between IFRS and US GAAP that are considered to be significant.

7. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND US GAAP

7.1 First Time Adoption

IFRS 1, First-Time Adoption of International Financial Reporting Standards, is the standard that is applied during preparation of a company's first IFRS-based financial statements. IFRS 1 was created to help companies transition to IFRS and provides practical accommodations intended to make first-time adoption cost-effective. It also provides application guidance for addressing difficult conversion topics. The key principle of IFRS 1 is full retrospective application of all IFRS standards that are effective as of the closing balance sheet or reporting date of the first IFRS financial statements. Full retrospective adoption can be very challenging and burdensome. To ease this burden, IFRS 1 gives certain optional exemptions and certain mandatory exceptions from retrospective application. The transition to IFRS can be a long and complicated process with many technical and accounting challenges to consider. Experience with conversions in Europe and Asia indicates there are some challenges that are consistently underestimated by companies making the change to IFRS, including:

- ✓ **Consideration of data gaps** — Preparation of the opening IFRS balance sheet may require the calculation or collection of information that was not previously required under US GAAP. Companies should plan their transition and identify the differences between IFRS and US GAAP early so that all of the information required can be collected and verified in a timely manner. Likewise, companies should identify differences between local regulatory requirements and IFRS. This could impact the amount of information-gathering necessary. For example, certain information required by the SEC but not by IFRS (e.g., a summary of historical data) can still be presented, in part, under US GAAP but must be clearly labeled as such, and the nature of the main adjustments to comply with IFRS must be discussed. Other incremental information required by a regulator might need to be presented in accordance with IFRS. For example, the SEC in certain instances requires two years of comparative IFRS financial statements, whereas IFRS would require only one.
- ✓ **Consolidation of additional entities**—IFRS consolidation principles differ from those of US GAAP in certain respects and those differences might cause some companies either to deconsolidate entities or to consolidate entities that were not consolidated under US GAAP. Subsidiaries that previously were excluded from the consolidated financial statements may be required to be consolidated as if they were first-time adopters on the same date as the parent. Companies also will have to consider the potential data gaps of investees to comply with IFRS informational and disclosure requirements.

- ✓ **Consideration of accounting policy choices**—a number of IFRS standards allow companies to choose between alternative policies. Companies should select carefully the accounting policies to be applied to the opening balance sheet and have a full understanding of the implications to current and future periods. Companies should take this opportunity to evaluate their IFRS accounting policies with a "clean sheet of paper" mind-set. Although many accounting requirements are similar between US GAAP and IFRS, companies should not overlook the opportunity to explore alternative IFRS accounting policies that might better reflect the economic substance of their transactions and enhance their communications with investors.

7.2 Revenue recognition

US GAAP revenue recognition guidance is extensive and includes a significant number of standards issued by FASB, EITF, AICPA and SEC. The guidance tends to be highly detailed and is often industry-specific. While the FASB's codification has put authoritative US GAAP in one place, it has not impacted the volume and/or nature of the guidance. IFRS has two primary revenue standards and four revenue-focused interpretations. The broad principles laid out in IFRS are generally applied without further guidance or exceptions for specific industries.

The following examples illustrate industry-specific US GAAP guidance and how that guidance can create differences between US GAAP and IFRS and produce conflicting results for economically similar transactions.

- ✓ US GAAP guidance **on software revenue recognition** requires the use of vendor specific objective evidence (VSOE) of fair value in determining an estimate of the selling price. IFRS does not have an equivalent requirement.
- ✓ **Activation services provided by telecommunications providers** are often economically similar to connection services provided by cable television companies. The US GAAP guidance governing the accounting for these transactions, however, differs. As a result, the timing of revenue recognition for these economically similar transactions also varies.

  IFRS contains minimal industry-specific guidance. Rather, the broad principles-based approach of IFRS is to be applied across all entities and industries. A few of the more significant, broad- based differences are highlighted below:
- ✓ **Contingent pricing and how it factors into the revenue recognition models** vary between US GAAP and IFRS. Under US GAAP, revenue recognition is based on fixed or determinable pricing criterion, which results in contingent amounts generally not being recorded as revenue until the contingency is resolved. IFRS looks to the probability of economic benefits associated with the transaction flowing to the entity and the ability to reliably measure the revenue in question, including any contingent revenue. This could lead to differences in the timing of revenue recognition, with revenue potentially being recognized earlier under IFRS.
- ✓ TWO OF THE MOST COMMON REVENUE RECOGNITION ISSUES RELATE TO

  (1) the determination of when transactions with multiple deliverables should be separated into components and

  (2) the method by which revenue gets allocated to the different components. US GAAP requires arrangement consideration to be allocated to elements of a transaction based on relative selling prices. A hierarchy is in place which requires VSOE of fair value to be used in all circumstances in which it is available. When VSOE is not available, third-party evidence (TPE) may be used. Lastly, a best estimate of selling price may be used for transactions in which VSOE or TPE does not exist. The residual method of allocating arrangement consideration is no longer permitted under US GAAP (except under software industry guidance), but continues to be an option under IFRS. Under US GAAP and IFRS, estimated selling prices may be derived in a variety of ways, including cost plus a reasonable margin.
- ✓ The accounting for **customer loyalty programs** may drive fundamentally different results. The IFRS requirement to treat customer loyalty programs as multiple-element arrangements, in which consideration is allocated to the goods or services and the award credits based on fair value through the eyes of the customer, would be acceptable for US GAAP purposes. US GAAP reporting companies, however, may use the incremental cost model, which is different from the multiple-element approach required under IFRS. In this instance, IFRS generally results in the deferral of more revenue.
- ✓ US GAAP prohibits use of the cost-to-cost percentage-of-completion method for service transactions (unless the transaction explicitly qualifies as a particular type of construction or production contract). Most service transactions that do not qualify for these types of construction or production contracts are accounted for under a proportional-performance model. IFRS requires use of the percentage-of-completion method in recognizing revenue in service arrangements unless progress toward completion cannot be estimated reliably (in which case a zero-profit approach is used) or a specific act is much more significant than any other (in which case revenue recognition is postponed until the significant act is executed). Prohibition of the use of the completed contract method under IFRS and diversity in application of the percentage-of-completion method might also result in differences.

KEY DIFFERENCES BETWEEN US GAAP AND IFRS

S.No	Basis	US GAAP	IFRS
1	**Acronym**	United States Generally Accepted Accounting Principles	International Financial Reporting Standard
2	**Meaning**	A set of accounting guidelines and procedures, used by the companies to prepare their financial statements is known as GAAP.	IFRS is the universal business language followed by the companies while reporting financial statements.
3	**Developed by**	Financial Accounting Standard Board (FASB).	International Accounting Standard Board (IASB).
4	**Based on**	Rules. With GAAP accounting, there's little room for exceptions or interpretation, as all transactions must abide by a specific set of rules.	Principles. With a principle-based accounting method, such as the IFRS, there's potential for different interpretations of the same tax-related situations.
5	**Locally vs. Globally**	GAAP is exclusively used within the United States and has a different set of rules for accounting than most of the world.	IFRS is a globally accepted standard for accounting, and is used in more than 110 countries.
6	**Inventory valuation**	FIFO, LIFO and Weighted Average Method.	FIFO and Weighted Average Method. Use of Last in First out (LIFO) is not permissible as per IFRS. The Last In, First Out valuation for inventory does not reflect an accurate flow of inventory in most cases, and thus results in reports of unusually low income levels.
7	**Extraordinary items**	Extraordinary items are shown below the statement of income in case of GAAP.	Not segregated in the income statement.
8	**Development cost**	Treated as an expense. Exception - Software	Capitalized, only if certain conditions are satisfied.
9	**Inventory write-down reversals**	Prohibited. GAAP specifies that if the market value of the asset increases, the amount of the write-down cannot be reversed. GAAP is overly cautious of inventory reversal and does not reflect any positive changes in the marketplace.	Permissible, if specified conditions are met.
10	**Consolidation**	There are two models for consolidation in the US GAAP. In the first model, entities are exposed to the influence of variable interest entity (VIE). If the VIE model cannot be applied, then the entities are subjected to the voting interest model (VIM). The	IFRS favors a **control** model
		VIE model allows a reporting entity to have control of the financial interests in a VIE Under the VIM, interest in controlling the financial processes of the reporting entity is existent if the reporting entity has an interest in another entity.	
11	**Earning-per-Share**	Under GAAP the computation averages the individual interim period incremental shares.	Under IFRS, the earning-per-share calculation does not average the individual interim period calculations.
12	**Intangible Assets**	Intangible assets measured under GAAP are recognized at the fair market value and nothing more.	For Intangible assets, such as research and development or advertising costs, IFRS takes into account whether an asset will have a future economic benefit as a way of assessing the value.
13	**PPE and Intangible Assets - Subsequent measurement**	**PPE and Intangible Assets** are valued using the cost model. The cost model takes into account the historical value of an asset minus any accumulated depreciation.	IFRS allows cost model and revaluation model. Revaluation model is based on the fair value at the current date minus any accumulated depreciation and impairment losses.

14	**Asset Valuation**	Assets can only be written down but cannot be written up.	Assets can be re-evaluated upwards when an active market is existent for what is abstract. It also allows the PP and E to be revalued to a more fair value.
15	**Statement format and presentation**	Similar to IFRS Standards, an entity may report comprehensive income either in a single continuous statement or in two separate but consecutive financial statements.	An entity may present either a single statement of profit or loss and other comprehensive income or two separate statements
16	**Format for the statement of comprehensive income**	U.S. GAAP does not prescribe a standard format for the income statement. Either the single-step format (expenses are classified by function) or multiple-step format (operating and non-operating items are displayed separately) is acceptable. How ever, SEC Regulation requires specific line items to appear on the face of the income statement, where applicable.	IAS 1 does not require a specific format for the statement of comprehensive income; how ever, it does require certain minimum line items to be presented for the period in addition to those required by other IFRS Standards (IAS 1.82). Expenses recognized in profit or loss are presented based on either their nature or function w ithin the entity depending on w hich is reliable and more relevant
17	**Cash flow statement - Interest and dividends**	Interest and dividends received and interest paid (and expensed) are classified as operating activities. Dividends paid are classified as financing activities.	Interest and dividends received and paid are classified in a consistent manner from period to period as operating, investing, or financing activities. Interest paid and interest and dividends received are usually classified as operating cash flow s for a financial institution.
18	**Cash flow statement - Taxes**	Taxes are generally classified as operating activities.	Taxes paid are classified as cash flows from operating activities unless they can be specifically identified w ith financing and investing activities
19	**Disclosure of accounting policies**	No similar requirement	An entity whose financial statements comply w ith IFRS Standards makes an explicit and unreserved statement of such compliance in the notes. Financial statements are not described as complying w ith IFRS Standards unless they comply w ith all the requirements of IFRS Standards.
20	**Review of residual value and the useful life**	There is no requirement that residual values and useful life be reviewed annually.	The residual value and the useful life of an asset is reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) is accounted for as a change in an accounting estimate in accordance with IAS 8
21	**Component depreciation**	Component depreciation is not required but is allowed.	Component depreciation is required w hereby each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately
22	**Borrowing costs**	The definition of a qualifying asset does not include the term substantial.	IAS 23 applies to a qualifying asset which is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale
23	**Investment property**	There is no equivalent requirement. Property held for investment purposes is treated the same as other property, plant and equipment	Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both

24	**Impairment loss**	If the carrying amount of the asset or group is not recoverable and it is greater than its fair value, an impairment loss is recognized. The first step determines if the asset or group is recoverable. If the carrying amount of the asset or group exceeds the sum of the undiscounted cash flow s expected from the use and eventual disposition of the asset or group, it is not recoverable. The second step measures the impairment loss as the difference between the fair value of the asset or group and its carrying amount	If the recoverable amount of the unit is less than the carrying amount of the unit, an impairment loss is recognized and allocated in accordance w ith IAS 36
25	**Reversing an impairment loss**	Reversals of impairment losses are not permitted	An impairment loss for assets other than goodwill is reversed provided certain conditions are met.
26	**Measurement of inventories**	Inventories measured using LIFO or the retail inventory method are subsequently measured at the lower of cost or market (but with a ceiling of net realizable value and a floor of net realizable value less normal profit margin)	Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale.
27	**Asset retirement obligations – recognition and measurement**	A liability for an asset retirement obligation (ARO) is recognized at fair value in the period in which it is incurred if a reasonable estimate of fair value can be made. If a reasonable estimate of the fair value of the liability cannot be made in the period the obligation is incurred, a liability is recognized when a reasonable estimate of fair value can be made . If the fair value of an ARO is estimated using the expected cash flow approach, the cash flow s are initially discounted using the current credit-adjusted risk-free rate..	Provisions for the estimated cost of dismantling and removing an asset and restoring a site are recognized and measured in accordance with the provisions in IAS 37. According to IAS 16, the cost of an item of property, plant, and equipment includes the initial estimate of the costs of dismantling and removing an asset and restoring the site on w hich it is located, the obligation for w hich an entity incurs either w hen the entity acquires the item or as a consequence of using the item
		ASSETS—NON-FINANCIAL ASSETS	
1	**Impairment of long-lived assets held for use**	US GAAP requires a two- step impairment test and measurement model as follows: Step 1 — The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognized, although it might be necessary to review depreciation (or amortization) estimates and methods for the related asset. Step 2 — If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at measurement date (an exit price). Fair value should be based on the assumptions of market participants and not those of the reporting entity. Changes in market interest rates are not considered impairment indicators. The reversal of impairments is prohibited.	IFRS uses a one-step impairment test. The carrying amount of an asset is compared with the recoverable amount. The recoverable amount is the higher of (1) the asset's fair value less costs of disposal or (2) the asset's value in use. In practice, individual assets do not usually meet the definition of a CGU. As a result, assets are rarely tested for impairment individually but are tested within a group of assets. Fair value less costs of disposal represents 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 less costs of disposal. Value in use represents entity-specific or CGU-specific future pretax cash flows discounted to present value by using a pretax, market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset or CGU for which the cash flow estimates have not been adjusted. Changes in market interest rates can potentially trigger impairment and, hence, are impairment indicators.

			If certain criteria are met, the reversal of impairments, other than those of goodwill, is permitted.
2	**Impairment of long-lived assets held for sale**	US GAAP requires a disposal group to include items associated with accumulated other comprehensive income. This includes any cumulative translation adjustment, which is considered part of the carrying amount of the disposal group [ASC 830- 30-45- 13].	IFRS 5 requires an entity to present separately any cumulative income or expense recognized in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.
3	**Acquired Research and development assets**	Research and development intangible assets acquired in an asset acquisition are capitalized only if they have an alternative future use. For an asset to have alternative future use, it must be reasonably expected (greater than a 50% chance) that an entity will achieve economic benefit from such alternative use and further development is not needed at the acquisition date to use the asset.	The price paid reflects expectations about the probability that the future economic benefits of the asset will flow to the entity. The probability recognition criterion is always assumed to be met for separately acquired intangible assets.
4	**Carrying basis**	US GAAP generally utilizes historical cost and prohibits revaluations except for certain categories of financial instruments, which are carried at fair value.	Historical cost is the primary basis of accounting. However, IFRS permits the revaluation to fair value of some intangible assets; property, plant, and equipment; and investment property and inventories in certain industries (e.g., commodity broker / dealer). IFRS also requires that biological assets (except bearer plans) be reported at fair value.
5	**Indefinite-lived intangible assets—level of assessment for impairment testing**	Separately recorded indefinite-lived intangible assets, whether acquired or internally developed, shall be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another. Indefinite-lived intangible assets may be combined only with other indefinite lived intangible assets; they may not be tested in combination with goodwill or with a finite-lived asset.	As most indefinite-lived intangible assets (e.g., brand name) do not generate cash flows independently of other assets, it might not be possible to calculate the value in use for such an asset on a standalone basis. Therefore, it is necessary to determine the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or
		US GAAP literature provides a number of indicators that an entity should consider in making a determination of whether to combine intangible assets	groups of assets, (known as a CGU), in order to perform the test.
6	**Impairments of software costs to be sold, leased, or otherwise marketed**	When assessing potential impairment, at least at each balance sheet date, the unamortized capitalized costs for each product must be compared with the net realizable value of the software product.	Under IFRS, intangible assets not yet available for use are tested annually for impairment because they are not being amortized. Once such assets are brought into use,
		The amount by which the unamortized capitalized costs of a software product exceed the net realizable value of that asset shall be written off. The net realizable value is the estimated future gross revenue from that product reduced by the estimated future costs of completing and disposing of that product. The net realizable value calculation does not utilize discounted cash flows.	amortization commences and the assets are tested for impairment when there is an impairment indicator. The impairment is calculated by comparing the recoverable amount (the higher of either (1) fair value less costs of disposal or (2) value in use) to the carrying amount. The value in use calculation uses the present value of future cash flows.

7	**Depreciation**	US GAAP generally does not require the component approach for depreciation. While it would generally be expected that the appropriateness of significant assumptions within the financial statements would be reassessed each reporting period, there is no explicit requirement for an annual review of residual values.	IFRS requires that separate significant components of property, plant, and equipment with different economic lives be recorded and depreciated separately. The guidance includes a requirement to review residual values and useful lives at each balance sheet date.
8	**Overhaul costs**	US GAAP permits alternative accounting methods for recognizing the costs of a major overhaul. Costs representing a replacement of an identified component can be (1) expensed as incurred, (2) accounted for as a separate component asset, or (3) capitalized and amortized over the period benefited by the overhaul	IFRS requires capitalization of the costs of a major overhaul representing a replacement of an identified component. Consistent with the componentization model, the guidance requires that the carrying amount of parts or components that are replaced be derecognized.
9	**Inventory costing**	A variety of inventory costing methodologies such as LIFO, FIFO, and/or weighted-average cost are permitted. For companies using LIFO for US income tax purposes, the book/tax conformity rules also require the use of LIFO for book accounting/reporting purposes. Reversals of write-downs are prohibited.	A number of costing methodologies such as FIFO or weighted-average costing are permitted. The use of LIFO, however, is precluded. Reversals of inventory write- downs (limited to the amount of the original write-down) are required for subsequent recoveries.
		ASSETS—FINANCIAL ASSETS	
1	**Available-for sale financial assets—fair value versus cost of unlisted equity instruments**	Unlisted equity investments generally are scoped out of ASC 320 and would be carried at cost, unless either impaired or the fair value option is elected. Certain exceptions requiring that investments in unlisted equity securities be carried at fair value do exist for specific industries (e.g., broker/dealers, investment companies, insurance companies, and defined benefit plans).	There are no industry-specific differences in the treatment of investments in equity instruments that do not have quoted market prices in an active market. Rather, all available-for sale assets, including investments in unlisted equity instruments, are measured at fair value (with rare exceptions only for instances in which fair value cannot be reliably measured). Fair value is not reliably measurable when the range of reasonable fair value estimates is significant and the probability of the various estimates within the range cannot be reasonably assessed.
2	**Available-for- Sale ebt financial assets— foreign exchange gains/losses on debt instruments**	The total change in fair value of available-for-sale debt securities—net of associated tax effects—is recorded within other comprehensive income (OCI). Any component of the overall change in fair market value that may be associated with foreign exchange gains and losses on an available-for-sale debt security is treated in a manner consistent with the remaining overall change in the instrument's fair value.	For available-for-sale debt instruments, the total change in fair value is bifurcated, with the portion associated with foreign exchange gains/losses on the amortized cost basis separately recognized in the income statement. The remaining portion of the total change in fair value (except for impairment losses) is recognized in OCI, net of tax effect.
3	**Fair value option for equity-method Investments**	The fair value option exists for US GAAP entities under ASC 825, Financial Instruments, wherein the option is unrestricted. Therefore, any investor's equity-method investments are eligible for the fair value option.	IFRS permits venture capital organizations, mutual funds, and unit trusts (as well as similar entities, including investment-linked insurance funds) that have investments in associates (entities over which they have significant influence) to carry those investments at fair value, with changes in fair value reported in earnings (provided certain criteria are met) in lieu of applying equity- method accounting.

4	**Fair value of investments in investment company entities**	US GAAP provides a practical expedient for the measurement of fair value of certain investments that report a net asset value (NAV), to allow use of NAV as fair value.	Under IFRS, since NAV is not defined or calculated in a consistent manner in different parts of the world, IFRS does not include a similar practical expedient.
5	**Losses on available-for- Sale equity securities subsequent to initial impairment recognition**	Impairment charges establish a new cost basis. As such, further reductions in value below the new cost basis may be considered temporary (when compared with the new cost basis).	Impairment charges do not establish a new cost basis. As such, further reductions in value below the original impairment amount are recorded within the current-period income statement.
LIABILITIES AND EQUITIES			
1	**Tax base of an asset liability**	Tax base is based upon the relevant tax law. It is generally determined by the amount that is depreciable for tax purposes or deductible upon sale or liquidation of the asset or settlement of the liability.	Tax base is based on the tax consequences that will occur based upon how an entity is expected to recover or settle the carrying amount of assets and liabilities. The carrying amount of assets or liabilities can be recovered or settled through use or through sale. Assets and liabilities may also be recovered or settled through use and through sale together. In that case, the carrying amount of the asset or liability is bifurcated, resulting in more than a single temporary difference related to that item.
2	**Initial recognition of an asset or a liability**	A temporary difference may arise on initial recognition of an asset or liability. In asset purchases that are not business combinations, a deferred tax asset or liability is recorded with the offset generally recorded against the assigned value of the asset. The amount of the deferred tax asset or liability is determined by using a simultaneous equations method. An exemption exists from the initial recognition of temporary differences in connection with transactions that qualify as leveraged leases under lease accounting guidance.	An exception exists that deferred taxes should not be recognized on the initial recognition of an asset or liability in a transaction which is not a business combination and affects neither accounting profit nor taxable profit/loss at the time of the transaction. No special treatment of leveraged leases exists under IFRS.
3	**Recognition of deferred tax assets**	Deferred tax assets are recognized in full, but are then reduced by a valuation allowance if it is considered more likely than not that some portion of the deferred tax assets will not be realized.	Deferred tax assets are recognized to the extent that it is probable (or "more likely than not") that sufficient taxable profits will be available to utilize the deductible temporary difference or unused tax losses.
4	**Recognition of deferred taxes where the local currency is not the functional currency**	No deferred taxes are recognized for differences related to nonmonetary assets and liabilities that are remeasured from local currency into their functional currency by using historical exchange rates (if those differences result from changes in exchange rates or indexing for tax purposes).	Deferred taxes should be recognized for the difference between the carrying amount determined by using the historical exchange rate and the relevant tax base, which may have been affected by exchange rate changes or tax indexing.

5	**Inter-company transactions**	For purposes of the consolidated financial statements, any tax impacts to the seller as a result of an intercompany sale or transfer are deferred until the asset is sold to a third- party or otherwise recovered (e.g., amortized or impaired). In addition, the buyer is prohibited from recognizing	There is no exception to the model for the income tax effects of transferring assets between the entities in the consolidated groups. Any tax impacts to the consolidated financial statements as a result of the intercompany transaction are recognized as incurred.
		a deferred tax asset resulting from the difference between the tax basis and consolidated carrying amount of the asset.	If the transfer results in a change in the tax base of the asset transferred, deferred taxes resulting from the intra group sale are recognized at the buyer's tax rate.
6	**Change in tax laws and rates**	US GAAP requires the use of enacted rates when calculating current and deferred taxes.	Current and deferred tax is calculated using enacted or substantively enacted rates.
7	**Interim reporting**	In general, the interim tax provision is determined by applying the estimated annual worldwide effective tax rate for the consolidated entity to the worldwide consolidated year-to-date pretax income.	The interim tax provision is determined by applying an estimated average annual effective tax rate to interim period pretax income. To the extent practicable, a separate estimated average annual effective tax rate is determined for each material tax jurisdiction and applied individually to the interim period pretax income of each jurisdiction.
8	**Separate financial statements**	The consolidated current and deferred tax amounts of a group that files a consolidated tax return should be allocated among the group members when they issue separate financial statements using a method that is systematic, rational and consistent with the broad principles of ASC 740. An acceptable method is the "separate return" method. It is also acceptable to modify this method to allocate current and income taxes using the "benefits for- loss" approach.	There is no specific guidance under IFRS on the methods that can be used to allocate current and deferred tax amounts of a group that files a consolidated tax return among the group members when they issue separate financial statements.
9	**Levies**	Specific guidance does not exist within US GAAP. Levies and their related fines and penalties follow the guidance in ASC 450 unless other guidance established for the specific obligation exists (e.g., environmental).	Levies are defined as a transfer of resources imposed by a government on entities in accordance with laws and/or regulations, other than those within the scope of other standards (such as IAS 12); and fines or other penalties imposed for breaches of laws and/or regulations. The obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its financial statements under the going concern principle, does not create an obligation to pay a levy that will arise from operating in the future. A liability to pay a levy is recognised when the obligating event occurs, at a point in time or progressively over time, and an obligation to pay a levy triggered by a minimum threshold is recognised when the threshold is reached.
10	**Written put the option on own issuer's shares**	A financial instrument— other than an outstanding share—that at inception (1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation, and (2) requires or may require the issuer to settle the obligation by transferring assets shall be classified	If the contract meets the definition of an equity instrument (because it requires the entity to purchase a fixed amount of its own shares for a fixed amount of cash), any premium received or paid must be recorded in equity. Therefore, the premium received on such a written put is classified as equity (whereas under US GAAP, the fair value of the written put is recorded as a financial liability).

		as a financial liability (or an asset, in some circumstances). Examples include written put options on the issuer's equity shares that are to be physically settled or net cash settled. ASC 480 requires written put options to be measured at fair value, with changes in fair value recognized in current earnings.	In addition, when an entity has an obligation to purchase its own shares for cash (e.g., under a written put) the issuer records a financial liability for the discounted value of the amount of cash that the entity may be required to pay. The financial liability is recorded against equity.
11	**Initial measurement of a liability with a related party**	When an instrument is issued to a related party at off-market terms, one should consider which model the instrument falls within the scope of as well as the facts and circumstances of the transaction (i.e., the existence of unstated rights and privileges) in determining how the transaction should be recorded. There is, however, no requirement to initially record the transaction at fair value. The presumption in ASC 850 that related party transactions are not at arm's length and the associated disclosure requirements also should be considered.	When an instrument is issued to a related party, the financial liability initially should be recorded at fair value, which may not be the value of the consideration received. The difference between fair value and the consideration received (i.e., any additional amount lent or borrowed) is accounted for as a current-period expense, income, or as a capital transaction based on its substance.
12	**Non recourse liabilities**	US GAAP provides an alternative measurement for CFEs that allows the use of the more observable of the fair value of the financial assets or the fair value of the financial liabilities of the CFE to measure both the financial assets and the financial liabilities. This eliminates the measurement difference that may exist when financial assets and financial liabilities of the CFE are measured at fair value independently.	IFRS does not provide a separate measurement approach for nonrecourse liabilities. Financial assets and liabilities follow their respective classification and measurement models.
13	**Measurement of provisions**	A single standard does not exist to determine the measurement of obligations. Instead, entities must refer to guidance established for specific obligations (e.g., environmental or restructuring) to determine the appropriate measurement	The amount recognized should be the best estimate of the expenditure required (the amount an entity would rationally pay to settle or transfer to a third party the obligation at the balance sheet date).
		methodology. Pronouncements related to provisions do not necessarily have settlement price or even fair value as an objective in the measurement of liabilities, and the guidance often describes an accumulation of the entity's cost estimates. When no amount within a range is a better estimate than any other amount, the low end of the range is accrued.	Where there is a continuous range of possible outcomes and each point in that range is as likely as any other, the midpoint of the range is used.

14	**Discounting of provisions**	For losses that meet the accrual criteria of ASC 450, an entity will generally record them at the amount that will be paid to settle the contingency, without considering the time that may pass before the liability is paid. Discounting these liabilities is	IFRS requires that the amount of a provision be the present value of the expenditure expected to be required to settle the obligation. The anticipated cash flows are discounted using a pretax discount rate (or rates) that reflect(s) current market assessments of the time value of money and
		acceptable when the aggregate amount of the liability and the timing of cash payments for the liability are fixed or determinable. Entities with these liabilities that are eligible for discounting are not, however, required to discount those liabilities; the decision to discount is an accounting policy choice. The classification in the statement of operations of the accretion of the liability to its settlement amount is an accounting policy decision that should be consistently applied and disclosed. When discounting is applied, the discount rate applied to a liability should not change from period to period if the liability is not recorded at fair value. There are certain instances outside of ASC 450 (e.g., in the accounting for asset retirement obligations) where discounting is required.	the risks specific to the liability (for which the cash flow estimates have not been adjusted) if the effect is material. Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. The carrying amount of a provision increases in each period to reflect the passage of time with said increase recognized as a borrowing cost.
15	**Onerous contracts**	Provisions are not recognized for unfavorable contracts unless the entity has ceased using the rights under the contract (i.e., the cease-use date). One of the most common examples of an	Provisions are recognized when a contract becomes onerous regardless of whether the entity has ceased using the rights under the contract. When an entity commits to a plan to exit a
		unfavorable contract has to do with leased property that is no longer in use. With respect to such leased property, estimated sublease rentals are to be considered in a	lease property, sublease rentals are considered in the measurement of an onerous lease provision only if management has the right to sublease and such sublease income is probable.
		measurement of the provision to the extent such rentals could reasonably be obtained for the property, even if it is not management's intent to sublease or if the lease terms prohibit subleasing. Incremental expense in either instance is recognized as incurred.	IFRS requires recognition of an onerous loss for executory contracts if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
		CONSOLIDATION	
1	**Consolidation model**	All consolidation decisions are evaluated first under the Variable Interest Entity (VIE) model. US GAAP requires an entity with a variable interest in a VIE to qualitatively assess the determination of the primary beneficiary of the VIE. In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria:	IFRS focuses on the concept of control in determining whether a parent-subsidiary relationship exists. An investor controls an investee when it has all of the following: □ Power, through rights that give it the current ability, to direct the activities that significantly affect (the relevant activities that affect) the investee's returns

		□ Power to direct activities of the VIE that most significantly impact the VIE's economic performance (power criterion) □ Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (losses / benefits criterion) In assessing whether an enterprise has a controlling financial interest in an entity, it should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders. Only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one enterprise could meet the losses / benefits criterion, only one enterprise, if any, will have the power to direct the activities of a VIE that most significantly impact the entity's economic performance.	□ Exposure, or rights, to variable returns from its involvement with the investee (returns must vary and can be positive, negative, or both) □ The ability to use its power over the investee to affect the amount of the investor's returns In assessing control of an entity, an investor should consider the entity's purpose and design to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities, and who is exposed or has rights to the returns from those activities. Only substantive rights can provide power. The greater an investor's exposure to variability of returns, the greater its incentive to obtain rights to give it power, i.e., it is an indicator of power and is not by itself determinative of having power.
		Increased skepticism should be given to situations in which an enterprise's economic interest in a VIE is disproportionately greater than its stated power to direct the activities of the VIE that most significantly impact the entity's economic performance. As the level of disparity increases, the level of skepticism about an enterprise's lack of power is expected to increase. All other entities are evaluated under the voting interest model. Unlike IFRS, only actual voting rights are considered. Under the voting interest model, control can be direct or indirect. In certain unusual circumstances, control may exist with less than 50 percent ownership, when contractually supported. The concept is referred to as effective control.	When an entity is controlled by voting rights, control is presumed to exist when a parent owns, directly or indirectly, more than 50 percent of an entity's voting power. Control also exists when a parent owns half or less of the voting power but has legal or contractual rights to control either the majority of the entity's voting power or the board of directors. Control may exist even in cases where an entity owns little or none of a structured equity. The application of the control concept requires, in each case, judgment in the context of all relevant factors.
2	**Accounting policies and reporting periods**	Consolidated financial statements are prepared by using uniform accounting policies for all of the entities in a group. Limited exceptions exist when a subsidiary has specialized industry accounting principles. Retention of the specialized accounting policy in consolidation is permitted in such cases. The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date.	Consolidated financial statements are prepared by using uniform accounting policies for like transactions and events in similar circumstances for all of the entities in a group. The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, the subsidiary accounts as of a different reporting date can be consolidated, provided the difference between the reporting dates is no more than three months. Adjustments are made to the

		However, the consolidation of subsidiary accounts can be drawn up at a different reporting date provided the difference between the reporting dates is no more than three months. Recognition is given, by disclosure or adjustment, to the effects of intervening events that would materially affect consolidated financial statements	financial statements for significant transactions that occur in the gap period.
3	**Potential voting rights**	Potential voting rights are generally not considered in the assessment of whether an investor has significant influence.	Potential voting rights are considered in determining whether the investor exerts significant influence over the investee.
			Potential voting rights are important in establishing whether the entity is an associate. Potential voting rights are not, however, considered in the measurement of the equity earnings recorded by the investor.
4	**Definition and types of joint ventures**	The term joint venture refers only to jointly controlled entities, where the arrangement is carried on through a separate entity. A corporate joint venture is defined as a corporation owned and operated by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group. Most joint venture arrangements give each venturer (investor) participating rights over the joint venture (with no single venturer having unilateral control), and each party sharing control must consent to the venture's operating, investing, and financing decisions.	A joint arrangement is a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control of an economic activity. Unanimous consent is required for the relevant activities of the parties sharing control, but not necessarily of all parties in the venture. IFRS classifies joint arrangements into two types: ▪ Joint operations, which give parties to the arrangement direct rights to the assets and obligations for the liabilities ▪ Joint ventures, which give the parties rights to the net assets or outcome of the arrangement
5	**Accounting for joint arrangements**	Prior to determining the accounting model, an entity first assesses whether the joint venture is a VIE. If the joint venture is a VIE, the accounting model for VIE is applied. Joint ventures often have a variety of service, purchase, and/or sales agreements, as well as funding and other arrangements that may affect the entity's status as a VIE. Equity interests are often split 50- 50 or near 50-50, making non-equity interests (i.e., any variable interests) highly relevant in consolidation decisions. Careful consideration of all relevant contracts and governing documents is critical in the determination of whether a joint venture is within the scope of the variable interest model and, if so, whether consolidation is required. If the joint venture is not a VIE, venturers apply the equity method to recognize the investment in a jointly controlled entity.	The classification of a joint arrangement as a joint venture or a joint operation determines the investor's accounting. An investor in a joint venture must account for its interest using the equity method in accordance with IAS 28. An investor in a joint operation accounts for its share of assets, liabilities, income and expenses based on its direct rights and obligations. If the joint operation constitutes a business, the investor must apply the relevant principles on business combination accounting contained in IFRS 3, Business Combinations, and other standards, and disclose the related information required under those standards. A joint operator that increases its interest in a joint operation that constitutes a business should not remeasure previously held interests in the joint operation when joint control is retained.

		Proportionate consolidation is generally not permitted except for unincorporated entities operating in certain industries. A full understanding of the rights and responsibilities conveyed in management, shareholder, and other governing documents is necessary.	
6	**Equity method of accounting—exemption from applying the equity method**	Equity method investments are considered financial assets and therefore are eligible for the fair value accounting option. An entity can measure an investment in associates or joint ventures at fair value through profit or loss, regardless of whether it is a venture capital or similar organization.	An entity can only elect fair value through profit or loss accounting for equity method investments held by venture capital organizations, mutual funds, unit trusts, and similar entities, including investment-linked insurance funds. If an associate or joint venture is an investment entity, the equity method of accounting is applied by either (1) recording the results of the investment entity that are at fair value or (2) undoing the fair value measurements of the investment entity. In other instances, an entity must apply the equity method to its investments in associates and joint ventures unless it is exempt from preparing consolidated financial statements.
7	**Equity method of accounting—classification as held for sale**	Under US GAAP, equity method investments are not classified as held for sale. An investor applies equity method accounting until significant influence is lost.	If an equity method investment meets the held for sale criteria in accordance with IFRS 5, an investor records the investment at the lower of its (1) fair value less costs to sell or (2) carrying amount as of the date the investment is classified as held for sale.
8	**Accounting for investments in qualified affordable housing projects**	An investor that owns a passive investment in limited liability entities that manage or invest in qualified affordable housing projects can use the proportional amortization method if certain conditions are met. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax benefits received over the period that the investor expects to receive the tax credits and other benefits. Both the amortization expense determined under the proportional amortization method and the tax benefits received will be recognized as a component of income taxes.	IFRS does not contain any guidance specific to accounting for investments in qualified affordable housing projects.
		Use of the proportional amortization method for investments that meet the requisite conditions is an accounting policy election. Once elected, the proportional amortization method should be applied to all qualifying investments.	
		BUSINESS COMBINATIONS	
1	**Definition of control**	Consolidation decisions are evaluated first under the variable interest entity model. Qualitatively assess if the variable interest meets both criteria: ✓ Power to direct activities that most significantly impact economic	An investor has control over an investee when all of the following elements are present: ✓ Power over the investee ✓ Exposure, or rights, to variable returns from its involvement with the investee ✓ Ability to use power to affect the returns

		✓ performance o Potential to receive significant benefits or absorb significant losses ✓ All other entities are evaluated under the voting interest model.	✓
2	**Acquired contingencies**	Acquired assets and liabilities subject to contingencies are recognized at fair value if fair value can be determined during the measurement period. If fair value cannot be determined, companies should typically account for the acquired contingencies using existing guidance. If recognized at fair value on acquisition, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.	The acquiree's contingent liabilities are recognized at the acquisition date provided their fair values can be measured reliably. The contingent liability is measured subsequently at the higher of the amount initially recognized less, if appropriate, cumulative amortization recognized under the revenue guidance or the best estimate of the amount required to settle (under the provisions guidance— IAS 37). Contingent assets are not recognized.
3	**Non-controlling interests**	Non-controlling interests are measured at fair value.	Entities have an option, on a transaction-by-transaction basis, to measure non-controlling interests at their proportion of the fair value of the identifiable net assets or at full fair value. This option applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by IFRS. The use of the full fair value option results in full goodwill being recorded on both the controlling and non-controlling interest.
4	**Combinations involving entities under common control**	Combinations of entities under common control are generally recorded at predecessor cost, reflecting the transferor's carrying amount of the assets and liabilities transferred.	IFRS does not specifically address such transactions. In practice, entities develop and consistently apply an accounting policy; management can elect to apply the acquisition method of accounting or the predecessor value method to a business combination involving entities under common control. The accounting policy can be changed only when criteria for a change in an accounting policy are met in the applicable guidance in IAS 8 (i.e., it provides more reliable and more relevant information).
5	**Identifying the acquirer**	The acquirer is determined by reference to ASC 810 –10, under which generally the party that olds greater than 50 percent of the voting shares has control, unless the acquirer is the primary beneficiary of a variable interest entity in accordance with ASC 810.	The acquirer is determined by reference to the consolidation guidance, under which generally the party that holds greater than 50 percent of the voting rights has control. In addition, control might exist when less than 50 percent of the voting rights are held, if the acquirer has the power to most significantly affect the variable returns of the entity in accordance with IFRS 10.
6	**Measurement period adjustment**	An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. If during the measurement period, the measurements are not finalized as of the end of a reporting period, the acquirer should record the cumulative impact of measurement period adjustments made to	An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. An acquirer should retrospectively record measurement period adjustments made to provisional amounts as if the accounting was completed at the acquisition date. The acquirer should revise comparative information for prior periods presented in the financial statements as needed, including

		provisional amounts in the period that the adjustment is determined. However, the acquirer should present separately on the face of the income statement or disclose in the notes the portion of the adjustment to each income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.	making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting.
1	**Restructuring costs**	In general, a liability for a cost associated with an exit or disposal activity is recognized when the definition of a liability is met. Therefore, unlike IFRS Standards, an entity's commitment to an	A provision for restructuring costs is recognized when the general recognition criteria for provisions in IAS 37, are met. One of those criteria is that an entity has a present obligation (legal or *constructive*) as a result of a past event.
		exit or disposal plan is not by itself the requisite past transaction or event for recognition of a liability	A *constructive obligation* to restructure arises only when an entity: • Has a detailed formal plan for the restructuring; and • Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
2	**Onerous contracts**	Unless specific U.S. GAAP applies, obligations for onerous contracts are not recognized.	IAS defines an *onerous contract* as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the expected economic benefits. If an entity has an onerous contract, the present obligation is recognized and measured as a provision
3	**Deferred taxes - tax rate**	Deferred taxes are measured using enacted tax rate(s) expected to apply to taxable income in periods in which deferred tax is expected to be settled or realized. Unlike IFRS, tax rates that have been substantially enacted by the balance sheet date are not to be used.	Deferred taxes are measured at the tax rates that are expected to apply when the asset is realized or the liability is settled, based on tax rates (and tax law s) that have been enacted or substantively enacted by the end of the reporting period (IAS
4	**Deferred taxes - a revaluation model**	No similar requirement as assets are not permitted to be measured under a revaluation model nor is investment property permitted to be measured at fair value.	If a deferred tax asset or a deferred tax liability arises from a non-depreciable asset measured under the revaluation model in IAS 16, the measurement of deferred taxes reflects the tax consequences of recovering the carrying amount of that asset through sale.
5	**Revenue - Scope**	Similar to IFRS Standards (ASC 606-10-15-2). Loan guarantee fees (in which an entity lends its creditworthiness to another party for a fee) are specifically scoped out of ASC 606.	Apply to all contracts with customers except : • Lease contracts • Insurance contracts • Financial instruments and other contractual rights or obligations Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers
6	**Revenue - Identify performance obligations**	Shipping and handling activities that are performed before the customer obtains control of the good are not a promised service to the customer, but instead are activities to fulfil the entity's promise to transfer the good. If shipping and handling activities are performed after a	No similar specific guidance exists in IFRS 15.

		customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good	
7	**Revenue - Identify performance obligations**	An entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. If revenue is recognized related to a performance obligation that includes immaterial goods or services is recognized before they are transferred to the customer, then the related costs to transfer those goods or services shall be accrued	No similar specific guidance exists in IFRS 15.
8	**Revenue - Intellectual property licenses**	An entity must determine whether the promise to provide a right to access intellectual property is for functional or symbolic intellectual property. Functional intellectual property has significant standalone functionality, and is recognized at a point in time. Symbolic intellectual property does not have significant standalone functionality and is recognized over time.	IFRS does not use the concepts of functional versus symbolic intellectual property. Judgments of over time versus point in time recognition in IFRS are made based on the criteria in IFRS 15.
9	**Revenue - Intellectual property licenses renewal**	An entity would recognize revenue from a license renewal no earlier than the beginning of the renew al period.	No similar specific guidance about recognizing revenue for the renew al of a license exists under IFRS.
10	**Contract costs - impairment loss**	An entity would not recognize the reversal of an impairment loss previously recognized	Some or all of an impairment loss is reversed when the impairment conditions no longer exist or have improved.
11	**Revenue - Determine the transaction price - amounts collected on behalf of third parties.**	Under U.S. GAAP an entity is permitted to make an **accounting policy election to exclude from the measurement of the transaction price all taxes assessed by a governmental authority** that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer.	Consider terms of the contract and entity's customary business practices to determine transaction price. The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring promised goods or services to a customer, **excluding amounts collected on behalf of third parties.**
		SHARE-BASED PAYMENTS -	
1	**Share-based payments - Relevant guidance :**	ASC 718 (for employees) and ASC 505-50 (for nonemployees)	IFRS 2
2	**Share-based payments - Introduction**	ASC 718 and ASC 505-50 apply to share-based payment transactions in which an entity acquires goods or services by issuing equity instruments or by incurring liabilities that either are (a) settled in an amount based, at least in part, on the price of the entity's shares or other equity instruments of the entity or (b) require or may require settlement by issuing the entity's shares or other equity instruments. Equity or liability classification of a share-based award could differ from IFRS Standards which could result in significant differences in accounting for these awards under ASC 718 and IFRS 2.	IFRS 2 requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees (IFRS 2.1). The scope of IFRS 2 includes all share-based payment transactions including (IFRS 2 IN4 and 2.2): • Equity-settled share-based payment transactions – the entity receives goods or services as consideration for its equity instruments Cash-settled share-based payment transactions – the entity acquires goods or services by incurring liabilities that are based on the price of the entity's shares or other equity instruments

			• Equity-settled or cash-settled transactions – the entity receives or acquires goods or services and the entity or the supplier has a choice of whether the entity settles the transaction in cash or by issuing equity instruments
3	**Share-based payments - Employee Stock Purchase Plan (ESPP)**	Unlike IFRS Standards, an employee share purchase plan **that satisfies certain explicit criteria is** not considered compensatory. In practice, most ESPPs are compensatory.	All employee share purchase plans are considered compensatory arrangements and are within the scope of IFRS 2. They are treated like any other equity settled share based payment arrangement.
4	**Share-based payments - Group share based payment transaction**	Share based payments awarded to an employee on behalf of an entity, by a related party or other holder of an economic interest in the entity as compensation for services provided to the entity are share based payment transactions and thus accounted for as such unless the transfer is clearly for a purpose other than compensation for services to the entity. The economic interest holder makes a capital contribution to the entity, who makes a share based payment to its employee in exchange for services rendered	Share based payment transactions may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. The guidance in IFRS 2 also applies to an entity that • Receives goods or services when another entity in the same group (or shareholder of any group entity) has the obligation to settle the share based payment transaction, or • Has an obligation to settle a share based payment transaction when another entity in the same group receives the goods or services unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.
5	**Share-based payments - *Equity-settled transactions***	The measured compensation cost for share-based awards to employees is recognized as those employee services are received. The corresponding credit is an increase in equity. Similar to IFRS Standards, vesting conditions, other than market conditions, affect the timing of expense recognition (service or performance-based) and the number of equity instruments included in	For equity instruments granted that vest immediately, the expense is recognized on the grant date with a corresponding increase in equity. If the equity instruments granted do not vest until the counterparty completes a specified period of service, an expense is recognized during the vesting period with a corresponding increase in equity. Vesting conditions, other than market conditions are not taken into account when
6		the measurement of the transaction amount (forfeitures). Market conditions are taken into account when estimating the fair value of the equity instruments. **An entity is permitted to make an accounting policy decision to use a straight-line or accelerated attribution method for awards that have graded service requirements regardless of the method used to value the award.**	estimating the fair value of the shares or share options at the measurement date. Vesting conditions, other than market conditions, are taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognized for goods or services received as consideration for the equity instruments granted are based on the number of equity instruments that eventually vest. Unlike U.S. GAAP, IFRS Standards does not permit the use of a straight-line attribution method.
7	**Share-based payments - Market conditions**	The terms of some awards provide that a performance target that affects vesting could be achieved after an employee completes the requisite service period. Such a performance target is accounted for as a performance condition and thus is not reflected in estimating the fair value of the award at grant date. Compensation cost is recognized in the period it becomes probable the Performance target will be met and represents the compensation cost attributable to the periods for which the requisite service has already been rendered.	Market conditions are taken into account when estimating the fair value of the equity instruments granted. Unlike U.S. GAAP, terms of an award that affect vesting and could be achieved after an employee completes the requisite service period would not be a performance condition under IFRS 2. The period of achieving the performance target would not extend beyond the end of the service period (IFRS 2, Appendix A). As such those conditions would not meet the definition of a vesting condition in IFRS 2, Appendix A. Non-vesting conditions are taken into account when estimating the fair value of the equity instruments granted (IFRS 2.21A)

		If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost for which requisite service has not been rendered is recognized prospectively over the remaining requisite service period (ASC 718-10-30-28). Under IFRS Standards, a performance target that could be achieved after the requisite service period would not meet the definition of a performance condition and thus are accounted for as non-vesting conditions that are reflected in the grant-date fair value of the award.	
8	**Grant date –**	The grant date is the date on which the fair value of the employee awards is measured. Unlike IFRS Standards, it is the date the employer and the employee have a shared understanding of the terms and conditions of the arrangement and the employee is affected by subsequent changes in the share price.	Grant date – the date at which an entity and another party (including an employee) agree to a share-based payment arrangement being when the entity and the counterparty have a similar understanding of the terms and conditions of the arrangement.
9	**Calculated value –**	Unlike IFRS Standards, nonpublic companies may measure awards based on a calculated value (using historical volatility of an industry index) if the company is unable to reasonably estimate its expected volatility	IFRS does not include such alternatives for non-public companies. It requires use of fair value in all circumstances.
10	**Cash-settled transactions with employees**	Share-based payment awards classified as liabilities are accounted for under ASC 718's measurement and recognition provisions for liabilities, which require variable accounting until the award is settled or expires unexercised. Unlike IFRS Standards, U.S. nonpublic entities are permitted to make an accounting policy election to use intrinsic value for liability classified awards.	The goods or services acquired and the liability incurred are measured at the fair value of the liability. Until the liability is settled, the fair value of the liability is remeasured at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.
11	**Tax withholding**	Similar to IFRS, if an amount in excess of the maximum statutory tax rates in the employee's jurisdiction is withheld, or may be withheld at the employee's discretion, the entire award is classified and accounted for as a liability. To qualify for equity classification, the employer must have a statutory obligation to withhold taxes on an employee's behalf, and the amount withheld cannot exceed maximum statutory tax rates of the employee's jurisdiction.	If a share based payment arrangement has a net-settlement feature for withholding tax obligations, the transaction may be classified as an equity-settled if it would have been classified as such without the net settlement feature. Any excess shares withheld under a net settlement feature that exceeds the monetary value of the employee's tax obligation would be accounted for as a cash-settled share-based payment when the amount is paid in cash (or other assets) to the employee
12	**Equity-settled transactions with nonemployees**	The transaction is measured based on the fair value of the goods or services received or the fair value of the equity instruments issued, whichever is more reliably measurable.	Fair value – goods or services received are measured at the fair value of the goods or services received. If fair value of the goods or services received cannot be estimated reliably, then the fair value is measured by reference to the fair value of the equity instruments granted. **Under IFRS Standards, there is a presumption that goods or services received can be reliably measured.**

13	**Measurement date for awards to nonemployees –**	The measurement date for awards to nonemployees is generally the earlier of the date at which the counterparty's performance is complete or the date at which a commitment for performance by the counterparty to earn the equity instruments is reached.	The date the entity obtains the goods or the counterparty renders the services
14	**Modification causes an award that was considered improbable of vesting to becomeprobable of vesting.**	U.S. GAAP differs from IFRS Standards in a situation in which a modification causes an award that was considered improbable of vesting to become probable of vesting. Under U.S. GAAP, compensation cost would be based on the updated fair value measurement at the modification date.	Under IFRS Standards, the original fair value of the award would be used for measurement purposes. The only change would be in the number of options expected to vest.
		FINANCIAL INSTRUMENTS	
1	**Reclassification**	Transfers into or from the trading category are to be rare	Financial assets are only reclassified when an entity changes its business model for managing those financial assets. Reclassification of financial liabilities is prohibited
2	**Categories**	No explicit categorization scheme for financial assets. They could be categorized as follows: • Derivative financial instruments. • Hybrid financial instruments that would be required to be separated into a host and derivative component under which the entity has irrevocably elected to measure at fair value. • Eligible financial assets that the entity elects to measure at fair value – fair value option • Loans and receivables • Debt with-in the scope of ASC 320: ✓ Trading ✓ Held-to-maturity –those debt securities that the enterprise has the positive intent and ability to hold to maturity ✓ Available-for-sale – debt securities not classified as trading or held-to-maturity Securities • Equity securities within the scope of ASC	On subsequent measurement, most financial assets w ill be categorized at amortized cost, fair value through other comprehensive income, or fair value through profit or loss on the basis of both the - • Entity's business model for managing financial assets, and Contractual cash flow characteristics of the financial asset
3	**Financial assets are measured at fair value through other comprehensive income**	No similar requirement	Financial assets are measured at fair value through other comprehensive income if both of the following are met : • Objective of business model is both collecting contractual cash flow s and selling financial assets, and • Contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
4	**Measurement on initial recognition**	An entity may elect to measure eligible financial assets at fair value – fair value option	An entity may designate a financial asset at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency.

5	**Equity instrument - irrevocable election to present in OCI,**	No similar requirement.	At initial recognition, an entity may make an irrevocable election to present in OCI, subsequent changes in the fair value of an investment in an equity instrument, not held for trading.
6	**Transaction costs**	Financial assets are recognized initially at fair value which may lead to the recognition of premiums and discounts on loans and debt securities acquired. Except for certain costs associated with certain lending activities and loan purchases, transaction costs that are directly attributable to the purchase of a financial asset are expensed as incurred.	When a financial asset is recognized initially, an entity measures it at fair value plus, for a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.
7	**Financial liabilities**	Most financial liabilities are measured initially at fair value	When a financial liability is recognized initially, an entity measures it at its fair value plus, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial liability.
8	**Treatment of change in fair value of financial liability**	Report unrealized gains and losses for items for which fair value option has been elected, in earnings	Recognize the gain or loss on financial liability designated at fair value through profit or loss as follows: • Amount of change in fair value of financial liability attributable to changes in ow n credit risk of that liability in OCI (unless it creates an accounting mismatch and then include in profit or loss (IFRS 9.5.7.8) • The remaining amount of change in profit or loss If the accounting mismatch would be created or enlarged, present all changes in fair value, including the effects of changes in the credit risk of the liability in profit or loss.
9	**Offsetting**	Offsetting of financial assets and financial liabilities is permitted only when- • The parties owe each other determinable amounts • There is a right and intention to set-off • The right of set-off is enforceable by law.	A financial asset is offset against a financial liability when and only when an entity: • Currently has a legally enforceable right to set off the recognized amounts, and • Intends either to settle on a net basis or realize the asset and settle the liability simultaneously
		RECOGNITION AND MEASUREMENT OF DERIVATIVES	
1	**Characteristics of derivatives**	A derivative instrument is a financial instrument or other contract with all of the following characteristics: • One or more underlyings and one or more notional amounts or payment provisions or both • Requires no initial net investment or an initial investment that is smaller than would be required for other	A derivative instrument is a financial instrument or other contract with all of the following characteristics: Its value changes in response to changes in a specified underlying • Requires no initial net investment or an initial investment that is smaller than would be required for other types of contracts with similar responses to changes in market factors
		types of contracts with similar responses to changes in market factors • **The contract can be settled net.**	• **Settled at a future date (not required under U.S. GAAP)**

2	**Derivative instruments - Classification**	Derivative instruments are classified as assets and liabilities at **fair value**, except those designated as hedging instruments.	Derivative instruments are classified as assets and liabilities at **fair value through profit or loss,** except those designated as hedging instruments.
		HEDGE ACCOUNTING	
1	**Hedging Instruments**	A proportion of a derivate instrument may be eligible for hedging under certain conditions.	Instruments are designated for hedging in their entirety, with certain exceptions.
2	**Qualifying criteria**	Similar to IFRS Standards. How ever, a *shortcut method* is permitted under which an entity is allowed to assume no ineffectiveness in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability and an interest rate swap if certain conditions are met.	A hedging relationship qualifies for hedge accounting only if all of the follow ing are met: • Hedging relationship includes only eligible hedging instruments and hedged items • At inception of hedging relationship there is formal designation and documentation of the hedging relationship and entity's risk management objective and strategy • All hedge effectiveness requirements are met
3	**Discontinue hedge accounting**	If the hedge fails the effectiveness test at any time the hedge ceases to qualify for hedge accounting.	Testing of hedge effectiveness is performed at least quarterly and thus the assessment is not based on when financial statements are issued. Discontinue hedge accounting prospectively when hedging relationship no longer meets qualifying criteria.