IND AS 28
INVESTMENT IN ASSOCIATES & JOINT VENTURES

I. Objective
a) Prescribes the accounting for investments in associates and 
b) Set out requirements for application of equity method for accounting for investments in associates & joint ventures. This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.

II. Definitions:
1. **Associate** is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

2. **Control** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

3. **Equity method** is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor’s share of net assets of the investee. The profit or loss of the investor includes the investor’s share of the profit or loss of the investee.

4. **Joint control** is the contractually agreed sharing of control over an economic activity, & exists only when the strategic financial & operating decisions relating to the activity require unanimous consent of the parties sharing control (the venturers).

5. **Joint Ventures** is one in which two or more companies form a new entity to carry out a specified operating purpose.
III. Significant Influence

1. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Generally, if an entity holds 20% or more of voting power of investee it is presumed to have significant influence. However, substance of the circumstance must be considered while establishing significant influence.

2. Existence of significant influence may be judged by the following factors:
   - Representation on the board of directors or equivalent governing body of the investee
   - Participation in policy-making processes, including participation in decisions about dividends or other distributions
   - Material transactions between the entity and its investee;
   - Interchange of managerial personnel
   - Provision of essential technical information

3. Any potential voting rights that will arise in future will not be considered while determining significant influence.

IV. Equity Method

1. When Investment is made: Investment in Associate A/c

   To Cash A/c

If Associate or joint venture makes profit: Investment in Associate A/c

   To Share in Profit from Associate A/c

In case of Loss reverse the entry

Cash dividend received

   Cash A/c

   To Investment in Associate A/c

2. 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 other comprehensive income of the investor.

3. An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor’s share of the net fair value of the associate’s identifiable assets and liabilities is accounted for as follows:
   
   i. Goodwill relating to an associate is included in the carrying amount of investment. Amortisation of that goodwill is not permitted as it is not recorded separately.
   
   ii. Any excess of the investor’s share of the net fair value of the associate’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.

4. The investor needs to apply equity method of accounting when it has joint control or significant influence over the investee except if an entity is a parent that is exempt from preparing consolidated financial statements by the scope exception as per IND AS 110 CFS.

5. An entity’s net investment in associate or joint venture includes investment in ordinary shares, other interests that are accounted using the equity method, and other long term interests, such as preference shares and long term receivables or loans, the settlement of which is neither planned nor likely to occur in the foreseeable future. These long term interests are not accounted for in accordance with Ind AS 28, instead they are governed by the principles of Ind AS 109.

5. Profits and losses resulting from ‘upstream’ and ‘downstream’ transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor’s financial statements only to the extent of unrelated investors’ interests in the associate. ‘Upstream’ transactions are, for example, sales of assets from an associate to the investor. ‘Downstream’
transactions are, for example, sales of assets from the investor to an associate. The investor’s share in the associate’s profits and losses resulting from these transactions is eliminated.

6. The investor should discontinue the use of Equity Method from the date the significant influence or joint control ceases.

7. When an associate or a JV has subsidiaries, associates or joint ventures, the consolidation should be done after including their financial elements in the that of associate or JV and after any adjustments necessary to give effect to uniform accounting policies.

8. If an investor’s share of losses of an associate equal or exceeds its interest in the associate, the investor discontinues recognising its share of further losses i.e. Investment in Associate or JV cannot turn negative.

6. After the investor’s interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

7. Impairment Loss: After application of the equity method, it is necessary to recognise any additional impairment loss with respect to Investor’s net investment in the associate or joint venture. There has to be substantial objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. There may be combined multiple events that may result in impairment. It is important to note that any losses expected from future events, no matter how likely, are not recognized. Objective evidences may include
V. Loss of Significant Influence

1. Investor shall discontinue equity method from the date that it ceases to have significant influence over an associate & shall account for the investment in accordance with Ind AS 32 from that date, unless associate becomes a subsidiary/JV.

2. On the loss of significant influence, investor shall measure at fair value any investment the investor retains in the former associate. The investor shall recognise in P&L any difference between:
   a. Fair value of any retained investment and any proceeds from disposing of the part interest in the associate; and
   b. the carrying amount of the investment at the date when significant influence is lost.

3. Fair value of investment at the date when it ceases to be an associate is considered as, fair value on initial recognition as a financial asset in accordance with Ind AS 32.

VI. Practical Questions

Q1. 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?

Q2. 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?

Q3. 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?

Q4. Entity X & entity Y, operate in 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 strategic direction of entity Y. Terms of agreement provide 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 & recruitment of new staff, 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.

Q5. BS acquired 40% of AD’s shares on 1st April 2014, the price paid was ₹ 1,40,000. AD’s equity status was as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity share capital</td>
<td>50,000</td>
</tr>
<tr>
<td>Securities Premium</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>50,000</td>
</tr>
<tr>
<td>Total</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>
Further AD reported a net income of ₹ 30,000 and paid a dividend of ₹ 10,000 for the year ended 31/03/2014. BS has a subsidiary on 31/03/2015, Calculate the amount at which the investment should be shown in consolidated balance sheet of BS on 31/03/2015.

Q6. Fincorp acquired 30% of Suncorp voting stock for ₹ 2,00,000 on 01/04/2014. On the date Suncorp has net worth of ₹ 6.67 Lakhs. Fincopr’s 30% interest in suncorp gain the ability to exercise significant control over suncorp’s operating financial policies. During the year 14-15 Suncorp limited earned ₹ 8,00,000 and paid interim dividend of ₹ 5,00,000. Calculate the amount at which the investment should be shown in consolidated balance sheet.

Q7. A ltd acquired 25% of shares in B Ltd on 31.03.2014 for ₹ 300,000 and the balance sheet of B ltd as on that date is follows.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Equity and Liabilities</td>
<td></td>
</tr>
<tr>
<td>a. Share capital</td>
<td>500,000</td>
</tr>
<tr>
<td>b. Reserves and Surplus</td>
<td>500,000</td>
</tr>
<tr>
<td>Total</td>
<td>10,00,000</td>
</tr>
<tr>
<td>2. Assets</td>
<td></td>
</tr>
<tr>
<td>a. Fixed Assets</td>
<td>500,000</td>
</tr>
<tr>
<td>b. Non Current Assets</td>
<td>200,000</td>
</tr>
<tr>
<td>c. Current Assets</td>
<td>300,000</td>
</tr>
<tr>
<td>Total</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

During the year ended 31.03.2015, followings is additional information available.

1. A received from B for this year ended 31.03.2014 at 40% from reserves.
2. B made a profit after tax of ₹ 7,00,000 for the year ended 31.03.2015.
3. B declared dividend at 50% for the year ended 31.03.2015 on 30.04.2015.
Prepare consolidated balance sheet as per IND AS 110. Calculate

1. Goodwill if any on acquisition of B

2. How A will reflect the investment value of B in CFS.

Q8. Given Below are the balance sheet of A ltd B Ltd and S ltd as on 31.03.2015 (₹ In Lakhs)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>1000</td>
<td>300</td>
<td>200</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>2000</td>
<td>500</td>
<td>300</td>
</tr>
<tr>
<td>Loan Funds</td>
<td>1000</td>
<td>200</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4000</td>
<td>1000</td>
<td>600</td>
</tr>
<tr>
<td>Fixed Asset</td>
<td>3100</td>
<td>600</td>
<td>400</td>
</tr>
<tr>
<td><strong>Non current Investment</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in Subsidiary S</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(80%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in Associate B</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(40%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Asset</td>
<td>100</td>
<td>400</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4000</td>
<td>1000</td>
<td>600</td>
</tr>
</tbody>
</table>

A acquired shares in B and S at the beginning of financial year 2014-2015 when balance reserves

and surplus of B and S were 600 and 400 respectively. The subsidiary and associate have sustained

loss of ₹ 100 Lakhs each during 2014 -2015 but neither of have declared dividends. Prepare

consolidated balance sheet.

Q9. X floated a Joint Venture with Y on 1:1 basis. A new venture Z is floated. Balance sheet of three

companies as on 31.03.2015 are given below.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>X</th>
<th>Y</th>
<th>Z</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>14000</td>
<td>10000</td>
<td>4000</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>24000</td>
<td>26000</td>
<td>2000</td>
</tr>
<tr>
<td>Loan Funds</td>
<td>14000</td>
<td>10000</td>
<td>8000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>52000</td>
<td>46000</td>
<td>14000</td>
</tr>
</tbody>
</table>
Fixed Asset 36000 40000 10000

Non current Investment

Investment in JV 2000 2000

Current Asset 14000 4000 4000

Total 52000 46000 14000

Prepare consolidated balance sheet

Q10. B Ltd acquired a 30% interest in D Ltd and achieved significant influence. The cost of the investment was ₹ 2,50,000. The associate has net assets of ₹ 5,00,000 at the date of acquisition. The fair value of those net assets is ₹ 6,00,000 as a fair value of property, plant & equipment is ₹ 1,00,000 higher than its book value. This property, plant & equipment has a remaining useful life of 10 years.

After acquisition D Ltd recognize profit after tax of ₹ 1,00,000 and paid a dividend out of these profits of ₹ 9,000. D Ltd has also recognized exchange losses of ₹ 20,000 directly in OCI. Calculate B Ltd’s interest in D Ltd at year end.

Theory Answers

A1. Despite the fact that 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 X Ltd. from exerting significant influence. In this situation, Y Ltd would not be an associate of X Ltd.

A2. 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. Considering circumstance even one board member may represent significant influence even if that board member has less than 20% of the voting power.

A3. Q Ltd is highly dependent on the retailer for its continued existence hence despite having only a 10% interest in Q Ltd, P Ltd has significant influence.
A4. The above arrangement 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 takes into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.
IND AS 111
JOINT ARRANGEMENTS

I. Objective

The objective of Indian Accounting Standard (Ind AS) 111 is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e. joint arrangements).

II. Joint Arrangement

1. A joint arrangement is an arrangement of which 2 or more parties have joint control. A joint arrangement has the following characteristics:

   a. The parties are bound by a contractual arrangement.

   b. Contractual arrangement gives two / more of those parties joint control of arrangement

Explanation:

   a. Contractual Agreements: Normally, there is a written contract that binds the parties. It outlines the terms and conditions based on which the parties will contribute in the arrangement. The contract, generally, includes matters such as

      a. Purpose of the arrangement;

      b. Duration of arrangement;

      c. Scope of activities

      d. The way the members of the governing body shall be appointed

      e. Contribution of capital by the parties;

      f. Sharing of assets, liabilities, revenues, expenses, profits or losses.

   b. Joint Control: The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The control is shared when all the parties involved in the arrangement, considered collectively, can make the relevant decisions of the arrangement. It requires that all the decisions about the relevant activities are being taken unanimously by the parties sharing control.
i. Collective control: Here, no single party enjoys full control i.e. contract gives all parties or a group of parties, control of the arrangement. For this first, one needs to identify the relevant activities of the arrangement i.e. activities which significantly affect the returns or the outcome of the arrangements. This can be done by understanding the purpose of arrangement & risk and returns involved in activities.

ii. Unanimous decision: There has to be unanimous consent of all parties having joint control on decisions for arrangement. Requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions without its consent.

III. Classification

a. An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

i. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators. It covers all arrangements that are not structured through separately identifiable financial structure, including separate legal entities (“Separate Vehicle”).

ii. A joint venture is a joint arrangement whereby parties that have joint control of arrangement have rights to net assets of arrangement. They are called joint venture partners.

b. Further, the arrangements which are structured through separate vehicle can be classified as Joint operation or Joint venture depending on the following:

i. Structure or the legal form of the joint arrangement is important in assessing the type of joint arrangement. It determines the initial assessment of parties’ rights to the assets and obligations for the liabilities held in the separate vehicle. The legal form specifies whether the parties have
interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.

*For Example, two parties may conduct a joint arrangement where the assets and liabilities of the separate vehicle are not individually controlled by the parties. Assets and liabilities so held are the assets and liabilities of the separate vehicle. Hence it will be a Joint venture. If the parties have right to individual assets and obligation for liabilities, then it will be a joint operation.*

ii. It is essential to understand the terms of the contractual arrangement in order to classify the joint arrangement. Pertinent questions, to be analysed from contract, are

1. Do parties have rights to assets and obligation to liabilities of the joint arrangements?
2. Do the parties share all interests (e.g. rights, title or ownership) in the assets relating to the arrangement in a specified proportion?
3. Do parties share all liabilities, obligations, costs & expenses in a specified proportion?
4. Does allocation of revenue & expenses are agreed on the basis of relative performance of each party to the joint arrangement?

If the answer to the above questions is ‘yes’, then arrangement is joint operations

iii. When the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

iv. It will then be worthwhile to consider whether the activities of arrangement primarily aim to provide parties with an output. This indicates that parties shall have rights to all the benefits of the assets of the arrangement. The parties will make sure that output is not sold to third parties but used by them only. Such are joint operations.

IV. **Accounting**

1. A joint operator shall **recognise** in relation to its interest in a joint operation the following in accordance with the applicable Ind AS:

   a. Its assets, including its share of any assets held jointly
b. Its liabilities, including its share of any liabilities incurred jointly

c. Its revenue from the sale of its share of the output arising from the joint operation

d. Its share of revenue from the sale of the output by the joint operation

e. Its expenses, including its share of any expenses incurred jointly

2. A joint venturer shall recognise its interest in a joint venture as an investment and shall account for
that investment using the equity method in accordance with Ind AS 28, Investments in Associates
and Joint Ventures

**Practical Question**

**Q1.** Two parties A & B agree in their contractual arrangement to establish an arrangement. Each has
50% of the voting rights. The contract specifies that at least 51% of the voting rights are required to
make decisions with respect to the relevant activities. Do A & B have joint control over the
arrangement?

**Q2.** There is an arrangement in which Ram and Shyam each have 35% of the voting rights in the
arrangement with the remaining 30% being widely dispersed. Decisions about the relevant
activities require approval by a majority of the voting rights. Do Ram & Shyam have joint control
over the arrangement?

**Q3.** An arrangement has three parties: Om has 50% of the voting rights in the arrangement and Jay and
Jagdish each have 25%. The contractual arrangement between Om, Jay and Jagdish specifies that at
least 75% of the voting rights are required to make decisions about the relevant activities of the
arrangement. Discuss the different combinations of joint control that can affect the decision making
of the relevant activities of the arrangement?
Q4. Entity C & entity D operates in a telecommunication industry and entered into a joint arrangement in order to combine their 4G access networks. Purpose of this arrangement is to reduce operating cost for both parties, make capital infrastructure savings & obtain economies of scale from jointly managing & maintaining a consolidated network. All significant decisions about strategic investing and financing activities are decided by a simple majority of the voting rights. Entity C and entity D each have one vote in the decision making process. Is it a joint arrangement or not.

Q5. NFG Limited is owned by numerous shareholders with the following holdings:
- Shareholders N owns 51%
- Shareholders F owns 30%
- The rest of the shares are widely held by other investors, altogether 19%.

NFG Limited’s articles of association require a 75% majority to approve decisions about any of the entity’s relevant activities. They also outline that each shareholder is entitled to vote in proportion to its respective ownership interest. Is NFG jointly controlled?

Q6. 2 entities, E & F, set up an entity and sign a joint operating agreement. Board is comprised of 3 directors appointed by & representing each entity. Board is entity’s main decision-making body. Decisions are made by simple majority. Each party has a 50% interest in the net profit. Is entity jointly controlled by E & F.

Q7. Entities P and Q set up a joint venture company, entity PQ by signing a joint operating agreement. Both investors delegate one director to entity PQ’s board of directors. Both directors have to agree unanimously on the decisions on the annual budget. The joint operating agreement also sets up an operating committee and specifies power delegated by the board of directors to the committee. The operating committee has the main operational decision-making responsibility. Decisions are made by simple majority in this committee. Only entity P can appoint members to the operating committee. Discuss if Entity PQ is a joint arrangement or not.
Q8. CDEF limited is a strategic co-operation between investors C, D, E and F to provide property development services. CDEF Limited is an incorporated entity, and investors’ share ownership is 20:30:25:25 respectively. There is a formal contractual agreement in place that requires a voting majority on all relevant activities. Investors C, D & E have informally agreed to vote together. This informal agreement has been effective in practice. Does C, D & E have control over the joint arrangement?

Q9. Shareholders C and D form a new joint arrangement (entity CD). Entity CD’s article of association including a clause stating that all shareholders must unanimously agree on the entity’s relevant activities. The shareholders have not entered into any other agreement to manage the activities of entity CD. Determine whether clause in CD’s articles of association is sufficient to meet the definition of joint arrangement?

Q10. ECL Limited has a wholly owned subsidiary, entity B, that holds a portfolio of buildings. ECL Limited wishes to reduce its exposure to this market. It sells 50% of its investment in entity B to Investment Bank. ECL Limited and Investment Bank enter into a contractual agreement, whereby decisions regarding entity B’s relevant activities are made jointly. ECL Limited continues to act as asset manager of entity B for a specified fee, and decisions are made in line with the entity B’s pre-approved budgets and business plan. Is entity B jointly controlled?

Q11. M Ltd. and N Ltd. set up a joint venture company, MN Ltd., by signing a joint operating agreement. Both investors delegate 3 directors each to entity MN’s board of directors. Decisions are made by simple majority. In the event of a deadlock, the chairman (a director of N Ltd.) has casting vote. Does N Ltd. has control over MN Ltd.?

Q12. Three separate aerospace companies form an alliance to jointly manufacture an aircraft. They carry responsibility for different areas of expertise such as:

- Manufacturing engines
• Manufacturing fuselage and wings; and
• Aerodynamics

They carry out different parts of the manufacturing process, each using its own resources and expertise in order to manufacture, market and distribute the aircraft jointly. Three entities share revenues from sale of aircraft and jointly incur expenses. The revenues and common costs are shared, as agreed in the consortium contract. Parties also incur their own separate costs such as labour costs, manufacturing costs, supplies, inventory of unused parts and work in progress. Each party recognizes its separately incurred costs in full. Would, arrangement be classified as joint operation?

Q13.
Two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity.

(i) Identify the type of arrangement?

(ii) If the parties modify the features of corporation though a contractual arrangement such that each has an interest in assets & each is liable for liabilities what type of joint arrangement would that be?

Q14. Entities B & C form a partnership to own & operate a crude oil refinery. Each party has 50% interest in net profits of partnership. What considerations would management have to consider in classifying arrangement as joint venture or joint operation?

Q15. Two parties, W and F form a limited company to build and use a pipeline to transport gas. Each party has a 50% interest in the company. Under their contractual terms, entities W and F must each use 50% of the pipeline capacity; unused capacity is charged at the same price as used capacity. Entities W and F can sell their share of the capacity to a third party without consent from both investors. The Price entities W and F pay for the gas transport is determined in a way that ensures all costs incurred by the company can be recovered. The Joint arrangement is structured through a
separate vehicle. Each party has a 50% interest in the company. However, contractual terms require a specific level of usage by each party and, because of the pricing structure, and the entities have an obligation for company’s liabilities. What type of joint arrangement the company might be?

Q16. Two parties structure a joint arrangement in an incorporated entity (entity D) in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of entity D (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity D are the assets and liabilities of entity D. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity D.

(i) What type of joint arrangement would entity D be?
(ii) Would your classification change if the parties instead of using the share of output themselves sold to third parties?
(iii) If parties changed the terms of contractual arrangement such that entity D would be able to sell the output to third parties, would your answer be same as in part (i) above?

Answers

A1. In this case joint control is implied as for every decision both the parties have to agree to arrive 51%.

A2. Only if the contractual agreement specifies that both Ram & Shyam require to take joint decision of relevant activities only then there is joint control.

A3. To be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to take decisions about the relevant activities of the arrangement.
A4. The contractual arrangement does not explicitly require unanimous consent, but the fact that all decisions must be made by majority leads to implicit joint control.

A5. NFG Limited is jointly controlled by shareholders N and F, based on their collectively ownership interest of 81%.

A6. Entities E and F are likely to have joint control, because each party has a 50% interest in net profit and both have a right to appoint three directors. This is because the three directors representing a single shareholder would generally be presumed to vote in accordance with the wishes of that shareholder. So the consent of both entity E and entity F would be required for decision making, and this would represent joint control. However, if the directors are not obliged to represent one shareholder, decisions will be made by simple majority. It is possible that (say) one director of shareholder E agrees with three directors of shareholder F and takes a decision that is against the interest of shareholder E. Although this is expected to be unlikely in practice, such a situation would not represent joint control. All relevant facts have to be considered before reaching such a conclusion.

A7. Although directors have veto rights over the annual budget, the decisions about relevant activities are not made at the board of directors level, but at operating committee level and entity P has control over the operating committee because it can appoint its members. Hence P is in control of entity PQ’s.

A8. In this case, a single investor cannot prevent a majority decision. However, three of investors have agreed to make unanimous decisions. Investors C, D & E, therefore, have joint control over CDEF Ltd., with investor F having significant influence at best.
A9. Entity CD meets the definition of a joint arrangement even though there is no separate joint venture agreement.

A10. Entity B is jointly controlled, as ECL Limited and investment bank are required to agree unanimously on relevant activities, and ECL must abide to those decision.

A11. It is likely that N Ltd. has control over MN Ltd., as decisions made on behalf of N Ltd. cannot be prevented by M Ltd. Once it is established that there is a Joint Arrangement, it is required to classify whether the arrangement is joint venture or joint operation.

A12. This arrangement is classified as a joint operation because:
- The arrangement is not structured through a separate vehicle;
- Each party has obligations for the costs it incurs separately; and
- The contractual agreement outlines that each party is entitled to a share of revenue and associated costs from the sale of aircrafts based on the pre-determined agreement.

A13. (i) On assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement. In this case it would be classified as joint venture.

(ii) If parties modify features of corporation through their contractual arrangement so that each has an interest in assets & each is liable for the liabilities in a specified proportion then the arrangement may be a joint operation.

A14. The joint arrangement is structured through a vehicle, and the venture parties each have a 50% interest in the net profits of the partnership; so this appears to be a joint venture. However, management needs to evaluate whether the partnership creates separation, that is simply are the assets and liabilities those of the separate vehicle or do the parties have direct rights to the assets and have direct obligations for the liabilities held by the entity. Should the parties to the partnership
have a direct interest in the assets and liabilities, this would indicate a joint operation. Management should therefore, evaluate terms of the partnership agreement to assess the rights and obligations of each party.

A15. This entity might be a joint operation despite its legal form.

A16. (i) The legal form of entity D and the terms of the contractual arrangement indicate that the arrangement is a joint venture. However, the parties also consider the following aspects of the arrangement: The parties agreed to purchase all the output produced by entity D in a ratio of 50:50. Entity D cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by entity D. From the fact pattern above, the following facts and circumstances are relevant: The obligation of the parties to purchase all the output produced by entity D reflects the exclusive dependence of entity D upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity D. The fact that the parties have rights to all the output produced by entity D means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity D.

These facts and circumstances indicate that the arrangement is a joint operation. (ii) The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in subsequent manufacturing process, the parties sold their share of the output to third parties. (iii) If the parties changed the terms of the contractual arrangement so that arrangement was able to sell output to third parties, this would result in entity D assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of joint arrangement. Such facts & circumstances would indicate that arrangement is a joint venture.
IND AS 32; IND AS 109; IND AS 107
FINANCIAL INSTRUMENTS

I. SCOPE & DEFINITIONS

A. SCOPE OF FINANCIAL INSTRUMENTS

Scope of financial instruments excludes the following:

1. Interests in subsidiaries, associates and joint ventures. However, in some cases, those standard require or permit selective application of this standard.

2. Rights and obligations under leases to which Ind AS 116 Leases applies. However, 
   (i) finance lease receivables (i.e. net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;
   (ii) lease liabilities recognised by a lessee are subject to the derecognition requirements of this Standard &
   (iii) derivatives that are embedded in leases are subject to embedded derivatives requirements of this standard.

3. Employers' rights and obligations under employee benefit plans.

4. rights and obligations arising under (i) an insurance contract as defined in Ind AS 104 However, in some cases, it requires or permit selective application of this standard.

5. Any forward contract to buy or sell an acquiree that will result in a business combination at a future acquisition date.

6. Loan commitments other than those loan commitments described below –
   i. loan commitments that the entity designates as financial liabilities at fair value through profit or loss.
   ii. loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives.
   iii. commitments to provide a loan at a below-market interest rate

7. Financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 Share-based Payment applies, except for contracts to buy certain non-financial items.

8. Rights to payments to reimburse as per Ind AS 37 Provisions, Contingent Liabilities & Contingent Assets or for which, in an earlier period, it recognised a provision in accordance with Ind AS 37.
9. Rights and obligations within the scope of Ind AS 115 Revenue from Contracts with Customers that are financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with this Standard.

10. Contracts to buy or sell non-financial items (‘own use exemption’) are outside the scope, except for
(a) Contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments,
   i. as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.
   ii. that are irrevocably designated as measured at FVTPL even if it was entered into for point i above.
(b) A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, where such a contract was not entered into for the purpose of point i above.

There are various ways in which a contract to buy or sell non-financial items can be settled net in cash or another FI or by exchanging FI. These include:
(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
(b) when the ability of point a above is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in that way
(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
(d) when, non-financial item that is the subject of the contract is readily convertible to cash.
1. Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Here, a contract refers to an agreement between two or more parties that has clear economic consequences and which parties usually are bound to adhere, usually because the agreement may be enforceable by law. Contracts need not be in writing and may take a variety of forms.

Any assets or liabilities that are not contractual are not financial liabilities or financial assets. For eg.: income taxes are a statutory obligation and not arising from contract or constructive obligations as defined in Ind AS 37 and Contingent Assets do not arise from contracts and hence, are not financial liabilities, etc. Some common examples

<table>
<thead>
<tr>
<th>Financial Assets</th>
<th>Financial Liabilities</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cash</td>
<td>1. Loans &amp; borrowings</td>
<td>1. Equity instruments</td>
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<tr>
<td>2. Trade receivables</td>
<td>2. Payables for purchase</td>
<td>issued</td>
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<tr>
<td>3. Investments in bonds and deposits</td>
<td>3. Finance lease</td>
<td>number of shares at fixed price against each warrant</td>
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<tr>
<td>4. Investment in equity instruments</td>
<td>4. Redeemable</td>
<td>Other instruments</td>
</tr>
<tr>
<td>5. Loans receivable, etc.</td>
<td>instruments like preferenceshares, debentures, etc.</td>
<td>convertible into fixed number of equity shares,</td>
</tr>
</tbody>
</table>

2. Financial Asset

A ‘financial asset’ is any asset that is:

a. Cash;

b. An equity instrument of another entity;

c. A contractual right:

i. to receive cash or another financial asset from another entity; or
ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or

d. a contract that will or may be settled in entity’s own equity instruments and is:

i. a non-derivative for which the entity is or may be obliged to receive a variable number of entity’s own equity instruments; or

ii. a derivative that will or may be settled other than by exchange of fixed amount of cash or another financial asset for a fixed number of entity’s own equity instruments.

The ability to exercise a contractual right or to satisfy a contractual obligation may be absolute or it may be contingent on occurrence of one or more future events, not wholly within the control of either party to the contractual arrangement. A contingent right and obligation meets the definition of financial asset and financial liability, even though such assets and liabilities are not always recognized in the financial statements. For e.g.: A lender may be provided with a financial guarantee by a party (‘guarantor’) on behalf of borrower, entitling to recover outstanding dues from guarantor if the borrower were to default, etc.

Following are not FA: Physical assets, Right of us asset, Intangible assets & prepaid expenses: Physical assets (such as inventories, property, plant and equipment), right-of-use assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such assets, creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

Prepaid expenses for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is delivery of goods & services rather than a contractual obligation to pay cash or another FA.
3. Financial Liability

A financial liability is any liability that is:

a. A contractual obligation:
   i. To deliver cash or other financial asset to another entity; or
   ii. To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

b. A contract that will or may be settled in entity’s own equity instruments and is:
   i. A non-derivative for which the entity is or may be obliged to deliver a variable number of entity’s own equity instruments; or
   ii. A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

*Example of potentially unfavourable:* PQR Ltd. issues a cash settled call option (i.e. an option to buy) to ABC Ltd. to subscribe to PQR Ltd’s equity shares at a price of ₹100 per share. If at the balance sheet date, market value of equity share of PQR Ltd. is ₹110 per share, PQR Ltd. will be obliged to pay ₹10 to settle the option. Such a condition is potentially unfavourable to PQR Ltd. and hence ₹10 represents a financial liability for PQR Ltd.

4. Equity Instruments:

4.1. An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. An instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met:

a. The instrument includes no contractual obligation:
   i. to deliver cash or another financial asset to another entity; or
   ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

b. If the instrument will or may be settled in the issuer's own equity instruments and it is:
i. a non-derivative that includes **NO** contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

ii. a derivative that will be settled only by the issuer exchanging a **fixed amount of cash or another financial asset for a fixed number of its own equity instruments** (F3T).

Note: For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed **amount of any currency** are equity instruments.

4.2. A key characteristic of equity instruments is that they carry **NO** contractual obligation throughout for any payment or distribution towards the holders of such instruments.

5. **Differentiating Between FL & Equity:**

A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of issuer either to deliver cash or another financial asset to the holder or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation is a financial liability. The FI is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease (i.e. when the consideration is variable). There are very limited exceptions to this principle in the form of “puttable instruments” and “obligations arising on liquidation”.

5.1 **Contracts settled in own equity instruments but classified as ‘FL’ (where equity instrument is treated as currency) –**

a. **Non Derivative Contract:** A contract that will be settled in a variable number of entity's own shares whose value equals a fixed amount is a financial liability, because the entity is under an obligation to pay a fixed amount, that is settled through equity instruments (similar to settlement in currency).

Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.
b. **Derivative Contracts:** A contract that will be settled in a variable number of the entity's own shares whose value equals an amount based on changes in an underlying variable (e.g. a commodity price) is a financial asset or a financial liability. *For e.g. is a written option to buy gold that, if exercised, is settled not in the entity’s own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract.*

c. If an entity has a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation, such a contract is a financial liability.

d. **Fixed for Fixed Test (F3T) -** A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument i.e. fixed amount of cash or other financial asset for fixed number of own equity instruments. If the

<table>
<thead>
<tr>
<th>Consideration for FI instruments to be issued</th>
<th>No. of own equity</th>
<th>Classification</th>
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<tbody>
<tr>
<td>Fixed</td>
<td>Variable</td>
<td>Financial liability</td>
</tr>
<tr>
<td>(own EI are being used as currency to settle an obligation for a fixed amount)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed</td>
<td>Fixed</td>
<td>Equity</td>
</tr>
<tr>
<td>(Issuer does not have an obligation to pay cash and holder is not exposed to any variability)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>Fixed</td>
<td>Financial liability</td>
</tr>
<tr>
<td>(though issuer does not have an obligation to pay cash, but holder is exposed to variability.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>Variable</td>
<td>Financial liability</td>
</tr>
<tr>
<td>(though issuer does not have an obligation to pay cash, but both parties are exposed to variability)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

f. In certain situations, an instrument is convertible only at the option of issuer. While such instruments provide the issuer with an unconditional right to avoid payment of cash, it is important to understand
the economic substance of the option. It is also very important to determine whether the option is exercised by the issuer or by shareholders acting in their capacity as instrument holders. For example, if the convertible instrument is held by the equity shareholders of the issuer and the conversion requires unanimous consent of all the shareholders, it would be inappropriate to consider that the issuer has an unconditional right to avoid payment of cash. In this situation, it would be more relevant to consider the rights of the instrument holders in their capacity as equity shareholders of the issuer.

6. **Exceptions to classification as ‘financial liability’ for instruments settled in cash or another FA**

   a. Puttable instrument is a financial instrument that gives the holder:

      i. the **right** (not an obligation) to put the instrument back to the issuer for cash or another financial asset, or

      ii. is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

      (The phrase “put back to the issuer” refers to redemption of the instrument. If the holder has a right, but not an obligation to require the issuer to redeem the instrument, it is referred to as “put option”.)

   b. An obligation to deliver cash or another financial asset may be classified as “equity”, despite the fact that they otherwise meet all the conditions for “financial liability” if **all** of the following conditions are fulfilled by the instrument (PICS NO)(POS NIC)

      P - **Pro rata share in net assets**

      N - **No other contractual obligation**

      O - **Other instrument restricting returns**

      I - **Identical Features in Sub class**

      of this instrument should not be there.

      C - **Cash flow over term only as ESH**

      S - **Sub class to all instruments**

   P - It **entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation.** The logic behind this requirement is that entitlement to a pro rata share of entity’s net assets on liquidation is equivalent to having a residual interest in assets of an entity.
O - The issuer must have **no other financial instrument or contract** that has:

  ✓ Total cash flows on same terms as equity see point ‘C’ below, with
  ✓ Effect of substantially restricting or fixing residual return to puttable instrument holders.

S - It is in the class of instruments that is **subordinate to all other classes of instruments**, i.e., in its present form, it has no priority over other claims to the entity's assets **on liquidation** (entity will need to assume liquidation on date of classification).

**Additional Conditions for Puttable Instruments**

N - In case of puttable instruments, apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, there are **no other contractual obligations** to deliver cash or another financial asset, or to settle in variable number of entity’s own equity instruments. In other words, there are no other features of the instrument which could satisfy the definition of financial liability”.

I - In case of puttable instruments, all financial instruments in the most subordinate class have **identical features**: For example, they must all be puttable, & formula or other method used to calculate the repurchase or redemption price is same for all instruments in that class.

C - In case of puttable instruments, the **total expected cash flows attributable to the instrument** over the life of the instrument are based substantially on the profit or loss, change in the recognised net assets or change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

In other words, if the cash flows are attributable to any factors other than the three listed above, for example, an index, the puttable instrument will fail the equity classification.
7. **Reclassification**

**Date of classification** of a financial instrument as an equity instrument in accordance with exceptions mentioned above should be done from the date when the instrument has all the features and meets the conditions set out above.

**Reclassification** of a financial instrument should be done from the date when the instrument ceases to have all the features or meet all the conditions set out above.

For example, if an entity redeems all its issued non-puttable instruments and any puttable instrument that remain outstanding have all the features and meet all the conditions mentioned above, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

**Accounting for reclassification**

FL to Equity – At carrying amount at reclassification date

Equity to FL – At Fair value on reclassification date and Profit and Loss is adjusted in Equity.

8. **Preference shares**

In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attached to the share to determine whether it exhibits the fundamental characteristic of a financial liability or an equity instrument, as explained below:

**A. Redeemable preference shares:**

i. Compulsorily Redeemable & Redeemable at the option of holder: This contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. Hence, classified as ‘financial liability’

ii. Redeemable at the option of Issuer: An option of the issuer to redeem shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. Hence, classified as ‘equity instrument’. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the
shareholders of an intention to redeem the shares, at which time this instrument shall be reclassified from ‘equity’ to ‘financial liability’.

B. **Non-redeemable preference shares:** When distributions to holders of preference shares, whether cumulative or non-cumulative, are at discretion of the issuer, the shares are equity instruments. The contractual terms determine nature of instrument. Any historical trend or ability of Issuer does not affect the classification of instrument as ‘equity’ / ‘financial liability’.

C. **Distributions on preference shares**

i. Other than the terms for redemption of financial instrument, another important point for consideration is whether Company has an obligation to make payments of dividend ie, whether dividend on preference shares are cumulative or non-cumulative.

ii. Where dividends are at the discretion of the issuer–this is akin to an equity instrument. However, where the instrument itself is redeemable, the obligation to pay still exists but only to the extent of the redemption value and not dividends on such shares unless they are declared.

Where dividends are cumulative but payable only on liquidation–One needs to assess the key terms of the instrument to check if the entity has a contractual obligation:

a. Where no contractual obligation exists to pay–such preference shares may themselves be irredeemable and the dividend on such shares even if cumulative, the entity may be under no obligation to pay unless upon liquidation – then such preference shares may be classified as equity.

b. Where contractual obligation exists –In cases where the preference shares are not redeemable, it is like an equity instrument. But if they are entitled to dividend which is payable such that entity does not have an unconditional right to defer payment, then this provides the shareholders with a lender’s return on the amount invested. Such Instruments are classified as ‘compound financial instruments’ and each of the components as mentioned above are accounted separately.
9. Contingent settlement provisions

A financial instrument may require an entity to deliver cash or another financial asset, or settle it in some other way that would require it to be classified as a financial liability, but only in the event of the occurrence or non-occurrence of some uncertain future event. The ‘event’ may be within the control of the issuer or of the holder, or beyond the control of both. These types of contractual arrangements are referred to as ‘contingent settlement provisions’.

If the outcome is not in control of either of the party then it should be classified as Financial Liability, because issuer of such instruments do not have unconditional right to avoid delivering the cash or any other financial asset. However the instrument may be classified as equity if:

a. The part of the contingent settlement provision that requires the settlement in cash or another FA is not genuine. Thus a contract that requires the settlement in cash or variable number of entities own shares on occurrence or non-occurrence of extremely rare, highly abnormal or very unlikely event is an equity instrument.

b. The issuer can be required to settle the obligation only in the event of liquidation.

c. Instrument has all the features of PICS NO then it may be classified as equity.

10. Settlement Options: When a derivative financial instrument gives one party a choice over how it is settled, it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument. For instance - a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash is a financial liability.

11. Settlement by delivery of instruments that meet conditions for exceptions to classification as financial liability: If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are:

i. puttable financial instruments with all the features and meeting the conditions of PICS NO or

ii. instruments that impose on entity an obligation to deliver to another party a pro rata share of net assets of the entity only on liquidation with all the features & meeting the conditions of PICS NO, the contract is a financial asset or a financial liability.
This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

12. Rights issues, options or warrants to acquire entity’s own equity instruments for any currency: Rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments.

13. Compound Financial Instrument:
Instruments which have features of both a financial liability and equity instrument are called “compound financial instruments

a. Split accounting for compound financial instruments: Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, initially carrying amount of a compound financial instrument is allocated between the equity and liability component. The amount assigned to equity component is residual amount after deduction the fair value of liability from the total fair value of whole instrument. No gain or loss arises from initially recognising the components of the instrument separately.

1. Carrying amount of the liability component is determined by measuring the net present value of the discounted cash flows of interest and/or principal, ignoring the possibility of exercise of the conversion option, if any.

2. The discount rate is the market rate at the time of inception for a similar liability that does not have an associated equity component and

3. Carrying amount of equity component is determined as balancing figure.

b. Conversion of compound financial instruments
On conversion of a convertible instrument at maturity, the entity:

1. Derecognises the liability component and

2. Recognises it as equity.
3. Original equity component remains as equity (although it may be transferred from one line item within equity to another).

4. There is no gain or loss on conversion at maturity.

c. **Early settlement of compound financial instruments**
   
   1. Calculate the fair value of remaining liability on the date of early settlement based on the discount rate on early settlement date.
   
   2. Consideration paid – Step 1 = Equity
   
   3. Step 1 – CA of liability on settlement date = Gain / Loss Debited to P&L
   
   4. Step 2 is debited to Equity (Gain / Loss on Equity component is adjusted in Equity)

d. **Amendment in terms**

   An entity may amend the terms of a convertible instrument to induce early conversion,

   The difference, at the date the terms are amended, between

   1. Fair value of the consideration the holder receives on conversion of the instrument under the revised terms and
   
   2. Fair value of consideration the holder would have received under the original terms, is recognised as a loss in profit or loss.

14. **Treasury Shares**

   If an entity reacquires its own equity instruments:

   a. Consideration paid for those instruments ('treasury shares') shall be deducted from equity.
   
   b. An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired.
   
   c. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments.

   In the consolidated financial statements, consideration for treasury shares acquired and held by other members of the consolidated group, is deducted from equity.
15. Interest, Dividends, Gain & Loss
   • The classification of a financial instrument as a financial liability or an equity instrument
determines whether interest, dividends, losses and gains relating to that instrument are recognised
as income or expense in profit or loss.
   • Interest, dividends, losses and gains relating to a financial instrument or a component that is a
financial liability shall be recognised as income or expense in profit or loss.
   • Distributions to holders of an equity instrument shall be recognised by the entity directly in equity.

16. Transaction costs:
   • Equity transaction – accounted for as a deduction from equity to the extent they are incremental
costs directly attributable to the equity transaction that otherwise would have been avoided. The
costs of an equity transaction that is abandoned are recognised as an expense.
   • Compound financial instrument – allocated to the liability and equity components of the
instrument in proportion to the allocation of proceeds.
   • Income tax relating to distributions to holders of an equity instrument and to transaction costs of
an equity transaction shall be accounted for in accordance with Ind AS 12 Income Taxes
   • Changes in the fair value of an equity instrument are not recognised in the financial statements.

17. Presentation:
   a. The amount of transaction costs accounted for as a deduction from equity in the period is disclosed
separately in accordance with Ind AS 1.
   b. Dividends classified as an expense may be presented in the statement of comprehensive income
either with interest on other liabilities or as a separate item.
   c. Gains and losses related to changes in the carrying amount of a financial liability are recognised as
income or expense in profit or loss even when they relate to an instrument that includes a right to
the residual interest in the assets of the entity in exchange for cash or another financial asset.

a. Offsetting differs from derecognition of a FA/FL. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss. A FA & FL shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

i. Currently has a **legally enforceable right to set off** the recognised amounts

ii. **Intends** either to settle on a net basis, or to realise the asset and settle the liability simultaneously

b. Offsetting is usually inappropriate when:

1. several different FI are used to emulate the features of a single FI (a 'synthetic instrument') - *For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt:*

   i. Each of the individual FI that together constitute a 'synthetic instrument' represents a contractual right or obligation with its own terms and conditions

   ii. Each may be transferred or settled separately.

   iii. Each FI is exposed to risks that may differ from risks to which other FI are exposed.

   Accordingly, when one FI in a 'synthetic instrument' is an asset and another is a liability, they are not offset unless they meet the criteria for offsetting.

2. FA & FL arise from financial instruments having the same primary risk exposure *(for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments)* but involve different counterparties;

3. Financial or other assets are pledged as collateral for non-recourse financial liabilities;

4. Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation *(for example, a sinking fund arrangement)*; or

5. Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.
II. Recognition & Measurement

A. Financial Asset – Initial Recognition & Measurement

1. Initial recognition of financial Asset is done at Fair value using Trade Date Accounting or Settlement Date Accounting. **Fair value** of a financial instrument at initial recognition is **normally the transaction price** (i.e., fair value of consideration given or received).

2. **Off market transaction**: Sometimes certain type of instruments may be exchanged at off market terms (i.e., different from market terms for a similar instrument if exchanged between market participants). In such cases the fair value of financial assets can be measured as present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument & with a similar credit rating.

Subsequent Recognition and Measurement

1. Classification of financial assets (FA) is determined based on business model that determines how cash flows of the financial asset are collected & contractual cash flow characteristics; and can be:
   
   (a) Measured at **Amortised cost**
   
   (b) Measured at fair value through comprehensive income (**FVOCI**)
   
   (c) Measured at fair value through profit or loss (**FVTPL**).

**Exception to above**: An entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a accounting mismatch i.e. measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

2. A. **Business model (BM) test**: An entity's business model refers to how an entity manages its financial assets in order to generate cash flows.

   a. Entity's business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular financial assets
only in a stress case scenario, that scenario would not affect the entity's assessment of the business model for those assets if the entity reasonably expects that such a scenario will not occur.

b. An entity's business model for managing financial assets is a matter of fact & not merely an assertion. It is typically observable through activities that entity undertakes to achieve the objective of the business model & is not determined by a single factor or activity. Instead, entity must consider all relevant evidence that are available.

B. **Contractual Cash Flows characteristics Test:**

1. Financial asset are classified on basis of its CCF characteristics and its business models.

2. To do so, an entity is required to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

3. Principal is the fair value of financial asset at initial recognition. However, that principal amount may change over the life of the financial asset (for example, if there are repayments of principal).

4. Components of interest elements: Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest.

3. **Amortised cost:** 
   Amortised cost is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method (EIR) of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

   **In applying effective interest method** – Entity identifies fees that are an integral part of the effective interest rate of a financial instrument. Such fees are treated as an adjustment to the effective interest rate. Such fees adjusted in effective interest rate are then amortised over then expected life of the instrument. However if the financial instrument is measured at FVTPL the fees are recognised as revenue or expense on initial recognition of instrument.
Examples of fees that are integral part of EIR: Origination fee received by the entity relating to the creation or acquisition of a financial asset., Commitment fee received by the entity to originate a loan where it is probable that the entity will enter into a specific lending arrangement. Fees that are Not an integral part of EIR: Fee charged for servicing a loan, Commitment fee to originate a loan when it is unlikely that a specific lending arrangement will be entered into.

### Summary of Financial assets subsequent measurement

Subsequent measurement of financial assets is based on their classification as defined below:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Asset measured at Amortised cost</th>
<th>Asset measured at FVOCI</th>
<th>Asset measured at FVTPL</th>
<th>Equity Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>BM</td>
<td>Collecting contractual cash flow &amp; selling of FA</td>
<td>If Not classified into anyone of the previous two then classified as this.</td>
<td>FVTPL may be irrevocably recognised as FVOCI</td>
<td></td>
</tr>
<tr>
<td>Contractual Cash flows</td>
<td>CCF are solely sum of principle &amp; interest on it.</td>
<td>CCF are solely sum of principle &amp; interest on it.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IR</td>
<td>At fair value</td>
<td>At fair value</td>
<td>At fair value</td>
<td>At fair value</td>
</tr>
<tr>
<td>Transaction Cost</td>
<td>Add</td>
<td>Add</td>
<td>Charge to P&amp;L</td>
<td>Add</td>
</tr>
<tr>
<td>SM</td>
<td>CA - Repayment</td>
<td>At fair value</td>
<td>At fair value</td>
<td>At fair value</td>
</tr>
<tr>
<td>Interest &amp; Dividends</td>
<td>P&amp;L</td>
<td>P&amp;L</td>
<td>P&amp;L</td>
<td>P&amp;L</td>
</tr>
<tr>
<td>FV Gains/ Losses</td>
<td>N.A.</td>
<td>Realised – P&amp;L</td>
<td>Realised – P&amp;L</td>
<td>Realised – OCI</td>
</tr>
<tr>
<td></td>
<td>Unrealised - OCI</td>
<td>Unrealised – P&amp;L</td>
<td>Unrealised – OCI</td>
<td></td>
</tr>
</tbody>
</table>

*Lecture No: ___ Date: ___ / ___ / ___*
B. Financial Liability

1. Initial Recognition & Measurement:
   Upon initial recognition, all financial liabilities are measured at fair value.

2. Subsequent Recognition & Measurement:
   The classification of financial liabilities shall be as follows:

A. Measured at amortised cost

B. Measured at fair value through profit or loss:
   i. Liabilities that meet the definition of “held for trading”
   ii. Contingent consideration recognized by an acquirer in a business combination

C. Designated at fair value through profit or loss

D. Other specific measurement basis (with changes recognized in profit or loss):
   Irrespective of above classification, any FL may be designated at fair value through profit or loss

   a. Amortised Cost: Interest cost using effective interest method – In P&L
   b. FVTPL: Fair Value Changes
      i. Unrealised gain / loss other than change in own credit risk – In P&L
      ii. Unrealised gain / loss for change in own credit risk – In OCI
      iii. Realised gain / Loss on derecognised – In P&L

III. Specific transactions:

1. Restructuring of financial liability:
   i. If modification is substantial, resulting in an extinguishment of the old financial liability –
      ✓ then the old liability is derecognised and the restructured financial instrument is treated as a new
      financial liability.
      ✓ the effective interest rate of the new financial liability is calculated based on the revised terms at
      the date of the modification.
any costs or fees incurred are recognised as part of the gain or loss on extinguishment and do not adjust the carrying amount of the new liability.

ii. If the exchange or modification is not accounted for as an extinguishment –

✓ then any costs & fees incurred are recognised as an adjustment to carrying amount of the liability.

✓ the entity shall revised the amortised cost of the financial liability to reflect revised future cash flows by discounting them to their present value at the original effective interest rate.

✓ Difference between carrying value and revised amortised cost is recognized as a gain or loss in P&L.

2. Financial Assets and Financial Liabilities held for trading:

1. Financial assets and liabilities held for trading are defined as those that:
   (a) are acquired or incurred principally for the purpose of sale or repurchase in the near term;
   (b) on initial recognition are part of a portfolio of identified FI that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
   (c) are derivatives.

2. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading are normally used with the objective of generating a profit from short-term fluctuations in price or a dealer's margin.

3. Financial liabilities that are incurred with an intention to repurchase them in the near term, such as quoted debt instruments that issuer may buy back in near term depending on changes in fair value.


a. An entity shall reclassify FA, only if the entity changes its business model for managing those FA.

b. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's business model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations e.g. when entity has acquired, disposed of / terminated a business line.
c. Following are not changes in business model:

- a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions);
- the temporary disappearance of a particular market for financial assets;
- a transfer of financial assets between parts of entity with different business models.

d. Following changes in circumstances are not reclassifications:

- an item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;
- an item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and
- changes in measurement for a financial instrument, if the entity takes credit derivative that is measured at fair value through profit or loss to manage the credit risk of all, or part of such financial instrument and consequently, the underlying financial instrument is also designated at fair value through profit or loss.

e. Financial liabilities are not permitted to be reclassified.

f. Measurement

<table>
<thead>
<tr>
<th>From</th>
<th>AC</th>
<th>AC</th>
<th>FVTPL</th>
<th>FVTPL</th>
<th>FVOCI</th>
<th>FVOCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>To</td>
<td>FVTPL</td>
<td>FVOCI</td>
<td>AC</td>
<td>FVOCI</td>
<td>AC</td>
<td>FVPTL</td>
</tr>
<tr>
<td>Measurement</td>
<td>FV on</td>
<td>FV on</td>
<td>FV on</td>
<td>FV</td>
<td>FV on</td>
<td>FV</td>
</tr>
<tr>
<td>of DOR</td>
<td>DOR</td>
<td>DOR</td>
<td>DOR (new gross CA)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>G/L on reclassification</td>
<td>P/L</td>
<td>OCI</td>
<td>P/L</td>
<td>P/L</td>
<td>Past G/L</td>
<td>Past G/L</td>
</tr>
<tr>
<td>trf. from</td>
<td>Equity to</td>
<td>Equity to</td>
<td>FV of</td>
<td>P/L</td>
<td>asset*</td>
<td></td>
</tr>
</tbody>
</table>

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AC – Amortised Cost, DOR – Date of Reclassification, G/L – Gain/ Loss, EIR – Effective Rate of Interest, CA – Carrying Amount. * FVOCI to Amortised cost: The financial asset is measured at reclassification date as if it had always been measured at amortised cost.

4. Impairment:

a. An entity shall recognise a loss allowance for expected credit losses on the following:
financial asset that is measured at amortised cost, financial asset that is measured at FVOCI, a lease receivable, a contract asset or a loan commitment; and a financial guarantee contract. Ind AS 107 defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'.

b. For financial assets, a credit loss is the present value of the difference between:
   i. the contractual cash flows that are due to an entity under the contract; and
   ii. the cash flows that the entity expects to receive discounted at original effective interest rate.

c. How is loss allowance to be provided?

1. Trade Receivables, Lease Receivables & Contract Asset: Measure life time credit loss

2. For other assets –
   i. If credit risk increased significantly - Measure life time credit loss
   ii. If credit risk not increased significantly – Measure 12 months credit loss

d. Determining whether credit risk has increased significantly:

   i. When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument.

   ii. 30 days past due rebuttable presumption:

   ✓ There is a rebuttable presumption that credit risk on entity has increase significantly since initial recognition when contractual payments are more than 30 days past due.
this can be butted when there is reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly even if outstanding has been due for more than 30 days.

Rebuttable presumption is not available if credit risk increases significantly before end of 30 days.

e. **Measurement of expected credit losses:**

An entity shall measure expected credit losses of a financial instrument in a way that reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; the time value of money; and reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

f. **An entity may use practical expedients when measuring expected credit losses.**

For example for trade receivables using a provision matrix.

<table>
<thead>
<tr>
<th>Nature of contract</th>
<th>Recognition principle – when are assets or liabilities recognised?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not Due</td>
<td>1 per cent</td>
</tr>
<tr>
<td>less than 30 days past due</td>
<td>2 per cent</td>
</tr>
<tr>
<td>more than 30 days but less than 90 days past due</td>
<td>3 per cent</td>
</tr>
<tr>
<td>90–180 days past due</td>
<td>20 per cent</td>
</tr>
</tbody>
</table>

5. **Timing of Recognition:**

1. Initial Recognition: As per Ind AS 109, an entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument. For e.g.

<table>
<thead>
<tr>
<th>Nature of contract</th>
<th>Recognition principle – when are assets or liabilities recognised?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unconditional receivables and payables</td>
<td>When entity becomes a party to contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash</td>
</tr>
<tr>
<td>Firm commitment to purchase or sell goods or services</td>
<td>When at least one of the parties has performed under agreement i.e. until ordered goods / services have been shipped, delivered or rendered.</td>
</tr>
<tr>
<td>Firm commitment to purchase / sell goods / services designated as measured at FVTPL (refer note 2 below)</td>
<td>Net fair value is recognised as an asset or a liability on the commitment date. On the commitment date. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero (refer note 1 below). If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Forward contract</td>
<td>Option contracts</td>
</tr>
<tr>
<td>When holder/writer becomes a party to contract (refer note 1 below).</td>
<td>Never</td>
</tr>
</tbody>
</table>

**Note 1**
Generally, no upfront premium is paid by one party in a forward contract to the other at the inception of the contract. This is indicative of the fact that the fair value of a forward contract on inception is approximately zero. On the other hand, the option holder generally pays an upfront premium to the option writer at the inception of the option contract. This provides evidence that there is some fair value of the rights and obligations of the parties at the inception of an options contract.

**Note 2**
Contracts to buy or sell non-financial assets that can be settled net or by exchanging financial instruments are treated as if they are financial instruments, that is, derivatives unless they were entered into and continued to be held to meet the entity’s normal purchase, sale or usage requirements.

2. Regular way purchase or sale of financial assets: Ind AS 109 defines a regular way purchase or sale as, a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. A regular way purchase or sale of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting.

3.A. Trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to

a. Buyer of asset - recognition of an asset to be received and the liability to pay for it on the trade date, &
b. Seller of asset - derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on trade date.

B. Settlement date is date that an asset is delivered to or by an entity. Settlement date accounting refers to
a. Buyer of Asset - recognition of an asset on the day it is received by the entity, and
b. Seller of asset: the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity and does not recognise any fair value changes between the trade date and settlement date.

c. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words,
i. the change in value is not recognised for assets measured at amortised cost;
ii. it is recognised in P&L for assets classified as FA measured at FVTPL and
iii. it is recognised in OCI for financial assets measured at FVTOCI and for investments in equity instruments for which irrevocable option is selected.

4. The above mentioned accounting principles apply only to financial assets and Ind AS 109 does not contain any such principles for financial liabilities.

IV. Derecognition

Financial Assets

1. Derecognition refers to timing of removing a financial asset from the balance sheet.

2. Applicability of Derecognition rules to a part of asset or whole asset.

A. Derecognition is applied only to part of asset if it meets any one of the conditions

<table>
<thead>
<tr>
<th>Rule</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets).</td>
<td>When an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument,</td>
</tr>
</tbody>
</table>

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3. Derecognition: An entity shall derecognise a financial asset when, and only when

A. the contractual rights to the cash flows from the financial asset expire, or

B. it transfers the financial asset and the transfer qualifies for derecognition.

A. Cash flows from a financial asset expire upon payment of entire due amount or the legal release of the debtor by the creditor from the obligation to pay. In case of derivatives, this condition is considered met when, for example, contractual exercise period of an option expires and option is not exercised.

B.1. An entity Transfers Financial Asset if and only if, it either:

i. Transfers the contractual rights to receive the cash flows of the financial asset, or

ii. Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients.
**Explanation:** When an entity retains the contractual rights to receive the cash flows of a financial asset (the ‘original asset’), but assumes a contractual obligation to pay those cash flows to one or more entities (the ‘eventual recipients’), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.

a. The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.

b. The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.

c. The entity has an obligation to remit any cash flows it collects on behalf of eventual recipients without material delay. In addition, entity is not entitled to reinvest such cash flows, except for investments in cash/cash equivalents during short settlement period from collection date to the date of remittance to eventual recipients along with the interest earned on such investments.

B3. When an entity transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

a. if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

b. if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.

c. if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of FA. In this case:

i. if the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

ii. if the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset.
Examples of when entity has transferred substantially all the risks and rewards of ownership are:

a) an unconditional sale of a financial asset;

b) a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase and

c) a sale of a financial asset together with a put or call option that is deeply out of the money (i.e. an option that is so far out of the money it is highly unlikely to go into the money before expiry);

Examples of when an entity has retained substantially all the risks and rewards of ownership are:

a) Sale & repurchase transaction where repurchase price is a fixed price or sale price + lender's return;

b) a sale of a financial asset together with a deep in-the-money put or call option (i.e. an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and

c) a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

B4. Whether the entity has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee, has the practical ability to sell the asset in its entirety to an unrelated third party, and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, then the entity has not retained control. In all other cases, the entity has retained control. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist.

4. Accounting treatment of transfers

A. Transfers that qualify for derecognition

1. On derecognition of a financial asset in its entirety, the difference between the carrying amount (measured at the date of derecognition) and consideration received shall be recognised in P&L.

2. If the transferred asset is part of a larger financial asset
a. Divide the carrying amount of the larger asset into CA of asset transferred and retained on the basis of the relative fair values of those parts on the date of the transfer.

b. The difference between CA allocated to part derecognised (as above) and consideration received for the part derecognised (including any new asset obtained less any new liability assumed) shall be recognised in profit or loss.

B. Transfers that do not qualify for derecognition

If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset,

a. the entity shall continue to recognise the transferred asset in its entirety and

b. shall recognise a financial liability for the consideration received.

C. Continuing involvement in transferred assets

If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset,

a. the entity continues to recognise the transferred asset to the extent of its continuing involvement (The extent of the entity’s continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset)

b. When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability.

D. Different forms of continuing involvement

1. When the entity’s continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity’s continuing involvement is the lower of

   i. Amount of the asset and

   ii. Maximum amount of consideration received that entity could be required to repay. (‘guarantee amt’)

2. When the entity’s continuing involvement takes the form of a written or purchased option on the transferred asset, the extent of the entity’s continuing involvement is the amount of the transferred
asset that the entity may repurchase. 3. In the case of a written put option on an asset that is measured at fair value, the extent of the entity’s continuing involvement is limited to the lower of

i. the fair value of the transferred asset and

ii. the option exercise price

3. When the entity’s continuing involvement takes the form of a cash-settled option, the extent of the entity’s continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.

Financial liabilities

A. General principles:

1. Timing of derecognition: An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires.

A financial liability (or part of it) is extinguished when the debtor either:

a. discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

b. is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor.

However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.

B. Accounting treatment for extinguishment

1. Gain / Loss transfer to P&L = CA of Liability transferred - Consideration paid

2. Further, in some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In these circumstances the debtor:

a. recognises a new financial liability based on the fair value of its obligation for the guarantee, &
b. recognises a gain or loss as difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

C. Exchange of financial liability instruments

1. Many times entities re-negotiate terms of their existing debt with lenders. In India, this is popularly known as “Strategic Debt Restructuring” or SDR. Sometimes, entities approach their lenders to renegotiate terms of their debt, when they want to take advantage of falling interest rate regime.

2. As per Ind AS 109, an exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability, and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it shall be accounted in same way.

3. The terms are substantially different if present value of cash flows under the new terms, (including any fees paid net of any fees received) discounted using the original effective interest rate, is at least 10% different from discounted present value of the remaining cash flows of the original FL.

4. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjusts the carrying amount of liability and are amortised over the remaining term of the modified liability.

5. Accounting: If the 10% test is passed, principle of “extinguishment accounting” are applied, that is:
   i. De-recognition of the existing liability
   ii. Recognition of the new or modified liability at its fair value (net of any fees incurred directly related to the new liability)
   iii. Recognition of a gain or loss (G/L = CA of old liability – FV of new liability)
   iv. Recognising any incremental costs or fees incurred for modification (and not for the new liability), and any consideration paid or received, in profit or loss
   v. Calculating a new effective interest rate for modified liability, which is then used in future periods.
Note: Fair value of the new or modified liability is estimated based on the expected future cash flows of the modified liability, discounted using the interest rate at which the entity could raise debt with similar terms and conditions in the market.

6. **Modification accounting**: Ind AS 109 is not clear as to the accounting treatment if the 10% test is failed. Two alternate approaches are therefore possible:

**Approach 1**: Recognition of gain or loss on date of modification

Under this approach, the difference between:

- discounted present value of the remaining cash flows of the original financial liability, and
- discounted present value of the remaining cash flows of the new financial liability both computed using original effective interest rate, is recognized in profit or loss. In addition, any fees or costs incurred will also be recognized in profit or loss.

**Approach 2**: Amortisation of gain or loss on date of modification

- the fees or costs incurred are netted against the existing liability;
- the effective interest rate is recalculated. This is the rate which discounts the future cash flows as per modified contractual terms to the adjusted carrying amount mentioned above
- adjusted EIR is used to determine the amortised cost & interest expense in future periods

C. **Debt for equity swaps**

A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as ‘debt for equity swaps’.

The accounting principles are summarised below:

**Step1**: An entity shall remove a financial liability (or part of a financial liability) from its balance sheet when, and only when, it is extinguished in accordance with derecognition principles.

**Step2**: When equity instruments issued it shall measure them at the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished.
Step 3: In case part extinguishment of liability, if part of the consideration paid relates to modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding.

Step 4: The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If it is, then entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability.

Step 5: The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in profit or loss.

V. Derivatives

1. Define: Ind AS 109. Appendix A defines a derivative as a financial instrument or other contract with all of the following three characteristics:

   i. Value changes due to an underlying: its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

   ii. No or little initial net investment: it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

   iii. Future settlement: it is settled at a future date.

The definition of derivative excludes contracts which fulfil following two conditions:

- Value of the contract changes with reference to one or more non-financial variables; and
- That non-financial variable is specific to one of the parties to the contract.

As per Ind AS 109, a change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable).
Examples of non-financial variables that are not specific to a party to the contract are an index of earthquake losses in a particular region and an index of temperatures in a particular city.

Non-financial variables specific to a party to the contract include:

- Occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract
- Residual value of an asset which changes in response to changes in the asset’s physical condition

VI. Embedded Derivative:

1. An embedded derivative is a component of a hybrid contract that also includes a non-derivative host with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. Host contract can be financial asset like debt, equity etc. or non-financial asset like purchase, sale, insurance etc.

Separation of Host contract is required for accounting if all the following conditions are met:

a. The host contract should not be a financial asset.

b. Characteristic of the host contract & embedded derivative should NOT be closely related.

c. Embedded Derivative must be in a position to function as a standalone derivative.

c. The hybrid contract or instrument should not be measured at FVTPL.

If any of the above conditions are not satisfied then the hybrid contract / instrument should be recognised as a single unit.

2. Prepayment options in debt instruments

It is very common to have debt prepayment options in ordinary borrowing arrangements. “A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:

i. the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or

ii. the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract.
(Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.)

Note: Assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with Ind AS 32.”

3. Foreign currency derivative embedded in contract for purchase or sale of non-financial items

Another common situation in trade and commerce in today’s world is a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency.

“An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

i. the functional currency of any substantial party to that contract;

ii. the currency in which the price of related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as USD for crude oil transactions) or

iii. a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g. a relatively stable and liquid currency that is commonly used in local business transactions or external trade).”

Unless above exceptions apply, embedded foreign currency derivative should be separated from host contract.

Certain guidance on how to carry out the separation are enumerated below in detail:

1. the host contract is a sale or purchase contract denominated in functional currency of reporting entity

2. the amount of functional currency is determined using the relevant forward exchange rate (to the date of delivery) at the date the contract is entered into

3. the embedded derivative is a forward currency contract to buy or sell the applicable amount of the contract currency for the functional currency, at the same forward exchange rate. The effect is that the fair value of the embedded derivative is initially zero

4. subsequent changes in the fair value of the embedded derivative are recorded in profit or loss
5. On delivery of the non-financial item, the host contract is fulfilled and the embedded derivative is effectively settled. A foreign currency debtor or creditor is recognised for the contract amount, translated at the spot rate in accordance with Ind AS 21. The closing carrying amount of the embedded derivative is added to the functional currency amount of the host contract to give the initial carrying amount of the debtor or creditor.

4. Option and non-option based derivatives

A. Non-option based derivatives

The terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid contract. Non-option based derivatives represent obligations of the counterparties to a contract.

Fair value of a FI is a combination of its intrinsic value and time value. In a fair and perfect market, it would be inappropriate to conclude that immediately at the inception of a contract, it results in creation of rights and obligations for two independent parties i.e. the contract has no intrinsic value at inception. Also, the time value starts accumulating only after the first day of the contract.

Further, in the case of non-option based derivatives, terms of the host debt instrument reflect the (a) stated or (b) implied substantive terms of the hybrid contract. In the absence of implied or stated terms, the entity makes its own judgement of the terms.

B. Option based derivatives

The economic behaviour of a hybrid contract with an option-based embedded derivative depends critically on the strike price (or exercise price) specified for the option feature in the hybrid contract. Therefore, the separation of an option-based embedded derivative should be based on the stated terms of the option feature documented in the hybrid contract (unlike a non-option based derivative which is separated on the basis of implied terms also). As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at initial recognition of hybrid contract.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward
price will occur at a specified date, while the terms of an option are such that a payment based on the
difference between the price of the underlying and the strike price of the option may or may not occur
depending on the relationship between the agreed strike price and the price of the underlying at a
specified date or dates in the future. Adjusting the strike price of an option-based embedded
derivative, therefore, alters the nature of the hybrid contract. On the other hand, if the terms of a non-
option embedded derivative in a host debt instrument were determined so as to result in a fair value of
any amount other than zero at the inception of the hybrid contract, that amount would essentially
represent a borrowing or lending. Accordingly, it is not appropriate to separate a non-option
embedded derivative in a host debt instrument on terms that result in a fair value other than zero at
the initial recognition of the hybrid contract.

5. **Accounting for embedded derivatives**
   
a. If the embedded derivatives are required to be separated, an entity shall measure the derivatives at fair
   value at initial recognition and subsequently at FVTPL.

b. Initial carrying amount of host instrument is **residual amount** after separating embedded derivative.

As per Ind AS 109, if a contract contains one or more embedded derivatives and the host is not a
financial asset, an entity may designate the entire hybrid contract as at FVTPL unless:

i. the embedded derivative does not significantly modify the cash flows that otherwise would be
   required by the contract; or

ii. it is clear with little or no analysis when a similar hybrid instrument is first considered that separation
   of the embedded derivative is prohibited, such as a prepayment option embedded in a loan that
   permits the holder to prepay the loan for approximately its amortised cost.

c. These are two exceptions to the general principle that hybrid contracts can be measured at fair value
   in their entirety, without separation of embedded derivatives. Refer explanation below Illustration 5
   for interpretation of the phrase “significantly modify cash flows” mentioned above.

d. Further Ind AS 109, if an entity is required to separate an embedded derivative from its host, but is
   unable to measure the embedded derivative separately either at acquisition or at the end of a
   subsequent financial reporting period, it shall designate the entire hybrid contract as at FVTPL.
e. If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded derivative using this method, the hybrid contract is designated as at FVTPL.

VII. Hedge Accounting

1. The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss or other comprehensive income.

2. **Identifying the hedged item and designation of hedged items**

A hedged item can be a recognised asset or liability, an unrecognised firm commitment, a forecast transaction or a net investment in a foreign operation. The hedged item can be a single item or a group of items. A hedged item can also be a component of such an item or group of items.

a. The hedged item must be reliably measurable.

b. If a hedged item is a forecast transaction, that transaction must be highly probable.

c. An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship.

i. An entire item comprises all changes in cash flows or fair value of an item.

ii. A component comprises less than entire fair value change / cash flow variability of an item. In that case, an entity may designate only following types of components or its combinations) as hedged items:

- Only changes in the cash flows or fair value of an item attributable to a specific risk or risks, provided that, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable. Risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or other variable (a one-sided risk).
- One or more selected contractual cash flows.
- Components of a nominal amount, i.e. a specified part of the amount of an item
3. **Qualifying instruments for hedge accounting and designation of hedging instruments**

Hedging Instrument may be a derivative measured at FVTPL (Except Written Option) or non-derivative FA / FL measures at FVTPL.

4. **Exceptions to designating non-derivative financial asset or non-derivative financial liability as hedging instrument**

   a. A financial liability designated as at FVTPL for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in OCI.

   b. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative FA/FL may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in OCI.

   c. For hedge accounting purposes, only contracts with a party external to the reporting entity or group can be designated as hedging instruments.

   d. A qualifying instrument must be designated in its entirety as a hedging instrument.

   The only exceptions permitted are:

   • Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and not the change in its time value;

   • separating the forward element and the spot element of a forward contract and designating as the hedging instrument only the change in the value of the spot element of a forward contract and not the forward element; and

   • a proportion of the entire hedging instrument, such as 50% of the nominal amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding.

5. **Written options are not hedging instruments:** A derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation.

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6. **A hedging relationship qualifies for hedge accounting** only if all of the following criteria are met:

(a) Hedging relationship consists only of eligible hedging instruments and eligible hedged items.

(b) At the inception of the hedging relationship, there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio)

(c) Hedging relationship meets all of the following hedge effectiveness requirements:

i. there is an economic relationship between the hedged item and the hedging instrument;

ii. the effect of credit risk does not dominate the value changes that result from that economic relationship; and

iii. the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting.

7. **Accounting for qualifying hedging relationship**

a. An entity applies hedge accounting to hedging relationships that meet the qualifying criteria.

b. There are three types of hedge relationship: Fair Value hedge, Cash Flow hedge & Hedge of Net investment in foreign operation.

c. **Fair value hedge**: A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss.
d. i. If the hedged item is a financial asset (or a component thereof) that is measured at FVTOCI other
than equity instrument designated as FVTOCI, the hedging gain or loss on the hedged item shall be
recognised in profit or loss.

ii. When a hedged item is an unrecognised firm commitment (or a component thereof), the cumulative
change in the fair value of the hedged item subsequent to its designation is recognised as an asset or a
liability with a corresponding gain or loss recognised in profit or loss.

e. **Cash flow hedge:** A cash flow hedge is a hedge of the exposure to variability in cash flows that is
attributable to a particular risk associated with all, or a component of, a recognised asset or liability
(such as all or some future interest payments on variable debt), or a highly probable forecast
transaction, and could affect profit or loss.

Where a cash flow hedge meets the qualifying criteria, it shall be accounted as follows:

- The separate component of equity associated with the hedged item (cash flow hedge reserve) is
adjusted to the lower of the following (in absolute amounts):
  1. The cumulative gain or loss on the hedging instrument from inception of the hedge; and
  2. The cumulative change in fair value (present value) of the hedged item (i.e. the present value of the
cumulative change in the hedged expected future cash flows) from inception of the hedge.

- The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge
(i.e. the portion that is offset by the change in the cash flow hedge reserve calculated in accordance
with (a)) shall be recognised in other comprehensive income.

- any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the
change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that
shall be recognised in profit or loss

- the amount that has been accumulated in the cash flow hedge reserve in accordance with (a) shall be
accounted for as follows:
  1. If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or
non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial
liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall
remove that amount from the cash flow hedge reserve and include it directly in the initial cost or
other carrying amount of the asset or the liability. This is not a reclassification adjustment as defined in IAS 1 and hence it does not affect other comprehensive income.

ii. For cash flow hedges other than those covered by (i), that amount shall be reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment in the same period or periods during which the hedged expected future cash flows affect profit or loss (for example, in the periods that interest income or interest expense is recognised or when a forecast sale occurs).

iii. However, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment.

f. **Hedge of net investment in foreign operation:** Hedge of a net investment in foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, shall be accounted for similarly to cash flow hedges:

- Portion of gain/loss on hedging instrument that is determined to be effective hedge - Gain/loss recognized in OCI (Foreign currency translation reserve)
- Ineffective portion - Gain/loss recognized in P&L

The cumulative gain or loss on hedging instrument relating to effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from equity to profit or loss as a reclassification adjustment on the disposal or partial disposal of the foreign operation.

**VIII. DISCLOSURES**

Ind AS 107 provides disclosures for financial instruments to be made in the financial statements that enable users to evaluate:

(a) The significance of financial instruments for the entity’s financial position and performance; and

(b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period; and how the entity manages those risks.
Balance Sheet

1. Categories of financial assets and financial liabilities

The carrying amounts of each of the following categories, as defined in Ind AS 109, shall be disclosed either in the statement of financial position or in the notes:

(a) FA & FL measured at FVTPL, showing separately
   - those designated as such upon initial recognition or subsequently in accordance with Ind AS 109 (ie, FA / FL whose credit risk exposure is managed through credit derivative that is measured at fair value through profit or loss and hence, such FA / FL is also managed at FVTPL) and
   - FA mandatorily measured at fair value through profit or loss in accordance with Ind AS 109.
   - FL that meet the definition of held for trading in Ind AS 109.

(b) FA & FL measured at amortised cost.

(c) FA measured at FVTOCI, showing separately –
   - FA that are measured at FVTOCI in accordance with Ind AS 109;
   - Investments in equity instruments designated as such upon initial recognition as per Ind AS 109.

2. FA / FL at FVTPL

2.1 If the entity has designated as measured at FVTPL a FA (or group of FA) that would otherwise be measured at FVTOCI or amortised cost, it shall disclose:

   (a) the maximum exposure to credit risk of FA (or group of FA) at the end of the reporting period.

   (b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

   (c) the amount of change, during the period and cumulatively, in fair value of FA (or group of FA) that is attributable to changes in the credit risk of FA determined either:

      i. as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or

      ii. using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.
Changes in market conditions that give rise to market risk include changes in an observed
(benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.
(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that
has occurred during the period and cumulatively since the financial asset was designated.

2.2 If the entity has designated a FL as at FVTPL in accordance with Ind AS 109 and is required to
present the effects of changes in that liability's credit risk in OCI, it shall disclose:
(a) the amount of change, cumulatively, in the fair value of the FL that is attributable to changes in the
credit risk of that liability
(b) the difference between the financial liability's carrying amount and the amount the entity would be
contractually required to pay at maturity to the holder of the obligation.
(c) any transfers of the cumulative gain or loss within equity during the period including the reason for
such transfers.
(d) if a FL is derecognised during the period, amount (if any) presented in OCI that was realised at
derecognition.

2.3 If an entity has designated a FL as at FVTPL in accordance with Ind AS 109 and is required to
present all changes in the fair value of that liability (including the effects of changes in the credit risk
of the liability) in profit or loss, it shall disclose:
(a) Amount of change, during the period and cumulatively, in the fair value of the FL that is attributable
to changes in the credit risk of that liability; and
(b) Difference between the financial liability's carrying amount and the amount the entity would be
contractually required to pay at maturity to the holder of the obligation.

3. Investments in equity instruments designated at FVTOCI
If an entity has designated investments in equity instruments to be measured at FVTOCI in
accordance with Ind AS 109, it shall disclose:
(a) which investments in equity instruments have been designated to be measured at FVTOCI.
(b) the reasons for using this presentation alternative.
(c) the fair value of each such investment at the end of the reporting period.

(d) dividends recognised during the period, showing separately those related to investments derecognised and those held at the end of the reporting period.

(e) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

4. If an entity derecognised investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

(a) the reasons for disposing of the investments

(b) the fair value of the investments at the date of derecognition

(c) the cumulative gain or loss on disposal.

5. Reclassifications

5.1 An entity shall disclose if, in the current or previous reporting periods, it has reclassified any FA in accordance with Ind AS 109. For each such event, an entity shall disclose –

(a) the date of reclassification.

(b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.

(c) the amount reclassified into and out of each category.

5.2 For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of FVTPL category so that they are measured at amortised cost or FVTOCI.

(a) the effective interest rate determined on the date of reclassification; and

(b) the interest revenue recognised.

5.3 If, since its last annual reporting date, an entity has reclassified FA out of the FVTOCI category so that they are measured at amortised cost; or out of the FVTPL category so that they are measured at amortised cost or FVTOCI it shall disclose:

(a) the fair value of the FA at the end of the reporting period; and
(b) the fair value gain or loss that would have been recognised in profit or loss or OCI during the reporting period if the financial assets had not been reclassified.

6. Off-setting financial assets and financial liabilities

An entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised FA / FL that have been off-set in accordance with Ind AS 32:

(a) the gross amounts of those recognised FA / FL;

(b) the amounts that are set off as per Ind AS 32 when determining the net amounts presented in B/S;

(c) the net amounts presented in B/S;

(d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in the information disclosed for amounts set off in paragraph (b) above, including:

i. amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in Ind AS 32; and

ii. amounts related to financial collateral (including cash collateral); and

(e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

7. Collateral

7.1 An entity shall disclose:

(a) the carrying amount of FA it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with Ind AS 109; and

(b) the terms and conditions relating to its pledge.

7.2 When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or re-pledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

(a) The fair value of the collateral held;

(b) Fair value of any such collateral sold or re-pledged, & whether entity has an obligation to return it &

(c) The terms and conditions associated with its use of the collateral.
8. Allowance for credit losses

The carrying amount of FA measured at FVTOCI is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the B/S as a reduction of the carrying amount of the FA. However, an entity shall disclose the loss allowance in the notes to the financial statements.

9. Compound financial instruments with multiple embedded derivatives

If an entity has issued an instrument that contains both a liability and an equity component and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

10. Defaults and breaches

10.1 For loans payable recognised at the end of the reporting period, an entity shall disclose:

(a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) The carrying amount of the loans payable in default at the end of the reporting period; and

(c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

10.2 If, during the period, there were breaches of loan agreement terms other than those that are existing at the year end and covered by year-end disclosure above, an entity shall disclose the same information as required by paragraph above, if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).
Statement of Profit and Loss

An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) Net gains or net losses on:
   i. FA or FL measured at FVTPL, showing separately those on FA / FL designated as such upon initial recognition or subsequently in accordance with Ind AS 109, and those on FA / FL that are mandatorily measured at FVTPL in accordance with Ind AS 109

   For FL designated as at FVTPL, an entity shall show separately the amount of gain or loss recognised in OCI and the amount recognised in profit or loss.

   ii. Financial liabilities measured at amortised cost

   iii. Financial assets measured at amortised cost

iv. Investments in equity instruments designated at FVTOCI in accordance with Ind AS109

v. FA measured at FVTOCI in accordance with Ind AS 109, showing separately the amount of gain or loss recognised in OCI during the period and the amount reclassified upon derecognition from accumulated OCI to profit or loss for the period.

(b) Total interest revenue and total interest expense (calculated using the effective interest method) for FA that are measured at amortised cost or that are measured at FVTOCI (showing these amounts separately); or FL that are not measured at FVTPL.

(c) Fee income & expense (other than amounts included in determining the effective interest rate) arising from:
   i. FA and FL that are not at FVTPL; and

   ii. Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.

Other Disclosures

1. **Accounting policies**: An entity discloses its significant accounting policies comprising the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.
2. **Hedge accounting:** An entity shall apply these disclosure requirements for those risk exposures that an entity hedges and for which it elects to apply hedge accounting. Hedge accounting disclosures shall provide information about:

(a) an entity's risk management strategy and how it is applied to manage risk;
(b) how entity's hedging activities may affect the amount, timing & uncertainty of its future cash flows &
(c) the effect that hedge accounting has had on the entity's Balance Sheet, statement of comprehensive income and statement of changes in equity.

3. **Fair value**

i. For each class of FA & FL, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount. In disclosing fair values, an entity shall group FA & FL into classes, but shall offset them only to extent that their carrying amounts are offset in balance sheet.

ii. In some cases, an entity does not recognise a gain or loss on initial recognition of a FA & FL because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets. In such cases, the entity shall disclose by class of financial asset or financial liability:

(a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability
(b) aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

iii. Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value.
(b) for a contract containing a discretionary participation feature (as described in Ind AS 104) if the fair value of that feature cannot be measured reliably; or
(c) for lease liabilities.
4. **Nature and extent of risks arising from financial instruments**

i. **Qualitative disclosures**: For each type of risk arising from financial instruments, an entity shall disclose:

   (a) the exposures to risk and how they arise;

   (b) its objectives, policies & processes for managing the risk and methods used to measure the risk; and

   (c) any changes in (a) or (b) from the previous period.

ii **Quantitative disclosures** – For each type of risk arising from financial instruments, including –
credit risk, liquidity risk and market risk, an entity shall disclose:

   (a) summary quantitative data about its exposure to that risk at the end of the reporting period. This
disclosure shall be based on the information provided internally to KMP of entity.

   (b) certain detailed disclosures required for each type of risk mentioned above, to the extent not provided
in accordance with (a).

   (c) concentration of risk if not apparent from the disclosures made in accordance with (a) and (b).

5. **Credit risk**: An entity shall apply the disclosure requirements in of Ind AS 107 (as described below)
to financial instruments to which the impairment requirements in Ind AS 109 are applied. However:

   (a) For trade receivables, contract assets & lease receivables, paragraph 35J(a) applies to those trade
receivables, contract assets or lease receivables on which lifetime expected credit losses are
recognised as per Ind AS 109, if those FA are modified while more than 30 days past due; and

   (b) paragraph 35K(b) does not apply to lease receivables.

   (c) The credit risk disclosures described below shall enable users of financial statements to understand
the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this
objective, credit risk disclosures shall provide:

   i. information about an entity's credit risk management practices and how they relate to the recognition
and measurement of expected credit losses, including the methods, assumptions and information used
to measure expected credit losses

   ii. quantitative and qualitative information that allows users of financial statements to evaluate the
amounts in the financial statements arising from expected credit losses, including changes in the
amount of expected credit losses and the reasons for those changes; an
iii. information about an entity's credit risk exposure (i.e., the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations.

6. **The credit risk management practices:** An entity shall explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of FS to understand and evaluate:

   (a) how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:

      i. financial instruments are considered to have low credit risk in accordance with Ind AS 109, including the classes of financial instruments to which it applies; and

      ii. the presumption of Ind AS 109, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted;

   (b) an entity's definitions of default, including the reasons for selecting those definitions;

   (c) how the instruments were grouped if expected credit losses were measured on a collective basis;

   (d) how an entity determined that financial assets are credit-impaired financial assets;

   (e) an entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and

   (f) how the requirements in Ind AS 109 for the modification of contractual cash flows of financial assets have been applied, including how an entity:

      i. determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has improved to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with Ind AS 109; and

      ii. monitors the extent to which loss allowance on FA meeting the criteria in (i) is subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with Ind AS 109.

7. An entity shall explain the inputs, assumptions and estimation techniques used to apply the impairment requirements in Ind AS 109. For this purpose, an entity shall disclose:

   (a) the basis of inputs and assumptions and the estimation techniques used to:
i. measure the 12-month and lifetime expected credit losses;

ii. determine whether the credit risk of FI has increased significantly since initial recognition; and

iii. determine whether a financial asset is a credit-impaired financial asset.

(b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and

(c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

8. Quantitative and qualitative information about amounts arising from expected credit losses

To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

(a) the loss allowance measured at an amount equal to 12-month expected credit losses;

(b) the loss allowance measured at an amount equal to lifetime expected credit losses for:

i. financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

ii. financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

iii. trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with Ind AS 109

(c) financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

9. Credit risk exposure

To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments:

(a) for which the loss allowance is measured at an amount equal to 12-month expected credit losses;
for which loss allowance is measured at an amount equal to lifetime expected credit losses & that are:

i. financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

ii. FA that are credit-impaired at reporting date (but that are not purchased/originated credit-impaired) &

iii. trade receivables, contract assets or lease receivables for which the loss allowances are measured at life-time expected credit losses as an option provided in Ind AS 109.

10. For all financial instruments to which the impairment requirements in Ind AS 109 are not applied, an entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not quality for offset in accordance with Ind AS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) a description of collateral held as security and other credit enhancements, and their financial effect (eg quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

11. **Liquidity risk:** An entity shall disclose:

(a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

(b) a maturity analysis for derivative financial liabilities.

The maturity analysis shall include remaining contractual maturities for those derivative FL for which contractual maturities are essential for an understanding of the timing of cash flows.

(c) a description of how it manages the liquidity risk inherent in (a) and (b).

12. **Market risk:** An entity shall disclose:

(a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

(b) the methods and assumptions used in preparing the sensitivity analysis; and
(c) changes from the previous period in methods & assumptions used, and the reasons for such changes.

13. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified above. Entity shall also disclose:

(a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

(b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

IX. Practical Questions

Financial Assets

Q1. A Ltd. makes sale of goods to customers on credit of 45 days. The customers are entitled to earn a cash discount @ 2% per annum if payment is made before 45 days and an interest @ 10% per annum is charged for any payments made after 45 days. Company does not have a policy of selling its debtors and holds them to collect contractual cash flows. Evaluate the financial instrument.

Q2. Z Ltd. (the ‘Company’) makes sale of goods to customers on credit. Goods are carried in large containers for delivery to the dealers’ destinations. All dealers are required to deposit a fixed amount of ₹ 10,000 as security for the containers, which is returned only when the contract with Company terminates. The deposits carry 8% per annum which is payable only when the contract terminates. If the containers are returned by the dealers in broken condition or any damage caused, then appropriate adjustments shall be made from the deposits at the time of settlement. How would such deposits be treated in books of the dealers?

Q3. A Ltd. issues a bond at principal amount of CU 1000 per bond. The terms of bond require annual payments in perpetuity at a stated interest rate of 8 per cent applied to the principal amount of CU 1000. Assuming 8 % to be the market rate of interest for the instrument when it was issued, the issuer
assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU 1,000 on initial recognition. Evaluate FI, in hands of both the holder & issuer.

Financial Liability

Q4. A Ltd. (the ‘Company’) makes purchase of steel for its consumption in normal course of business. The purchase terms provide for payment of goods at 30 days credit and interest payable @ 12% per annum for any delays beyond the credit period. Analyse the nature of this financial instrument.

Q5. A Ltd. (the ‘Company’) makes a borrowing for INR 10 lacs from RBC Bank, with bullet repayment of INR 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay INR 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

(a) Does the above instrument meet definition of financial liability? Please explain.

(b) Analyse the differential amount to be exchanged for one-time settlement.

Q6. Entity – B Ltd writes an option contract for sale of shares of Target Ltd. at a fixed price of ₹ 100 per share to C Ltd. This option is exercisable anytime for a period of 90 days. Evaluate this under definition of financial instrument.

Q7. Target Ltd. took a borrowing from Z Ltd. for ₹ 10,00,000. Z Ltd. enters into an arrangement with Target Ltd. for settlement of the loan against issue of a certain number of equity shares of Target Ltd. whose value equals ₹ 10,00,000. For this purpose, fair value per share (to determine total number of equity shares to be issued) shall be determined based on the market price of the shares of Target Ltd. at a future date, upon settlement of the contract. Evaluate for financial instrument.
Differentiating between FL & Equity

Q8. Silver Ltd. issued irredeemable preference shares with face value of ₹10 each and premium of ₹90. These shares carry dividend @ 8% per annum, however dividend is paid only when Silver Ltd declares dividend on equity shares. Analyse the nature of this instrument.

Q9. A Ltd. invests in compulsorily convertible preference shares (CCPS) issued by its subsidiary – B Ltd. at ₹1,000 each (₹10 face value + ₹990 premium). Under the terms of the instrument, each CCPS is compulsorily convertible into one equity share of B Ltd at the end of 5 years. Such CCPS carry dividend @ 12% per annum, payable only when declared at the discretion of B Ltd. Evaluate this under definition of financial instrument.

Q10. A Ltd. issues warrants to all existing shareholders entitling them to purchase additional equity shares of A Ltd. (with face value of ₹100 per share) at an issue price of ₹150 per share. Evaluate whether this constitutes an equity instrument or a financial liability?

Q11. A Ltd. (issuer) issues preference shares to B Ltd. (holder). Those preference shares are redeemable at the end of 10 years from the date of issue & entitle the holder to a cumulative dividend of 15% p.a. The rate of dividend is commensurate with credit risk profile of the issuer.

Q12. X Co. Ltd. (issuer) issues debentures to Y Co. Ltd. (holder). Those debentures are redeemable at the end of 10 years from the date of issue. Interest of 15% p.a. is payable at the discretion of the issuer. The rate of interest is commensurate with the credit risk profile of the issuer.

Q13. Does the lack of access to foreign currency or need to obtain the approval from regulatory authority for payment effect the contractual obligation.

Q14. LMN Ltd. issues preference shares to PQR Ltd. These preference shares are redeemable at the end of 5 years from the date of issue. The instrument also provides a settlement alternative to the issuer.
whereby it can transfer a particular commercial building to the holder, whose value is estimated to be significantly higher than the cash settlement amount.

Q15. ST Ltd. purchases an option from AT Ltd. entitling the holder to subscribe to equity shares of issuer at a fixed exercise price of ₹ 50 per share at any time during a period of 3 months. Holder paid an initial premium of ₹ 2 per option. Examine whether the financial instrument will be classified as equity.

Q16. WC Ltd. writes an option in favour of GT Ltd. wherein the holder can purchase issuer’s equity instruments at prices that fluctuate in response to the share price of issuer. As per the terms, if the share price of issuer is less than ₹ 50 per share, option can be exercised at ₹ 40 per share. If the share price is equal to or more than ₹ 50 per share, option can be exercised at ₹ 60 per share. Explain nature of FI.

Q17. On 1 January 20X1, PG Ltd. subscribes to convertible preference shares of BG Ltd. at ₹ 100 per preference share. The preference shares are convertible in the ratio of 10:1 i.e. 10 equity shares for each preference share held. On a fully diluted basis, PG Ltd. is entitled to 30% stake in BG Ltd. If subsequent to the issuance of these convertible preference shares, BG Ltd. issues any equity instruments at a price lower than ₹ 10 per share, conversion ratio will be changed to compensate PG Ltd. for dilution in its stake below the expected dilution at a price of ₹ 10 per share. Examine the nature of the financial instrument.

Q18. On 1 January 20X1, NG Ltd. subscribes to convertible preference shares of AG Ltd. at ₹ 100 per preference share. On a fully diluted basis, NG Ltd. is entitled to 30% stake in AG Ltd. The preference shares are convertible at fair value, subject to, NG Ltd.’s stake not going below 15% and not going above 40%. Examine the nature of the financial instrument.
Exception to Classification of FL & Equity

Q19. ABC Ltd. has two classes of puttable shares – Class A shares and Class B shares. On liquidation, Class B shareholders are entitled to a pro rata share of the entity’s residual assets up to a maximum of ₹ 10,000,000. There is no limit to the rights of the Class A shareholders to share in the residual assets on liquidation. Examine the nature of the financial instrument.

Q20. Mutual Fund X has an Investment Manager Y. At the inception of the fund, Y had invested a nominal or token amount in units of X. Such units rank last for repayment in the event of liquidation. Accordingly, they constitute the most subordinate class of instruments. Examine the nature of the FI.

Q21. T Motors Ltd. has issued puttable ordinary shares and puttable ‘A’ ordinary shares whereby holders of ordinary shares are entitled to one vote per share whereas holders of ‘A’ ordinary shares are not entitled to any voting rights. The holders of two classes of shares are equally entitled to receive share in net assets upon liquidation. Examine whether the financial instrument will be classified as equity.

Q22. S Ltd. has issued a class of puttable ordinary shares to T Ltd. Besides the put option (which is consistent with other classes of ordinary shares), T Ltd. is also entitled to convert the class of ordinary shares held by it into equity instruments of S Ltd. whose number will vary as per the market value of S Ltd. Examine whether the financial instrument will be classified as equity.

Q23. P Ltd. has issued puttable ordinary shares to Q Ltd. Q Ltd. has also entered into an asset management contract with P Ltd. whereby Q Ltd. is entitled to 50% of the profit of P Ltd. Normal commercial terms for similar contracts will entitle the service provider to only 4%-6% of the net profits. Examine whether the financial instrument will be classified as equity.
Q24. Entity A issues a bond with face value of USD 100 & carrying a fixed coupon rate of 6% p.a.
Each bond is convertible into 1,000 equity shares of issuer. Examine, nature of FI.

**Compound Financial Instruments**

Q25. On 1 July 20X1, D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a fixed coupon of 6% p.a. The prevailing market rate for similar preference shares, without the conversion feature, is 9% p.a. Calculate the value of the liability and equity components.

Q26. A Limited issues INR 1 crore convertible bonds on 1 July 20X1. The bonds have a life of eight years and a face value of INR 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited at any time in the next eight years. Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8 per cent per annum. Required:
   a. Provide the appropriate accounting entries for initial recognition.
   b. Calculate the stream of interest expenses across the eight years of the life of the bonds.
   c. Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year.

Q27. ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1st April 20X1 @ ₹ 150 each. Rate of dividend is 10% payable every year. Preference shares are convertible into 5,000 equity shares of company at the end of 5th year from date of allotment.
When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% p.a. Transaction cost on date of issuance is 2% of value of proceeds.
Date of Allotment: 01-Apr-20X1
Date of Conversion: 01-Apr-20X6
Number of Preference Shares: 10,000
Face Value of Preference Shares: 150
Total Proceeds: 15,00,000
Rate of dividend: 10%
Market Rate for Similar Instrument: 15%
Transaction Cost: 30,000

Q28. The amortisation schedule of the instrument is set out below:

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash Flows</th>
<th>Interest @ EIR</th>
<th>Liability</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1July 20X1</td>
<td>10,00,000</td>
<td>-</td>
<td>9,24,061</td>
<td>75,939</td>
</tr>
<tr>
<td>30 June 20X2</td>
<td>(60,000)</td>
<td>83,165</td>
<td>9,47,226</td>
<td>75,939</td>
</tr>
<tr>
<td>30 June 20X3</td>
<td>(60,000)</td>
<td>85,250</td>
<td>9,72,476</td>
<td>75,939</td>
</tr>
<tr>
<td>30 June 20X4</td>
<td>(10,60,000)</td>
<td>87,524</td>
<td>-</td>
<td>75,939</td>
</tr>
</tbody>
</table>

Assume that D Ltd. has an early redemption option to prepay the instrument at ₹ 11 lakhs & on 30/06/20X3, it exercises that option. At that time, D Ltd. could have issued a one-year (i.e. maturity 30/06/20X4) non-convertible instrument at 5%. Calculate the liability & equity components.

Q29. As part of staff welfare measures, Y Co Ltd. has contracted to lend to its employees sums of money at 5% p.a. rate of interest. The amounts lent are to be repaid in five equal instalments for principle along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent ₹ 1,600,000 to its employees on 1st January 20X1. Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31 December 20X1, for the transaction and also compute the value of loan initially to be recognised and amortised cost for all subsequent years. For purpose of calculation, following discount factors at @ of 10% p.a. may be adopted at year end – Year 1 2 3 4 5

<table>
<thead>
<tr>
<th></th>
<th>0.909</th>
<th>0.827</th>
<th>0.751</th>
<th>0.683</th>
<th>0.620</th>
</tr>
</thead>
<tbody>
<tr>
<td>PVF</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Q30. Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who’s executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Principal amount: 1,000,000
- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 January 20X1
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Following table shows the contractually expected cash flows from the loan given to Mr. X:

<table>
<thead>
<tr>
<th>Date</th>
<th>Outflows</th>
<th>Principal</th>
<th>Interest 7%</th>
<th>Interest 4%</th>
<th>Principal O/S</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-Jan-20X1</td>
<td>(1,000,000)</td>
<td>1,000,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>31-Dec-20X1</td>
<td>200,000</td>
<td>42,000</td>
<td>16,000</td>
<td>800,000</td>
<td></td>
</tr>
<tr>
<td>31-Dec-20X2</td>
<td>200,000</td>
<td>28,000</td>
<td>16,000</td>
<td>600,000</td>
<td></td>
</tr>
<tr>
<td>31-Dec-20X3</td>
<td>200,000</td>
<td>14,000</td>
<td>16,000</td>
<td>400,000</td>
<td></td>
</tr>
<tr>
<td>31-Dec-20X4</td>
<td>200,000</td>
<td>-</td>
<td>16,000</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>31-Dec-20X5</td>
<td>200,000</td>
<td>-</td>
<td>8,000</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Mr. S, pre-pays ₹ 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to ₹ 400,000. Following table shows the actual cash flows from the loan given to Mr. X, considering the pre-payment event on 31 December 20X2: (amount in ₹)

<table>
<thead>
<tr>
<th>Date</th>
<th>Outflows</th>
<th>Principal</th>
<th>Interest 7%</th>
<th>Interest 4%</th>
<th>Principal O/S</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-Jan -20X1</td>
<td>(1,000,000)</td>
<td>1,000,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>31-Dec-20X1</td>
<td>200,000</td>
<td>42,000</td>
<td>16,000</td>
<td>800,000</td>
<td></td>
</tr>
<tr>
<td>31-Dec-20X2</td>
<td>400,000</td>
<td>28,000</td>
<td>16,000</td>
<td>400,000</td>
<td></td>
</tr>
</tbody>
</table>
Record journal entries in the books of Wheel Co. Ltd. considering the requirements of Ind AS 109.

**Q31.** Wheel Co. Limited borrowed ₹500,000,000 from a bank on 1/01/20X1. Original terms of loan were:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: ₹5,870,096 Effective interest rate on loan: 11.50%

On 31/12/20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments & re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3
- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2

**Q32.** K Ltd. issued 500,000, 6% convertible debentures @ ₹10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%. You are required to separate the debt and equity components at the time of issue and show the accounting entries in Company’s books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

<table>
<thead>
<tr>
<th>Interest rate/Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>6%</td>
<td>0.94</td>
<td>0.89</td>
<td>0.84</td>
<td>0.79</td>
</tr>
<tr>
<td>10%</td>
<td>0.91</td>
<td>0.83</td>
<td>0.75</td>
<td>0.68</td>
</tr>
</tbody>
</table>
Q33. On 1 April 20X1, an 8% convertible loan with a nominal value of ₹ 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ₹ 200 worth of loan. An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 48,000 has already been paid and included as a finance cost. Present value rates are as follows:

<table>
<thead>
<tr>
<th>Year End</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>@ 8%</td>
<td>0.93</td>
<td>0.86</td>
<td>0.79</td>
<td>0.73</td>
</tr>
<tr>
<td>@10%</td>
<td>0.91</td>
<td>0.83</td>
<td>0.75</td>
<td>0.68</td>
</tr>
</tbody>
</table>

How will company present the above loan notes in financial statements for year ended March 20X2?

Q34. Containers Ltd provides containers for use by customers for multiple purposes. The containers are returnable at the end of the service contract period (3 years) between Containers Ltd and its customers. In addition to the monthly charge, there is a security deposit that each customer makes with Containers Ltd for ₹ 10,000 per container and such deposit is refundable when the service contract terminates. Deposits do not carry any interest. Analyse the fair value upon initial recognition in books of customers leasing containers. Market rate of interest for 3 year loan is 7% per annum.

**Subsequent Recognition – Business Model Test**

Q35. Entity B sells goods to customers on credit. Entity B typically offers customers up to 60 days following the delivery of goods to make payment in full. Entity B collects cash in accordance with the contractual cash flows of trade receivables and has no intention to dispose of the receivables. Evaluate the business model.

Q36. An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period. The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return. The managers
responsible for the portfolio are remunerated based on the overall return generated by the portfolio. Evaluate the business model.

Q37. An entity has a business model with the objective of originating loans to customers and subsequently selling those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors. The originating entity controls the securitisation vehicle (SPV) and thus consolidates it. The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors. In the consolidated balance sheet, loans continue to be recognised because they are not derecognised by the securitisation vehicle. Evaluate the business model.

Q38. A financial institution holds financial assets to meet liquidity needs in a 'stress case' scenario (e.g., a run on the bank's deposits). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realised. However, the entity also monitors fair value of financial assets from a liquidity perspective to ensure that cash amount that would be realised if the entity needed to sell the assets in a stress case scenario would be sufficient to meet entity's liquidity needs. Periodically, entity makes sales that are insignificant in value to demonstrate liquidity. Evaluate business model.

CCF Test

Q39. Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer. Analyse the nature of cash flows.

Q40. Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due. Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest. Analyse the nature of cash flows.
Q41. Instrument G is a loan that pays an inverse floating interest rate (i.e., the interest rate has an inverse relationship to market interest rates). Analyse the nature of cash flows.

Accounting Financial Asset

Q42. ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5-year term and 12% per annum for a 3-year term. Additionally, the bank charges processing fees @1% of the principal amount borrowed. Target Ltd borrowed loans as follows: ₹ 10 lacs for a term of 5 years & ₹ 8 lacs for a term of 3 years. Compute the fair value upon initial recognition of the loan in books of Target Ltd. and how will loan processing fee be accounted?

Q43. An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. How would transaction costs be accounted in books of the entity?

Q44. Silver Ltd. has made an investment in optionally convertible preference shares (OCPS) of a Company – Bronze Ltd. at ₹ 100 per share (face value ₹ 100 per share). Silver Ltd. has an option to convert these OCPS into equity shares in the ratio of 1:1 and if such option not exercised till end of 9 years, then the shares shall be redeemable at the end of 10 years at a premium of 20%. Analyse the measurement of this investment in books of Silver Ltd.

Q45. A Ltd has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit. Assume market interest rate for a deposit for similar period to be 12% per annum.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Security Deposit (Starting Date)</td>
<td>01-Apr-20X1</td>
</tr>
<tr>
<td>Date of Security Deposit (Finishing Date)</td>
<td>31-Mar-20X6</td>
</tr>
<tr>
<td>Description</td>
<td>Lease</td>
</tr>
</tbody>
</table>

Lecture No: Date: / / 33.66
Q46. A Ltd. invested in equity shares of C Ltd. on 15th March for ₹ 10,000. Transaction costs were ₹ 500 in addition to the basic cost of ₹ 10,000. On 31 March, the fair value of the equity shares was ₹ 11,200 and market rate of interest is 10% per annum for a 10 year loan. Pass necessary journal entries. Analyse the measurement principle and pass necessary journal entries.

Q47. Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for ₹ 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is ₹45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

Restructuring of financial liability

Q48. A Ltd has made a borrowing from RBC Bank for ₹ 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for ₹ 500 and loan is payable 4 half-yearly installments of ₹ 2,500 each. Details are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan amount</td>
<td>₹ 10,000</td>
</tr>
<tr>
<td>Date of loan (Starting Date)</td>
<td>01-April-20X1</td>
</tr>
<tr>
<td>Date of loan (Finishing Date)</td>
<td>31-March-20X3</td>
</tr>
<tr>
<td>Repayment of loan starts on from 30-Sept-20X1</td>
<td>(To be paid half yearly)</td>
</tr>
<tr>
<td>Installment amount</td>
<td>₹ 2,500</td>
</tr>
<tr>
<td>Interest rate</td>
<td>12.00%</td>
</tr>
<tr>
<td>Interest charge</td>
<td>Interest to be charged quarterly</td>
</tr>
</tbody>
</table>
Upfront fees ₹ 500

How the loan be accounted in book of A ltd.

Q49. A Ltd. issued compulsorily convertible preference shares (CCPS) at ₹100 each (₹10 face value plus ₹90 premium per share) for ₹10,00,000. These are convertible into equity shares at the end of 10 years, where the number of equity shares to be issued shall be determined based on fair value per equity share to be determined at the time of conversion. Evaluate if this is financial liability or equity? What if the conversion ratio was fixed at the time of issue of such preference shares?

Reclassification

Q50. Pass Journal entries for the following
   a. Bonds for ₹ 1,00,000 reclassified as FVTPL. Fair value on reclassification is ₹ 90,000.
   b. Bonds for ₹ 1,00,000 reclassified as FVOCI. Fair value on reclassification is ₹ 90,000.
   c. Bonds for ₹ 100,000 reclassified as Amortised cost. Fair value on reclassification is ₹ 90,000.
   d. Bonds for ₹ 100,000 reclassified as FVOCI. Fair value on reclassification is ₹ 90,000.
   e. Bonds for ₹ 100,000 reclassified as Amortised cost. Fair value on reclassification is ₹ 90,000 and ₹ 10,000 loss was recognised in OCI till date of reclassification.
   f. Bonds for ₹ 100,000 reclassified as FVTPL. Fair value on reclassification is ₹ 90,000.

Impairment of FA

Q51. Entity A originates a single 10 year amortising loan for ₹1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PoD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PoD are a reasonable approximation of the changes in the lifetime PoD for determining whether there has been a significant increase in credit risk since initial recognition. Loss given default is estimated as 25% of the balance outstanding. Calculate loss allowance.
Impairment - Loss rate approach

Q52. Bank A originates 2,000 bullet loans with a total gross carrying amount of CU 500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU 200, for a total gross carrying amount of CU 200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of CU 300, for a total gross carrying amount of CU 300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees. Calculate loss rate when

<table>
<thead>
<tr>
<th>Group</th>
<th>Historic per annum average defaults</th>
<th>Present value of observed loss assumed</th>
</tr>
</thead>
<tbody>
<tr>
<td>X</td>
<td>4</td>
<td>CU 600</td>
</tr>
<tr>
<td>Y</td>
<td>2</td>
<td>CU 450</td>
</tr>
</tbody>
</table>

Q53. Company M, a manufacturer, has a portfolio of trade receivables of CU30 million in 2019 and operates only in one geographical region. The customer base consists of a large number of small clients and the trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component in accordance with Ind AS 115. In accordance with Ind AS 109 the loss allowance for such trade receivables is always measured at an amount equal to lifetime expected credit losses. Please use following information of debtors:

<table>
<thead>
<tr>
<th>Days Past due</th>
<th>Gross carrying amount</th>
<th>Days Past due</th>
<th>Gross carrying amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>CU 15,000,000</td>
<td>61–90</td>
<td>CU 2,500,000</td>
</tr>
<tr>
<td>1–30</td>
<td>CU 7,500,000</td>
<td>&gt; 90</td>
<td>CU 1,000,000</td>
</tr>
<tr>
<td>31–60</td>
<td>CU 4,000,000</td>
<td>Total</td>
<td>CU 30,000,000</td>
</tr>
</tbody>
</table>

Company M uses following default rates for making provisions:

<table>
<thead>
<tr>
<th>Days past due</th>
<th>Current</th>
<th>1–30</th>
<th>31–60</th>
<th>61–90</th>
<th>&gt; 90</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default rate</td>
<td>0.3%</td>
<td>1.6%</td>
<td>3.6%</td>
<td>6.6%</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

Determine the expected credit losses for the portfolio
Regular Way Transactions

Q54. On 1 January 20X1, X Ltd. enters into a contract to purchase a financial asset for ₹10 lakhs, which is its fair value on trade date. On 4 January 20X1 (settlement date), the fair value of the asset is ₹10.5 lakhs. The amounts to be recorded for the financial asset will depend on how it is classified & whether trade date / settlement date accounting is used. Pass necessary journal entries.

Q55. ST Ltd. enters into a forward contract to purchase 10 lakh shares of ABC Ltd. in a month’s time for ₹50 per share. This contract is entered into with a broker, Mr. AG and not through regular trading mode in a stock exchange. The contract requires Mr. AG to deliver the shares to ST Ltd. upon payment of agreed consideration. Shares of ABC Ltd. are traded on a stock exchange. Regular way delivery is two days. Assess the forward contract.

Derecognition of FA

Q56. State whether the derecognition principles will be applied or not.
   i. Interest strip of an interest-bearing FA i.e. the part entitles its holder to interest cash flows of a FA
   ii. Dividend strip of an equity share i.e. part entitles its holder to only dividends arising from an equity share
   iii. Cash flows (principal and asset) up to a certain tenure or first right on a proportion of cash flows of an amortising FA.

Q57. A financial asset is sold and the transferee has a put option. Let’s look at some alternate scenarios:
   i. Put option is deeply in the money
   ii. Put option is deeply out of the money.
   State whether the derecognition principles will be applied or not

Q58. A financial asset is sold and the transferor has a call option. Let’s look at some alternate scenarios:
   i. Call option is deeply in the money ii. Call option is deeply out of the money.
   What it the transferor holds a call option on an asset that is readily obtainable in the market?
iii Call option is neither deeply in the money nor deeply out of the money. State whether the
derecognition principles will be applied or not.

Q59. A financial asset is sold under repurchase agreement. The repurchase price as per that agreement is (a)
fixed price or (b) sale price plus a lender’s return. Let’s look at three alternate scenarios:
i. Repurchase agreement is for the same financial asset.
ii. Repurchase agreement is for substantially the same asset
iii. Repurchase agreement provides the transferee a right to substitute assets that are similar and of equal
fair value to the transferred asset at the repurchase date. State whether the derecognition principles will
be applied or not.

Derecognition – Continuing Involvement

Q60. ST Ltd. assigns its trade receivables to AT Ltd. The carrying amount of the receivables is ₹10,00,000.
The consideration received in exchange of this assignment is ₹9,00,000. Customers have been
instructed to deposit the amounts directly in a bank account for the benefit of AT Ltd. AT Ltd. has no
recourse to ST Ltd. in case of any shortfalls in collections. State whether the derecognition principles
will be applied or not.

Q61. Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms
of the arrangement, the factoring company B agrees to pay ₹91.5 Crs. less a servicing charge of ₹1.5
Crs. (net proceeds of ₹90 Crs.), in exchange for 100% of the cash flows from short-term receivables.
The receivables have a face value of ₹100 Crs. and carrying amount of ₹95 Crs.. The customers will
be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also
writes a guarantee to the factoring company under which it will reimburse any credit losses up to ₹5
Crs., over and above the expected credit losses of ₹5 Crs. & losses of up to ₹15 Crs. are considered
reasonably possible. Guarantee is estimated to have a fair value of ₹0.5 Crs. Comment.
Derecognition of FL - Extinguishment Accounting

Q62. On 1 January 2020, XYZ Ltd. issues 10 year bonds for ₹ 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 2029 for ₹ 10,00,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 2025 (i.e. after 5 years) XYZ Ltd. and bondholders agree to a modification in accordance with which:

1. the term is extended to 31 December 2031;
2. interest payments are reduced to 5% p.a.;
3. the bonds are redeemable on 31 December 2031 for ₹ 15,00,000; and
4. legal and other fees of ₹ 1,00,000 are incurred.

XYZ Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%. Check whether extinguishment accounting is applicable.

Modification

Q63. On 1 January 20X0, XYZ Ltd. issues 10 year bonds for ₹ 1,000,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for ₹ 1,000,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and bondholders agree to a modification in accordance with which:

1. no further interest payments are made
2. the bonds are redeemed on the original due date (31 December 20X9) for ₹ 1,600,000;
3. legal and other fees of ₹ 50,000 are incurred.

Debt for equity swaps

Q64. K Ltd. has an outstanding unsecured loan of ₹ 90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, K Ltd. is unable to service the debt and approaches the bank for a settlement. The bank offers the following terms which are accepted by K Ltd.:

- 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of K Ltd. is ₹ 80 crores.
1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is ₹ 25 crores. The fair value of the cash flows as per these revised terms is ₹ 28 crores. Apply debt for equity swap.

Derivatives

Q65. Entity S enters into a ₹ 100 crores notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C.

• The interest rate of the variable part of the swap is reset on a quarterly basis to three-month Mumbai Interbank Offer Rate (MIBOR).

• The interest rate of the fixed part of the swap is 10% p.a.

• Entity S prepays its fixed obligation under the swap of ₹ 50 crores (₹ 100 crores × 10% × 5 years) at inception, discounted using market interest rates

• Entity S retains the right to receive interest payments on the ₹ 100 crores reset quarterly based on three-month MIBOR over the life of the swap. Analyse.

Q66. Entity S enters into a ₹ 100 crores notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C.

• The variable leg of the swap is reset on a quarterly basis to three-month MIBOR.

• The fixed interest payments under the swap are calculated as 10% of the swap's notional amount, i.e. ₹ 10 crores p.a.

• Entity S prepays its obligation under the variable leg of the swap at inception at current market rates. Say, that amount is ₹ 36 crores.

• It retains the right to receive fixed interest payments of 10% on ₹ 100 crores every year. Analyse.

Q67. On 1st January 20X1, SamCo. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 20X1 for a rate equal to ₹ 68 per USD. SamCo. Ltd. did not pay any amount upon entering
into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March 20X1 – ₹ (25,000)  
As at 30th June 20X1 - ₹ (15,000)  
As at 30th September 20X1 - ₹ 12,000  
Spot rate of USD on 31st December 20X1 - ₹ 66 per USD

Q68. On 1st January 20X1, Sam Co. Ltd. entered into a written put option for USD ($) 20,000 with JT Corp to be settled in future on 31st December 20X1 for a rate equal to ₹ 68 per USD at the option of JT Corp. Sam Co. Ltd. did not receive any amount upon entering into the contract. Sam Co Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the classification principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of put option contracts at each reporting date:

As at 31st March 20X1 – ₹ (25,000),  
As at 30th June 20X1 - ₹ (15,000)  
As at 30th September 20X1 - ₹ NIL,  
Spot rate of USD on 31st December 20X1 - ₹ 66 per USD

Embedded Derivative

Q69. Entity X issues a redeemable fixed interest rate debenture to Entity Y. Amount of interest and principal is indexed to the value of equity instruments of Entity X. Analyse

Prepayment options in debt instruments

Q70. Entity PQR borrows ₹ 100 crores from CFDH Bank on 1 April 20X1.

Interest is payable at 12% p.a. and there is a bullet repayment of principal at the end of the term. Term of the loan is 6 years.
The loan includes an option to prepay the loan at 1st April each year with a prepayment penalty of 3%.

There are no transaction costs.

Without the prepayment option, the interest rate quoted by bank is 11% p.a. Analyse

Q71. On 1 January 20X1, ABG Pvt. Ltd., a company incorporated in India enters into a contract to buy solar panels from A&A Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30 June 20X1

The purchase price for solar panels is US$ 50 million.

The functional currency of ABG is Indian Rupees (INR) and of A&A is Dirhams.

The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.

Exchange rates:

1. Spot rate on 1 January 20X1: USD 1 = INR 60
2. Six-month forward rate on 1 January 20X1: USD 1 = INR 65
3. Spot rate on 30 June 20X1: USD 1 = INR 66 Analyse

Q72. Entity A (an INR functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an INR functional currency entity) to sell equipment on 30 June 20X1.

Spot rate on 1 January 20X1: INR/USD 45
Spot rate on 31 March 20X1: INR/USD 57
Three-month forward rate on 31 March 20X1: INR/USD 45
Six-month forward rate on 1 January 20X1: INR/USD 55
Spot rate on 30 June 20X1: INR/USD 60

Assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.
Theory Answers

A1. In the above case, the trade receivable recorded in books represents contractual cash flows that are solely payments of principal (and interest if paid beyond credit period). Further, Company’s business model is to collect contractual cash flows. Hence, this meets the definition of financial assets carried at amortised cost.

A2. In this case, deposits are receivable in cash at the end of contract period between the dealer and the Company. These deposits represent cash flows that are solely payments of principal and interest. Moreover, these deposits normally cannot be sold. Hence, they meet the definition of financial asset carried at amortised cost.

A3. • For the Holder – right to receive cash in future – classifies to be a financial asset
   • For the Issuer – contractual obligation to pay cash in future – classifies to be a financial liability.

A4. A Ltd. has entered into a contractual arrangement for purchase of goods at a fixed consideration payable to the creditor. A contractual arrangement that provides for payment in fixed amount of cash to another entity meets the definition of financial liability.

A5.
   (a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of FL.
   (b) Let’s compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –
      • Loan principal amount = ₹ 10,00,000
      • Amount payable at the end of 6th year = ₹ 12,54,400
      [10,00,000 * 1.12 * 1.12 (Interest for 5th & 6th year in default plus principal amount)]
      • One time settlement = INR 13,00,000
      • Additional amount payable = ₹ 45,600
The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavorable to A Ltd. (owing to additional amount payable in comparison to amount that would have been paid without one time settlement). Hence, the rescheduled arrangement meets definition of ‘financial liability’.

A6. In the above case – B Ltd has written an option, which if exercised by C Ltd. will result in B Ltd. selling equity shares of Target Ltd. for fixed cash of ₹100 per share. Such option will be exercised by C Ltd. only if the market price of shares of Target Ltd. increases beyond ₹100, thereby resulting in contractual obligation over B Ltd. to settle the contract under potential unfavorable terms.

In the above case, if the market price is already ₹120 which means that if option is exercised by C Ltd, then B Ltd shall buy shares from the market at ₹120 per share and sell at ₹100, thereby resulting in a loss or exchange at unfavorable terms to B Ltd. Hence, it meets the definition of financial liability in books of B Ltd.

A7. In the above scenario, Target Ltd. is under an obligation to issue variable number of equity shares equal to a total consideration of ₹10,00,000. Hence, equity shares are used as currency for purpose of settlement of an amount payable by Target Ltd. Since this is variable number of shares to be issued in a non-derivative contract for fixed amount of cash, it tantamount to use of equity shares as ‘currency’ and hence, this contract meets definition of financial liability in books of Target Ltd.

A8. In the above instrument, there is no contractual obligation on the Company to pay cash since –

(i) Face value is not redeemable (except in case of liquidation); and

(ii) Dividend is payable only if Company declares dividend on equity shares. Since dividend on equity shares is discretionary and the Company can choose not to pay, Company has an unconditional right to avoid payment of cash on preference shares also.

Hence, preference shares meet definition of equity instrument.
A9. Applying the definition of ‘equity’ under Ind AS 32 –

(a) There is no contractual obligation to deliver cash or other financial asset. Dividends are payable only when declared and hence, at the discretion of the Issuer – B Ltd., thereby resulting in no contractual obligation over B Ltd.

(b) Conversion is into a fixed number of equity shares.

Hence, it meets definition of equity instrument and shall be classified as such in books of B Ltd.

A10. Applying definition of equity under Ind AS 32, a derivative contract that will be settled by exchange of fixed number of equity shares for fixed amount of cash meets definition of equity instrument. The above contract is derivative contract that will be settled by issue of fixed number of own equity instruments by A Ltd. for fixed amount of cash and hence, is an equity instrument.

A11. This instrument provides for mandatory fixed dividend payments and redemption by the issuer for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment of principal) to the preference shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

A12. This instrument has two components – (1) mandatory redemption by the issuer for a fixed amount at a fixed future date, and (2) interest payable at the discretion of the issuer. The first component is a contractual obligation to deliver cash (for repayment of principal with or without premium, as per terms) to the debenture holder that cannot be avoided. This component of the instrument is a FL.

A13. Lack of access to foreign currency or need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or holder's contractual right under the instrument.

A14. Such preference shares are financial liability because the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation.
A15. For the issuer AT Ltd., this option is an equity instrument as it will be settled by the exchange of a fixed amount of cash for a fixed number of its own equity instruments. If, on the other hand, if the exercise price of the option was variable, say benchmarked to an index or a variable, other than the market price of equity shares of AT Ltd., the written option will be classified as a “financial liability” in the books of the issuer, AT Ltd.

A16. As the contract will be settled by delivery of fixed number of instruments for a variable amount of cash, it is a financial liability.

A17. The convertible preference shares will be classified as “financial liability” in the books of the issuer, BG Ltd. The variability in the conversion ratio underwrites the return on preference shares and not just protects the rights of convertible instrument holders vis-à-vis equity shareholders.

A18. The convertible preference shares will be classified as “financial liability” in the books of the issuer, AG Ltd. The variability in the conversion ratio underwrites the return on preference shares to an extent and also restricts that return. The preference shareholder is not entitled to residual net assets of issuer.

A19. The cap of ₹ 10,000,000 means that Class B shares do not have entitlement to a pro rata share of the residual assets of the entity on liquidation. They cannot therefore be classified as equity.

A20. Resultantly, the units held by other unit holders are classified as financial liability as they are not the most subordinate class of instruments – they are entitled to pro rate share of net assets on liquidation, and their claim has a priority over claims of Y. It may be noted that the most subordinate class of instruments may consist of two or more legally separate types of instruments.

A21. Neither of the two classes of puttable shares can be classified as equity, as they do not have identical features due to the difference in voting rights. It is not possible for T Motors Ltd. to achieve equity
classification of the ordinary shares by designating them as being more subordinate than the ‘A’ ordinary shares, as this does not reflect the fact that the two classes of share are equally entitled to share in entity’s residual assets on liquidation.

A22. The shares cannot qualify for equity classification in their entirety as in addition to the put option there is also a contractual obligation to settle the instrument in variable number of EOEI.

A23. The puttable ordinary shares cannot qualify for equity classification as (a) in addition to the put option, there is another contract between the issuer (P Ltd.) and holder of puttable instrument (Q Ltd.) whose cash flows are based substantially on profit or loss of issuer, (b) whose contractual terms are not similar to a contract between a non-instrument holder and issuer and (c) it has the effect of substantially restricting return on puttable ordinary shares.

A24. While the number of equity shares is fixed, the amount of cash is not. The variability in cash arises on account of fluctuation in exchange rate of INR-USD. Such a foreign currency convertible bond (FCCB) will qualify the definition of “financial liability”. However, Ind AS 32 provides, “the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity’s own equity instruments is an equity instrument if the exercise price is fixed in any currency.” Accordingly, FCCB will be treated as an “equity instrument”.

A35. Entity’s B objective is to collect contractual cash flows from trade receivables and therefore, trade receivables meet the business model test for the purpose of classifying the FA at amortised cost.

A36. An entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only
sales that are insignificant in value occur before maturity (unless there is an increase in credit risk).

The objective of this business model is to hold financial assets to collect contractual cash flows.

A37. The entity originating loans to customers has the objective of realising contractual cash flows on the loan portfolio only through sale to securitisation vehicle. However, the consolidated group originates loans with the objective of holding them to collect the contractual cash flows.

- Hence, the consolidated financial statements provide for a business model with the objective of collecting contractual cash flows by holding to maturity.

- And in separate financial statements of the entity originating loans to customers, business model is to collect cash flows through sale only.

A38. The objective of the entity's business model is to hold the financial assets to collect contractual cash flows. The analysis would not change –

- If during a previous stress case scenario the entity had sales that were significant in value in order to meet its liquidity needs; or

- Recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows; or

- If the entity is required by its regulator to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's business model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell FA, or that activity is at entity's discretion, is not relevant to the analysis.

A39. The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement i.e. return is linked to value of equity of issuer.

A40. The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional
interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding. If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.

A41. Here, interest on the instrument has an inverse relationship to the market rate of interest. Hence, it is unlike a basic lending arrangement which normally comprises of interest payable on any funds lent, as a consideration for the time value of money, credit risk and profit margin normally existing in such arrangements. This arrangement with an inverse floating interest rate provides the lender with a return which may be higher or lower to the market rate of interest and hence, is not necessarily a consideration for the time value of money on the principal amount outstanding. Thus, these do not represent CCF that are solely payments of principal and interest on the principal amount outstanding.

A44. The classification assessment for a financial asset is done based on two characteristics:

i. Whether the contractual cash flows comprise cash flows that are solely payments of principal and interest on the principal outstanding

ii. Entity’s business model (BM) for managing financial assets – Whether the Company’s BM is to collect cash flows; or a BM that involves realisation of both contractual cash flows & sale of FA;

In all other cases, the financial assets are measured at fair value through profit or loss.

In the above case, the Holder can realise return either through conversion or redemption at the end of 10 years, hence it does not indicate contractual cash flows that are solely payments of principal and interest. Therefore, such investment shall be carried at fair value through profit or loss. Accordingly, the investment shall be measured at fair value periodically with gain/loss recorded in profit or loss.

A51. At reporting date, no change in 12-month PoD and entity assesses that there is no significant increase in credit risk since initial recognition – therefore lifetime ECL is not required to be recognised. Allowance = ₹10,00,000 * 25% * 0.5 = ₹1,250
A55. In this case, the forward contract is not a regular way transaction and hence must be accounted for as a derivative i.e. between the date of entering into the contract to the date of delivery, all fair value changes are recognised in profit or loss. On other hand, if forward contract is a regular way transaction, such fair value changes are recognised in other comprehensive income if share of ABC Ltd. are equity instruments and not held for trading.

A57. In the first scenario, the transferred asset does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. However, in the second scenario, the transferor has transferred substantially all the risks and rewards of ownership.

A58. In the first scenario, the transferred asset does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. However, in the second scenario, the transferor has transferred substantially all the risks and rewards of ownership.

In the third scenario, the asset is derecognised. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control.

A59. In each of these scenarios, the transferred financial asset is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

A60. In this situation, ST Ltd. has transferred the rights to contractual cash flows and has also transferred substantially all the risks and rewards of ownership (credit risk being the most significant risk in this situation). Accordingly, ST Ltd. derecoginses the financial asset and recognises ₹ 1,00,000, the difference between consideration received & carrying amount, as an expense in the statement of P&L.

A65. The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond.
Therefore, the contract fulfils the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'.

Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the MIBOR index. Accordingly, the contract is regarded as a derivative contract.

A66. In effect, this contract results in an initial net investment of ₹36 crores which yields a cash inflow of ₹10 crores every year, for five years. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'. Therefore, the contract is not accounted for as a derivative contract.

A69. In the given case, the host is a fixed interest rate debt instrument. The economic characteristics and risks of a debt instrument are not closely related to those of an equity instrument. Hence, the exposure of this hybrid instrument to changes in value of equity instruments is an embedded derivative which is required to be separated.

The response above will not change even if the interest payment and principal repayments are indexed to a commodity index or similar underlying.
IND AS 101
FIRST TIME ADOPTION OF IND AS

I. OBJECTIVE

The objective of this Ind AS is to ensure that an entity’s first Ind AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) is transparent for users and comparable over all periods presented;
(b) provides a suitable starting point for accounting in accordance with Ind AS &
(c) can be generated at a cost that does not exceed the benefits.

II. SCOPE

An entity shall apply this Ind AS in:

(a) its first Ind AS financial statements; and
(b) each interim financial report, if any, that it presents in accordance with Ind AS 34, Interim Financial Reporting, for part of the period covered by its first Ind AS financial statements.

This Ind AS does not apply to changes in accounting policies made by an entity that already applies Ind ASs.

III. Definitions

1. **First Ind AS financial statements** are first annual financial statements in which the entity adopts Ind ASs, in accordance with Ind ASs notified under Companies Act, 2013 and makes an explicit & unreserved statement in those financial statements of compliance with Ind ASs. i.e. there has to be compliance with all Ind-AS, partial compliance is not enough to make entity Ind AS compliant.

2. **First –time adopter** is an entity that presents its first Ind AS financial statements, that entity is known as first time adopter.

3. **Opening Ind AS Balance sheet** is an entity’s balance sheet at the date of transition to Ind AS

4. **Date of Transition** to Ind AS is the beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS Financial statements.
5. **First Ind AS reporting period** the latest reporting period covered by an entity’s first Ind AS financial statements.

6. **Deemed cost** is an amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.

7. **Previous GAAP** is the basis of accounting that a first-time adopter used for its statutory reporting requirements in India immediately before adopting Ind AS. For instance, companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements.

IV. **Recognition & Measurement**

1. **Opening Balance sheet:** An entity shall prepare & present an opening Ind AS balance sheet at the date of transition to Ind AS. This is starting point for its accounting as per with Ind AS.

2. **Accounting Policies:** An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements.

   An entity shall, in its opening Ind AS Balance Sheet:
   
   (a) recognise all assets and liabilities whose recognition is required by Ind ASs;
   
   (b) not recognise items as assets/liabilities if Ind ASs do not permit such recognition;
   
   (c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and
   
   (d) apply Ind ASs in measuring all recognised assets and liabilities.

3. Accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except

   a. An entity’s estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after
adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

b. An entity may receive information after the date of transition to Ind ASs about estimates that it had made under previous GAAP such receipt is treated as non-adjusting events as per Ind AS 10.

c. An entity may need to make estimates in accordance with Ind ASs at the transition date that were not required at that date under previous GAAP. Such estimates in accordance with Ind ASs shall reflect conditions that existed at the date of transition to Ind ASs. In particular, estimates at the date of transition to Ind ASs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.

d. Above requirements apply to opening Ind AS Balance Sheet. They also apply to a comparative period presented in an entity’s first Ind AS financial statements.

V. Exceptions and Exemptions

There are two kinds of exceptions / exemptions in this Ind AS

A. Mandatory (Exceptions to the retrospective application of other Ind AS)

B. Optional (exemptions from application of other Ind AS)

A. Mandatory (Exceptions to the retrospective application of other Ind AS)

1. Estimates: An entity’s estimates in accordance with Ind AS at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error. If the previous estimates are in line with IND AS then use them else adjust those estimates to bring it in line with IND AS.

2. Derecognition of financial assets and liabilities: A first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind AS. An entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of entity’s choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.
3. **Hedge accounting:** At the date of transition to Ind AS an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

An entity **shall not** reflect in its opening Ind AS Balance Sheet a hedging relationship of a type that does not qualify for hedge accounting in accordance with Ind AS 109. However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate as a hedged item in accordance with Ind AS an individual item within that net position, or a net position if that meets the requirements in Ind AS 109, provided that it does so on the date of transition to Ind AS and not later. Ind AS 109 to discontinue hedge accounting. Transactions entered into before date of transition to Ind ASs shall not be retrospectively designated as hedges.

4. **Non-controlling interests:** A first-time adopter shall apply the following requirements of Ind AS 110 **prospectively** from the date of transition to Ind AS:

a) Total comprehensive income is attributed 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;

b) Accounting for changes in the parent’s ownership interest in a subsidiary that do not result in a loss of control; and

c) Accounting for a loss of control over a subsidiary, and the related requirements of Ind AS 105, Non-current Assets Held for Sale and Discontinued operations.

*However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 from that date.*

5. **Classification and measurement of financial assets:** An entity shall assess whether a financial asset meets the conditions of Ind AS 109 on the basis of the facts and circumstances that exist at the **date of transition** to Ind AS.

a. If it is impracticable to assess a modified time value of money element in respect of financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind AS without taking into
account the requirements related to the modification of the time value of money element. An entity shall disclose carrying amount at reporting date of such financial assets until they are derecognized.

b. If it is impracticable to assess whether the fair value of a prepayment feature is insignificant on the basis of the facts and circumstances that exist at the date of transition to Ind AS, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind AS without taking into account the exception for prepayment features. An entity shall disclose the carrying amount at the reporting date of such financial assets until those financial assets are derecognised.

c. If it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS.

6. **Impairment of financial assets**: An entity shall apply the impairment requirements of Ind AS 109 retrospectively subject to

a. At the date of transition to Ind AS, 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*.

b. An entity is not required to undertake an exhaustive search for information when determining, at date of transition to Ind AS, whether there have been significant increases in credit risk since initial recognition.

c. If, at the date of transition to Ind ASs, 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 derecognised, unless that financial instrument is low credit risk at a reporting date.
7. **Embedded derivatives:** A first-time adopter shall assess whether an embedded derivative is required to be separated from host contract and accounted for as a derivative on the basis of conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by Ind AS 109.

8. **Government loans:** A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32. A first-time adopter shall apply the requirements in Ind AS 109 and Ind AS 20 prospectively to government loans existing at the date of transition to Ind AS and shall not recognise the corresponding benefit of government loan at a below-market rate of interest as a government grant.

An entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government loan originated before the date of transition to Ind AS, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

B. **Optional (exemptions from application of other Ind AS)**

1. **Business combination:**
   a. Ind AS 103 need not be applied to combinations before date of transition. But, if one combination is restated, all subsequent combinations are restated. When exemption is used
   - There won’t be any change in classification
   - Assets and liabilities of past combination measured at carrying amount (deemed cost)
   - Assets and liabilities measured at fair value restated at date of transition- adjusted retained earnings.
   b. If an asset acquired, or liability assumed, in a past business combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening Ind AS Balance Sheet. Instead, the acquirer shall recognise and measure it in its Consolidated Balance Sheet on the basis that Ind ASs would require in the Balance Sheet of the acquiree.
   c. Conversely, if an asset or liability was subsumed in goodwill / capital reserve in accordance with previous GAAP but would have been recognised separately under Ind AS 103, that asset or liability remains in goodwill / capital reserve unless Ind AS would require its recognition in the financial statements of the acquiree
2. **Share based payment transactions**

   Apply Ind AS 102, Share-based Payment, to equity instruments that vested before date of transition to Ind AS. However, a first-time adopter may apply Ind AS 102 to equity instruments, if it has disclosed publicly the fair value of those equity instruments, determined at the measurement date. It is encouraged to apply Ind AS 102 to liabilities arising from share-based payment transactions that were settled before the date of transition to Ind AS.

4. **Deemed cost for PPE and intangible assets:** If an entity uses fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE, an intangible asset or a right-of-use asset, entity’s first Ind AS financial statements shall disclose, for each line item in opening Ind AS Balance Sheet:
   
   (a) the aggregate of those fair values; and

   (b) the aggregate adjustment to the carrying amounts reported under previous GAAP

   A first-time adopter may elect to use a previous GAAP revaluation of an item of PPE at, or before, the date of transition to Ind AS 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 Ind AS, adjusted to reflect, for example, changes in a general or specific price index.

   **For Investment Property:** Ind AS 40, Investment Property permits only the cost model. Therefore, option of availing fair value as deemed cost for investment property is not available for first time adopters of Ind AS for its FS.

   **Cumulative translation difference No need to:**

   - Recognise some translation differences in other comprehensive income.

   - Reclassify cumulative translation differences for foreign operation from entity to profit or loss as part of gain or loss on its disposal

   If first time adopter uses this exemption:

   - Cumulative translation differences set to zero for all foreign operations.

   - Gain/ loss on subsequent disposal of a foreign operation shall exclude these differences that arose before transition
A first time adopter may continue the policy adopted for accounting for exchange differences arising from long term monetary foreign currency items, as per previous GAAP.

**Investment in subsidiaries, joint ventures and associates:** It is measured at cost, the cost may be
• Cost determined in accordance with Ind AS 27or
• Deemed cost (which may be fair value or previous GAAP carrying amount)

**Compound financial instruments:** A first time adopter need not split the compound financial instruments into separate liability and equity component, if liability component not outstanding as at transition date.

**Fair value measurement of financial assets or financial liabilities:** An entity may apply requirement of Ind AS 109 prospectively to transactions entered into on or after date of transition.

**Decommissioning liabilities included in PPE:** An entity need not comply with the requirement for changes in such liabilities that accounted before the date of transition. However, entity may measure liability as at the transition date as per Ind AS 37 and recognise its effect.

**Designation of previously recognised financial instruments:** An entity may designate any financial liability or asset at fair value through profit or loss at transition date. Investment in equity may be designated at FVTOCI at transition date. If retrospectively application of effective interest method or impairment requirement is impracticable – fair value shall be new amortised cost of financial asset on the date of transition.

**Existing financial liabilities with equity instruments:** A first time adopter may apply Ind AS 109 from the date of transition to Ind AS.

**Leases:** A first time adopter may determine whether an arrangement existing at the date of transition to Ind AS contain a lease (including classification of each land and building element as finance or an operating lease) on basis of facts and circumstances existing on the date of transition.

A lessee which is a first-time adopter of Ind AS shall recognise lease liabilities and right-of-use assets, by applying the following approach to all of its leases at the date of transition to Ind AS:

(a) measure a lease liability at the present value of the remaining lease payments discounted using the lessee’s incremental borrowing rate at the date of transition to Ind AS;

(b) measure a right-of-use asset on a lease-by-lease basis either at:
(i) its carrying amount as if Ind AS 116 had been applied since the commencement date of the lease, but discounted using the lessee’s incremental borrowing rate at the date of transition to Ind AS; or

(ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet immediately before the date of transition to Ind AS.

(c) apply Ind AS 36 to right-of-use assets.

A first-time adopter that is a lessee may do one or more of the following at the date of transition to Ind AS, applied on a lease-by-lease basis:

(1) apply a single discount rate to a portfolio of leases with reasonably similar characteristics.

(2) elect not to apply the above requirements given in (a) to (c) to leases for which the lease term ends within 12 months of the date of transition to Ind AS. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted as per Ind AS 116.

(3) elect not to apply the above requirements given in (a) to (c) to leases for which the underlying asset is of low value. Instead, the entity shall account for (including disclosure of information about) these leases as per Ind AS 116.

(4) exclude initial direct costs from measurement of ROU asset at the date of transition to Ind AS.

(5) use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Financial asset or intangible assets accounted for service concession arrangements: Change in accounting policy to be accounted retrospectively except for amortization policy. Intangible assets relating to toll roads adopted as per previous GAAP.

If impracticable for an operator to apply the requirements of the Ind AS retrospectively at the date of transition to Ind AS, it shall recognise financial assets and intangible assets that existed at the date of transition to Ind AS using the previous carrying amounts.

Designation of contracts to buy or sell a non-financial item: An entity may designate at the date of transition to Ind AS, contract that already exist on that date as measured at fair value through profit or loss but they meet the requirements of Ind AS 109 at the date and the entity designate all similar contracts.
Striping costs in the production of surface mine: A first time adopter may apply appendix to Ind AS 16 stripping costs in the production phase of a surface mine from the date of transition to Ind AS. As at the transition date to Ind AS, any previously recognised asset balance that resulted from stripping activity undertaken during the production phase shall be reclassified as a part of an existing asset to which the stripping activity related, to the extent that there remains an identifiable component of the core body with which the predecessor stripping asset can be associated.

Non-current assets held for sale and discounted operations:

A first time adopter can:

- Measure noncurrent assets held for sale or discontinued operation at the lower carrying value and fair value less cost to sell at the date of transition to Ind AS in accordance with Ind AS 105; and
- Recognize directly in retain earnings any difference between that amount and the carrying amount of those assets at the date of transition to Ind AS determined under the entity’s previous GAAP

Assets and liabilities of subsidiaries, associates and joint ventures: If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall measure its assets and liabilities at either:

- The carrying amounts that would be included in the parent’s consolidated financial statements, based on the parent’s date of transition to Ind AS or
- The carrying amounts required by Ind AS 101, based on subsidiary’s date of transition to Ind AS.

If an entity becomes first time adopter later than its subsidiary, the entity shall measure the assets and liabilities at the subsidiary at the same carrying amounts as in the financial statements of the subsidiary, after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidy.

Revenue from Contract with Customers: Any of the following exemption may be used in applying Ind AS 115 retrospectively:

- For completed contracts: Need not restate contracts that begin and end within the same annual reporting period;
- For completed contracts that have variable consideration: Option to use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods;
• For all reporting periods presented before the beginning of the first Ind AS reporting period, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.

**Joint arrangements: Transition from Proportionate Consolidation to Equity Method**

• To measure initial investment at transition date at aggregate of carrying amount of assets & liabilities that had previously proportionately consolidated including goodwill arising on acquisition.

• To test the investment for impairment.

• If aggregate of all previously recognized assets/liabilities results in negative asset & if having legal or constructive obligation than recognize corresponding liability otherwise adjust retained earnings.

**Transition from Equity Method to accounting for assets and liabilities**

• To derecognize previous investment and recognize share of each asset and liability in respect of its interest in joint operation.

• Difference between amount as per Ind AS and previously recognized;
  
  (a) If carrying amount of previous investment is lower:  
  Offset against goodwill relating to investment and thereafter retained earning

  (b) If carrying amount of previous investment is higher: Adjust against retained earning

**Transitional provisions in entity’s Separate FS**

• To derecognise the investment and recognise assets and liabilities as per transition from equity method to accounting for assets and liabilities

• Provide reconciliation between amount derecognized, recognized and adjustment to retained earnings.

**Presentation and Disclosures:**

**A. Comparative Information**

• Ind AS does not require historical summaries to comply with the recognition and measurement requirement of Ind AS.

• In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:
• Label the previous GAAP information prominently as not being prepared in accordance with Ind AS; and
• Disclose the nature of the main adjustments that would make it comply with Ind AS. An entity need not quantify those adjustments.

B. Explanation of transition to Ind AS

• Reconciliation of
  (a) Equity from previous GAAP to Ind AS at transition and last year end;
  (b) Last year’s total comprehensive income under previous GAAP to Ind AS.
• Sufficient detail to understand adjustments to each line item.
• Reconciliation to distinguish correction of errors identified during transition from change in accounting policy.
• Fair value as deemed cost and the amount of the adjustment.
• Ind AS 36 disclosures for impairment during transition.
• If adopted first time exemption option, to disclose the fact and accounting policy until such time those PPE, Intangible Assets, investment properties or intangible assets significantly depreciated/impaired/derecognized.
• Interim financial reports to include reconciliation with equity and profit or loss under previous GAAP.
• Further information to comply with Ind AS34.

Practical Questions

Previous GAAP

Q1. Company B is a foreign subsidiary of Company A and has adopted IFRS as issued by IASB as its primary GAAP for its local financial reporting purposes. Company B prepares its financial statements as per Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 for the purpose of consolidation with Company A. On transition of Company A to Ind-AS, what would be the previous GAAP of the foreign subsidiary Company B for its FS prepared for consolidation with Company A?
Scope

Q2. E Ltd. is required to first time adopt Indian Accounting Standards (Ind AS) from April 1, 20X1. The management of E Ltd. has prepared its financial statements in accordance with Ind AS and an explicit and unreserved statement of compliance with Ind AS has been given by the management. However, there is a disagreement on application of one Ind AS between the management and the auditor. Can such financial statements of E Ltd. be treated as first Ind AS financial statements?

Date of Transition

Q3. X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for 20X0-20X1. What will be its date of transition?

Q4. X Ltd. was using cost model for its property, plant and equipment (tangible fixed assets) till 31st March, 20X1 under previous GAAP. On 1st April, 20X0, i.e., the date of its transition to Ind AS, it used fair values as the deemed cost in respect of its Property, Plant & Equipment. Whether it will amount to a change in accounting policy?

Exceptions

Q5. A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

NCI

Q6. Ind AS requires allocation of losses to the non-controlling interest, which may ultimately lead to a debit balance in non-controlling interests, even if there is no contract with the non-controlling
interest holders to contribute assets to the Company to fund the losses. Whether this adjustment is required or permitted to be made retrospectively?

**Business Combination**

**Q7.** A Ltd. had made certain investments in B Ltd. convertible debt instruments. The conversion rights are substantive rights and would provide A Ltd. with a controlling stake over B Ltd. A Ltd. has evaluated that B Ltd. would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS consolidated financial statements. B Ltd. was not considered as a subsidiary, associate or a joint venture under previous GAAP. How should B Ltd. be consolidated on transition to Ind AS assuming that A Ltd. has opted to avail the exemption from retrospective restatement of past business combinations?

**Q8.** A Ltd. has a subsidiary B Ltd. On first time adoption of Ind AS by B Ltd., it availed the optional exemption of not restating its past business combinations. However, A Ltd. in its CFS has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the CFS of A Ltd. considering that A Ltd. does not avail the business combination exemption? Will the answer be different if the A Ltd. adopts Ind AS after the B Ltd?

**ESOP**

**Q9.** X Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. It has given 200 stock options to its employees. Out of these, 75 options have vested on November 30, 20X0 and remaining 125 will vest on November 30, 20X1. What are options available to X Ltd. at date of transition?

**Deemed Cost**

**Q10.** X Ltd. is the holding company of Y Ltd. X Ltd. is required to adopt Ind AS from April 1, 20X1. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of its PPE whereas Y Ltd. wants to use fair value of its PPE as its deemed cost on the date of transition. Examine whether X Ltd. can do so for its consolidated financial statements. Also,
examine whether different entities in a group can use different basis for arriving at deemed cost for PPE in their respective standalone financial statements.

Q11. For the purpose of deemed cost on the date of transition, an entity has the option of using the carrying value as the deemed cost. In this context, suggest which carrying value is to be considered as deemed cost: original cost or net book value? Also examine whether this would have any impact on future depreciation charge?

Q12. Is it possible for an entity to allocate cost as per the previous GAAP to a component based on its fair value on the date of transition even when it does not have the component-wise historical cost?

Q13. Revaluation under previous GAAP can be considered as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to fair value or cost or depreciated cost of assets in accordance with Ind AS, adjusted to reflect, e.g., changes in a general or specific price index. What is the acceptable time gap of such revaluation from the date of transition? Can adjustments be made to take effects of events subsequent to revaluation?

Q14. Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. On the date of transition, there is a long-term foreign currency monetary liability of ₹ 60 crores (US $ 10 million converted at an exchange rate of US $ 1 = ₹ 21 60). The accumulated exchange difference on the date of transition is nil since Y Ltd. was following AS 11 notified under the Companies (Accounting Standards) Rules, 2006 and has not exercised the option provided in paragraph 46/46A of AS 11. The Company wants to avail the option under paragraph 46A of AS 11 prospectively or retrospectively on the date of transition to Ind AS. How should it account for translation differences in respect of this item under Ind AS 101?

Q15. Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1,20X1, it obtained a 7 year US$ 1,00,000 loan. It has been exercising the option provided in Paragraph
Q16. A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable). A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

Q17. On April 1, 20X1, Sigma Ltd. issued 30,000 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on March 31, 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is April 1, 20X3. Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition. The present value of ₹ 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

<table>
<thead>
<tr>
<th>Year End</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>6%</td>
<td>0.94</td>
<td>0.89</td>
<td>0.84</td>
<td>0.79</td>
</tr>
<tr>
<td>10%</td>
<td>0.91</td>
<td>0.83</td>
<td>0.75</td>
<td>0.68</td>
</tr>
</tbody>
</table>

Q18. Company A intends to restate its past business combinations with effect from 30 June 20X0 (being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for PPE, can be adopted?
Q19. X Ltd. was using cost model for its property, plant and equipment till March 31, 20X2 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 20X2. On April 1, 20X1, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS FS would amount to a change in accounting policy?

Q20. Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X0, it obtained a 7 year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21 with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so?

Q21. A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101. However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to PPE i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of PPE under previous GAAP?

Q22. H Ltd. has following assets & liabilities as at 31/03/20X1, prepared in accordance with previous GAAP:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Notes</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant &amp; Equipment</td>
<td>1</td>
<td>1,34,50,000</td>
</tr>
<tr>
<td>Investments in S. Ltd.</td>
<td>2</td>
<td>48,00,000</td>
</tr>
<tr>
<td>Trade Receivables</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>Advances for purchase of inventory</td>
<td></td>
<td>50,00,000</td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td>8,00,000</td>
</tr>
</tbody>
</table>
Cash 49,000

**Total assets 2,42,99,000**

- VAT deferral loan 60,00,000
- Creditors 30,00,000
- Short term borrowing 8,00,000
- Provisions 12,00,000
- Total liabilities 1,10,00,000
- Share capital 1,30,00,000
- Reserves: 2,99,000
- Cumulative translation difference 1,00,000
- ESOP reserve 20,000
- Retained earnings 1,79,000

**Total equity 1,32,99,000**

**Total equity and liabilities 2,42,99,000**

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 20X1:

1. In relation to property, plant and equipment, the following adjustments were identified:
   - Property, plant and equipment comprise land held for capital appreciation purposes costing ₹4,50,000 and was classified as investment property as per Ind AS 40 explaining
   - Exchange differences of ₹1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of ₹40,000 was recognised.
   - There were no asset retirement obligations.
   - The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.

2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for ₹48,00,000 that carried a fair value of ₹68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. **Financial instruments:**
• VAT deferral loan ₹ 60,00,000:

The VAT deferral loan of ₹ 60,00,000 was obtained on March 31, 20X1, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 20X1, is ₹ 37,25,528. The entity chooses to exercise the option given in Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan.

4. The retained earnings of the Company contained the following:

• ESOP reserve of ₹20,000:

The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised ₹ 12,000 towards the vested options and ₹ 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been ₹ 15,000 and ₹ 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

• Cumulative translation difference:

₹ 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 1,00,000 as part of reserves. On first-time adoption of Ind AS, company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero.

Theory Answers

A1. Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its statutory reporting requirements in India (emphasis added) immediately before adopting Ind AS.

For instance, companies preparing their financial statements in accordance with the Accounting
Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 shall consider those financial statements as previous GAAP FS. Accordingly, the previous GAAP of the foreign subsidiary for the purpose of consolidation under Ind-AS with the parent company would be accounting standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 and not the IFRS as issued by the IASB since the first time adoption has to be considered in the context of India only.

A2. Ind AS 101 defines first Ind AS financial statements as “The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS.” In accordance with the above definition, if an explicit and unreserved statement of compliance with Ind AS has been given in the financial statements, even if the auditor’s report contains a qualification because of disagreement on application of Indian Accounting Standard(s), it would be considered that E Ltd. has done the first time adoption of Ind AS. In such a case, exemptions given under Ind AS 101 cannot be availed again. If, however, the unreserved statement of compliance with Ind AS is not given in the financial statements, such financial statements would not be considered to be first Ind AS financial statements.

A3. The date of transition for X Ltd. will be April 1, 20X0 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to adopt an Ind AS from April 1, 20X1, and it will give comparatives as per Ind AS for 20X0-20X1. Accordingly, the beginning of comparative period will be April 1, 20X0 which will be considered as date of transition.

A4. Use of fair values on the date of transition will not tantamount to a change in accounting policy. The fair values of the property, plant and equipment on the date of transition will be considered as deemed cost without this being considered as a change in accounting policy.

A5. In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associates and joint ventures as its
deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

A6. In case an entity elects not to restate past business combinations, Ind AS 101 requires the measurement of NCI to follow from the measurement of other assets and liabilities on transition to Ind AS. However, Ind AS 101 contains a mandatory exception that prohibits retrospective allocation of accumulated profits between the owners of the parent and the NCI.

No restatement of business combination: In case an entity elects not to restate past business combinations, the previous GAAP carrying value of NCI is not changed other than for adjustments made (remeasurement of the assets and liabilities subsequent to the business combination) as part of the transition to Ind AS. As such, the carrying value of NCI in the opening Ind AS balance sheet cannot have a deficit balance on account of recognition of the losses attributable to the minority interest, which was not recognised under the previous GAAP as part of NCI in the absence of contract to contribute assets to fund such a deficit.

Restatement of business combination: In case an entity restates past business combination, Ind AS 101 requires that the balance in NCI as at the date of transition shall be determined retrospectively in accordance with Ind AS, taking into account the impact of other elections made as part of the adoption of Ind AS. As such, the NCI could have a deficit balance on account of losses attributable to the NCI, even if there is no obligation on the holders of NCI to contribute assets to fund such a deficit.

A7.a. Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no CFS were required under previous GAAP), then the subsidiary’s assets and liabilities would be included in the parent’s
opening CFS at such values as would appear in subsidiary’s SFS if the subsidiary were to adopt the
Ind AS as at the parent’s date of transition.

b. For this purpose, the subsidiary’s SFS would be prepared as if it was a first-time adopter of Ind AS
i.e. after availing relevant first-time adoption mandatory exceptions and voluntary exemptions. In
other words, the parent will adjust the carrying amount of the subsidiary’s assets and liabilities to
the amounts that Ind AS would require in the subsidiary’s balance sheet.

c. The deemed cost of goodwill equals the difference at the date of transition between:
   • the parent’s interest in those adjusted carrying amount; and
   • the cost in the parent’s separate financial statements of its investment in the subsidiary.

The measurement of NCI and deferred tax follows from measurement of other assets and liabilities.

d. However if CFS were required to be prepared & there is a change in classification of entity from
subsidiary to associate or vice versa in accordance with Ind AS, then above exemption does not apply.

A8. As per Ind AS 101: “A first-time adopter may elect not to apply Ind AS 103 retrospectively to past
business combinations (business combinations that occurred before the date of transition to Ind AS).
However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall
restate all later business combinations and shall also apply Ind AS 110 from that same date.

Based on the above, if A Ltd. restates past business combinations, it would have to be applied to all
business combinations of the group including those by subsidiary B Ltd. for the purpose of CFS. Ind AS
101 states, “However, if an entity becomes a first-time adopter later than its subsidiary (or associate or
joint venture) the entity shall, in its CFS, measure the assets and liabilities of the subsidiary (or associate
or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or
associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for
the effects of the business combination in which the entity acquired the subsidiary.” Thus, in case where
the parent adopts Ind AS later than the subsidiary then it does not change the amounts already
recognised by the subsidiary.
A9. Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on ‘Share-based Payment’ to equity instruments that vested before the date of transition to Ind-AS. However, if a first time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.

Having regard to the above, X Ltd. has the following options:

- For 75 options that vested before the date of transition:
  (a) To apply Ind AS 102 and account for the same accordingly, provided it has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS102.
  (b) Not to apply Ind AS102.

However, for all grants of equity instruments to which Ind AS 102 has not been applied, i.e., equity instruments vested but not settled before date of transition to Ind AS, X. would still need to disclosed.

- For 125 options that will vest after date of transition: X. will need to account for it as per Ind AS102.

A10. Where there is no change in its functional currency on the date of transition to Ind AS, a first- time adopter to Ind AS may elect to continue with the carrying value of all of its property, plant and equipment as at the date of transition measured as per the previous GAAP and use that as its deemed cost at the date of transition after making necessary adjustments. If a first time adopter chooses this option then the option of applying this on selective basis to some of the items of property, plant and equipment and using fair value for others is not available. Nothing prevents different entities within a group to choose different basis for arriving at deemed cost for the standalone financial statements. However, in Consolidated Financial Statements, the entire group should be treated as one reporting entity. Accordingly, it will not be permissible to use different basis for arriving at the deemed cost of PPE on the date of transition by different entities of the group for the purpose of preparing CFS.

A11. For the purpose of deemed cost on the date of transition, if an entity uses the carrying value as the deemed cost, then it should consider the net book value on the date of transition as the deemed cost and not the original cost because carrying value here means net book value. The future depreciation
charge will be based on the net book value and the remaining useful life on the date of transition. Further, as per the requirements of Ind AS 16, the depreciation method, residual value and useful life need to be reviewed at least annually. As a result of this, the depreciation charge may or may not be the same as the depreciation charge under the previous GAAP.

A12. Yes, an entity can allocate cost to a component based on its fair value on the date of transition. This is permissible even when the entity does not have component-wise historical cost.

A13. There are no specific guidelines in Ind AS 101 to indicate the acceptable time gap of such revaluation from the date of transition. The management of an entity needs to exercise judgement in this regard. However, generally, a period of 2–3 years may be treated as an acceptable time gap of such revaluation from the date of transition. In any case, adjustments should be made to reflect the effect of material events subsequent to revaluation.

A14. Ind AS 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 Ind AS financial reporting period as per the previous GAAP.

If the Company wants to avail the option prospectively: The Company cannot avail the exemption given in Ind AS 101 and cannot exercise option under paragraph 46/46A of AS 11, prospectively, on the date of transition to Ind AS in respect of long-term foreign currency monetary liability existing on the date of transition as the company has not availed the option under paragraph 46/46A earlier. Y Ltd. has not been.

If the Company wants to avail the option retrospectively: The Company cannot avail the exemption given in Ind AS 101 and cannot exercise the option under paragraph 46/46A of AS 11 retrospectively on the date of transition to Ind AS in respect of long-term foreign currency monetary liability that existed on the date of transition since the option is available only if it is in continuation of the accounting policy followed in accordance with the previous GAAP.
using the option provided in Para 46/46A of AS11, hence, it will not be permitted to use the option

given in Ind AS 101 retrospectively.

A15. Ind AS 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 Ind AS financial reporting period as per the previous GAAP. In view of the above, the
Company can continue to follow the existing accounting policy of amortising the exchange
differences in respect of this loan over the balance period of such long term liability.

A16. In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values,
as at the date of transition, of investments in subsidiaries, associates and joint ventures as its
deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of
such investments are not adjusted. Accordingly, any adjustments in relation to recognition of
contingent consideration on first time adoption shall be made in the statement of profit and loss.

A18. Ind-AS 101 prescribes that an entity may elect to use one or more of the exemptions of the
Standard. As such, an entity may choose to adopt a combination of optional exemptions in relation
to the underlying account balances. When the past business combinations after a particular date (30
June 20X0 in the given case) are restated, it requires retrospective adjustments to the carrying
amounts of acquiree’s assets and liabilities on account of initial acquisition accounting of the
acquiree’s net assets, the effects of subsequent measurement of those net assets (including
amortisation of non-current assets that were recognised at its fair value), goodwill on consolidation
and the consolidation adjustments. Therefore, the goodwill and equity (including non-controlling
interest (NCI)) cannot be computed by considering the deemed cost exemption for PPE. However,
entity may adopt deemed cost exemption for its PPE other than those acquired through business
combinations.

A19. In the instant case, X Ltd. is using revaluation model for property, plant and equipment for the first
annual Ind AS financial statements and using fair value of property, plant and equipment on the
date of the transition, as deemed cost. Since the entity is using fair value at the transition date as
well as in the first Ind AS financial statements, there is no change in accounting policy and mere use of the term ‘deemed cost’ would not mean that there is a change in accounting policy.

A20. Ind AS 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 Ind AS financial reporting period as per the previous GAAP. Ind AS 101 gives an option to continue the existing accounting policy. Hence, Y may opt for discontinuation of accounting policy as per previous GAAP and follow the requirements of Ind AS 21. Cumulative amount lying in FCMITDA should be derecognised by an adjustment against retained earnings on date of transition.

A21. Ind AS 101 permits to continue with the carrying value for all of its property, plant and equipment as per the previous GAAP and use that as deemed cost for the purposes of first time adoption of Ind AS. Accordingly, the carrying value of property, plant and equipment as per previous GAAP as at the date of transition need not be adjusted for the exchange fluctuations capitalized to property, plant and equipment. Separately, it allows a company to continue with its existing policy for accounting for exchange differences arising from translation of long term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Accordingly, given that Ind AS 101 provides these two choices independent of each other, it may be possible for an entity to choose the deemed cost exemption for all of its property, plant and equipment and not elect the exemption of continuing the previous GAAP policy of capitalising exchange fluctuation to property, plant and equipment. In such a case, in the given case, a harmonious interpretation of the two exemptions would require the company to recognise the property, plant and equipment at the transition date at the previous GAAP carrying value (without any adjustment for the exchanges differences capitalized under previous GAAP) but for the purposes of the first (and all subsequent) Ind AS financial statements, foreign exchange fluctuation on all long term foreign currency borrowings would be recognised in the statement of P&L.
INTEGRATED REPORTING

I. Introduction

In the last few decades, the concept of value is slowly and gradually shifting from price based or market value of an entity to asset based whether it is tangible or intangible assets. Since the dynamics of the global economy are changing, today’s organisations require to assess the value created over the time by actively managing a wider range of resources. Resources like intangible assets such as intellectual capital, development, brand value, natural and human capital have become as important as tangible assets in many industries. However, these intangible assets are not universally assessed in current financial reporting frameworks even though they often represent a substantial portion of market value.

II. Organisational Structure

1. Integrated Reporting is a concept first introduced in South Africa. Later on, this concept travelled to many countries. Integrated Reporting as the name suggest will integrate both financial and non-financial information.

2. In 2010, the International Integrated Reporting Council (IIRC) was set up which aims to create globally accepted integrated reporting framework. The IIRC is a global coalition of Regulators, Investors, Companies, Standard setters, accounting profession & NGOs.

3. Framework: With the purpose of communication about value creation as next step in corporate reporting, International Integrated Reporting Framework (IIRF) was issued. Framework has been developed keeping in mind the greater flexibility to be given to entity & management in reporting but at the same time should target to report the value created by organisation through various capital.

III. Purpose

1. IR is enhancing the way organizations think, plan and report the story of their business. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others.
2. IR explains how all of their resources are creating value and it helps businesses to think holistically about their strategy and plans. IR promotes a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.

3. An integrated report is a concise communication about how an organization’s strategy, governance, performance and Prospects in the context of its external environment. It leads to the creation of value over Short, Medium and Long term. It’s a portal by which the organisation communicates a holistic view of its Current position, where it’s going and how it intends to get there.

VI. Salient features of integrated reporting framework

1. Principal Based approach: This Framework identifies information to be included in an IR but it does not set benchmarks for such things as the quality of an organisation’s strategy or the level of its performance. It intent to strike an appropriate balance between flexibility and prescription that recognises the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs.

2. Target: This Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

3. Value Creation: Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization’s business activities and outputs. That value has two interrelated aspects, value created for the organization itself, which enables financial returns to the providers of financial capital and Others (i.e., stakeholders and society at large)

4. Capital: The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of organisation. This is interrelated with the value the organization creates for stakeholders and society at large through a wide range of activities, interactions and relationships. When these are material to the organization's ability to create value for itself, they are included in the integrated report. The concept of capitals seeks to assist an organisation in identifying all the
resources and relationships it uses and affects to report in a comprehensive manner. The Framework has categories the capital into 6 main forms which are

A. Financial
B. Intellectual
C. Natural
D. Human
E. Manufactured
F. Social & Relationship

However, it is not necessary that same categorisation of capital be followed by entities in their IR.

A. **Financial Capital:** The pool of funds
   - Available to an organization for use in production of goods or provision of services
   - Obtained through financing, such as:
     - Debt, equity or grants; or
     - Generated through operations or investments

B. **Manufactured Capital:** Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including:
   - Buildings
   - Equipment
   - Infrastructure (such as roads, ports, bridges, and waste and water treatment plants)

C. **Intellectual Capital:** Organizational, knowledge-based intangibles, including:
   - Intellectual property, such as patents, copyrights, software, rights and licences
   - “Organizational capital” such as tacit knowledge, systems, procedures and protocols
D. **Human Capital:** People’s competencies, capabilities and experience, and their motivations to innovate, including their:

- Alignment with and support for an organization’s governance framework, risk management approach, and ethical values
- Ability to understand, develop and implement an organisation’s strategy
- Loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate

E. **Social & Relationship Capital:** The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being. It includes:

- Shared norms, and common values and behaviours.
- Key stakeholder relationships, and the trust and willingness to engage that an organization has developed and strives to build and protect with external stakeholders
- Intangibles associated with brand and reputation that an organization has developed
- An organization’s social licence to operate

F. **Natural Capital:** All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organisation. It includes:

- Air, water, land, minerals and forests
- Biodiversity and eco-system health

**Note:** Not all capitals are equally relevant or applicable to all organizations. While most organizations interact with all capitals to some extent, these interactions might be relatively minor or so indirect that they are not sufficiently important to include in IR.
5. **Guiding principles for preparation and presentation of integrated report:**

One of the distinguishing features of IR is that there can be no model report. Every report must be built around the unique business model of the preparer. There are many good illustrations of how to report specific matters but they can only provide a starting point for a company’s own reporting, not a template. The starting point for understanding how IR works is considering the application of the content elements and guiding principles of IIRC’s IR framework. The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of report and how information is presented:

An integrated report should provide:

- Insight into the organization’s strategy and
- How it relates to the organization’s ability to create value & to its use of and effects on the capitals in short, medium and longterm
- An integrated report should answer the question that where does the organization wants to go and how does it intend to get there?
- The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

5.1. **Connectivity of information:** An integrated report shows the connections between the different components:

- Organisation's business model
- External factors that affect the organisation
- Various resources and relationships on which the organisation and its performance are dependent upon

The report should highlight the connection, for example, between past, present and future performance, between financial and non-financial information, and between qualitative and quantitative information.

5.2. **Stakeholder Relationships:** An integrated report should provide insight into nature and quality of the organization’s relationships with its key stakeholders including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.
5.3. **Materiality:** An integrated report should disclose information about matters that substantively affect the organization’s ability to create value over short, medium and long term. A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value overtime. Additional information can be placed in supporting reports.

5.4. **Conciseness:** An integrated report should be concise. Conciseness implies more than ‘as short as possible’. It implies that the information should be accessible through crisp presentation, the omission of immaterial information, and a logical easy-to-follow structure.

5.5. **Reliability and Completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. Both, increases and reductions in value of important capitals should be reflected. Where information is not perfectly accurate, estimates should be used and appropriate processes in place to ensure that the risk of material misstatement is reduced.

5.6. **Consistency and Comparability:** The information in an IR should be presented:

- On a basis that is consistent overtime.
- In a way that enables comparison with other organizations to the extent it is material to the organization’s own ability to create value overtime.

6. **Contents of integrated reporting:** An integrated report includes the eight Content Elements. The Content Elements are fundamentally linked to each other and are not mutually exclusive. The content of an organization’s integrated report will depend on the individual circumstances of the organization. The Content Elements are therefore stated in the form of questions rather than as
checklists of specific disclosures. Accordingly, judgement needs to be exercised in applying the Guiding Principles to determine what information is reported, as well as how it is reported.

<table>
<thead>
<tr>
<th>Content Element</th>
<th>Question to be answered</th>
<th>Content to be reported</th>
</tr>
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</table>
| Organisational Overview and External Environment | What does organisation do & what are the circumstances under which it operates? | Organisational Overview: An IR identifies the organization’s mission and vision, & provides essential context by identifying matters such as:  
  A. The organization’s Culture, ethics and values, Ownership & operating structure, Principal activities & markets, Competitive landscape and market positioning (considering factors such as the threat of new competition and substitute products or services, the bargaining power of customers and suppliers, and the intensity of competitive rivalry), Position within value chain  
  B. KQI: Key quantitative information examples: No. of employees, Revenue, No. of countries in which the organization operates, Highlighting in particular, significant changes from prior periods  
  C. Significant factors: Significant factors affecting external environment & organization’s response  

2. Governance: “How does An IR provides insight about how such matters as the
organisation's leadership structure, including skills and diversity of those charged with governance and whether regulatory requirements influence the design of the governance structure.

- Specific processes used to make strategic decisions and to establish and monitor culture of organization, including its attitude to risk and mechanisms for addressing integrity and ethical issues.
- Particular actions those charged with governance have taken to influence and monitor the strategic direction of the organization and its approach to risk management.
- How the organization’s culture, ethics and values are reflected in its use of and effects on the capitals, including its relationships with key stakeholders.
- Whether the organization is implementing governance practices that exceed legal requirements.
- The responsibility those charged with governance take for promoting and enabling innovation.
- How remuneration and incentives are linked to value creation, including how they are linked to the organization’s use of and effects on the capitals.

Business Model

What is the organisation’s business model?

An IR describes the business model, including key inputs, business activities, outputs, outcomes:

**Inputs:** An IR shows how key inputs relate to capitals on which the organization depends, or that provide a source of differentiation for the organization, to the extent they are material to understanding the robustness and
<table>
<thead>
<tr>
<th>Business Activities:</th>
<th>IR describes key business activities.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>This includes,</td>
</tr>
<tr>
<td></td>
<td>How organization differentiates itself in marketplace?</td>
</tr>
<tr>
<td></td>
<td>The extent to which the business model relies on revenue generation after the initial point of sale</td>
</tr>
<tr>
<td></td>
<td>How the organization approaches the need to innovate?</td>
</tr>
<tr>
<td></td>
<td>How business model has adaptable to change?</td>
</tr>
</tbody>
</table>

| Outputs: | An IR identifies an organization’s key products & services. There might be other outputs, such as by-products and waste (including emissions), that need to be discussed within the business model disclosure depending on their materiality. |
|          | |

| Outcomes: | An IR describes key outcomes, including: |
|          | Both internal outcomes (e.g., employee morale, organizational reputation, revenue and cash flows) & external outcomes (e.g., customer satisfaction, tax payments, brand loyalty, & social & environmental effects) |
|          | Both positive outcomes (i.e., those that result in a net increase in the capitals and thereby create value) and negative outcomes (i.e., those that result in a net decrease in the capitals and thereby diminish value). |

| Risks and Opportunities | An IR identifies the key risks and opportunities that are specific to the organization, including those that relate to the organization’s effects on, and the continued ability to create value & how is organisation availability, quality and afford ability of, relevant capitals in the short, medium and longterm. |
### Strategy & Resource Allocation

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
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</table>
| Where does the organisation want to go and how does it intend to get there? | An integrated report ordinarily identifies:  
  - The organization’s short, medium and long term strategic objectives  
  - The strategies it has in place, or intends to implement, to achieve those strategic objectives.  
  - The resource allocation plans it has to implement its strategy  
  - How it will measure achievements and target outcomes for the short, medium and long term. |

### Performance

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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</table>
| To what extent has the organisation achieved its strategic objectives for period & what are its outcomes in terms of effects on the capitals? | An IR contains qualitative and quantitative information about performance that may include matters such as:  
  - Quantitative indicators with respect to targets and risks and opportunities, explaining their significance, their implications, and the methods and assumptions used in compiling them  
  - Organization’s effects on the capitals, including material effects on capitals up and down the value chain  
  - The state of key stakeholder relationships and how the organization has responded to key stakeholders’ legitimate needs and interests  
  - The linkages between past and current performance, and between current performance and the organization’s outlook |

### Outlook

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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</thead>
<tbody>
<tr>
<td>What challenges &amp; uncertainties is the organisation likely to face?</td>
<td>IR ordinarily highlights anticipated changes over time &amp; provides information, built on sound &amp; transparent analysis, of:</td>
</tr>
</tbody>
</table>
encounter in pursuing its strategy, and what are potential implications for its business model & future performance?

• The organization’s expectations about the external environment the organization is likely to face in future.
• How that will affect the organization
• How the organization is currently equipped to respond to the critical challenges and uncertainties that are likely to arise.

<table>
<thead>
<tr>
<th>Basis of Preparation and Presentation</th>
<th>How does the organization determine what matters to include in IR and how are such matters quantified or evaluated?</th>
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<tbody>
<tr>
<td>IR describes its basis of preparation &amp; presentation, including:</td>
<td></td>
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<tr>
<td>A summary of organization’s materiality determination process</td>
<td></td>
</tr>
<tr>
<td>A description of reporting boundary &amp; how it has been determined</td>
<td></td>
</tr>
<tr>
<td>A summary of significant frameworks and methods used to quantify or evaluate material matters</td>
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</tbody>
</table>

7. **Securities and exchange board of India (SEBI):**

SEBI vide its circular no. SEBI/HO/CFD/CMD/CIR/P/2017/10 February 6, 2017 has advised top 500 companies [to whom Business Responsibility Report (‘BRR’) have been mandated under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("SEBI LODR")], to adopt Integrated Reporting on a voluntary basis from financial year 2017-18. Therefore, towards the objective of improving disclosure standards, in consultation with industry bodies and stock exchanges, the listed entities are advised to adhere to the following:

(a) The information related to Integrated Reporting may be provided in the annual report separately or by incorporating in Management Discussion &Analysis or by preparing a separate report (annual report prepared as per IR framework).

(b) In case the company has already provided the relevant information in any other report prepared in accordance with national/international requirement / framework, it may provide appropriate reference to the same in its Integrated Report so as to avoid duplication of information.

(c) As a green initiative, the companies may host the Integrated Report on their website and provide appropriate reference to the same in their Annual Report.
Practical Questions

Q1. State the categories defined in the International IR Framework for capitals. Comment whether an organisation has to follow these categories rigidly.

Q2. Can a Not-for-Profit organisation do the Integrated Reporting as per the Framework?

Q3. Can an Integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports?

Answers

A1. Various categories of capital are: Financial, Manufactured, Intellectual, Human, Social and Relationship & Natural. Organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the above lines of the capitals.

A2. The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

A3. An integrated report may be prepared in response to existing compliance requirements. For e.g., an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework, it can be considered an integrated report. If report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure concise information required by this Framework.

1. Sample of Extracts of IR

Extract of ABC LTD Sustainability Report Year 2016 Building Natural Achievements and Social Capital  ABC’s vision of sustainable and inclusive growth has led to the adoption of a Triple Bottom Line approach that simultaneously builds economic, social and environmental capital.
It’s Social Investment programmes, including Social Forestry, Soil & Moisture Conservation, Sustainable Agriculture, Livestock Development, Biodiversity, Women Empowerment, Education, Skilling & Vocational Training and Health & Sanitation, have had a transformational impact on rural India. These Programmes strive to empower stakeholder communities to conserve, manage and augment their natural resources, create sustainable on and off-farm livelihood sources and improve social infrastructure in rural areas. Through its Businesses and associated value chains, ABC has supported the generation of around 6 million livelihoods, touching the lives of many living at the margins in rural India. In line with its commitment to environmental goals, ABC has constantly strived to reduce the impact of its Businesses, processes, products and services and create a positive footprint. ABC has adopted a low-carbon growth strategy through reduction in specific energy consumption and enhancing use of renewable energy sources. ABC also endeavours to reduce specific water consumption and augment rainwater harvesting activities both on site and off site at watershed catchment areas, as well as minimise waste generation, maximise reuse & recycling & use external post-consumer waste as raw material in its units.

2. Sample Report

Schiphol Group Company – An Extract

Mission

We aim to rank among the world’s leading airport companies. We create sustainable value for our stakeholders by developing Airport Cities and by positioning Amsterdam Airport Schiphol as Europe’s preferred airport. Schiphol ranks among the most efficient transport hubs for air, rail and road connections and offers its visitors and the businesses located at Schiphol the services they require 24 hours a day, seven days a week.

Profile

XYZ Group is an airport operator, focusing particularly on Airport Cities. A prime example of an Airport City is Amsterdam Airport Schiphol. Europe’s fifth-largest airport in terms of passengers and third-largest in terms of cargo.
In addition to our Dutch operations (Amsterdam Airport Schiphol, Rotterdam The Hague Airport, Eindhoven Airport and Lelystad Airport), we have direct and indirect operations in the United States, Australia, Italy, Indonesia, Aruba and Sweden.

**Activities**

The operation of airport and development of airport cities involve 3 inextricably linked business areas: Aviation, Consumers and Real Estate. The integrated activities of Aviation, Consumers and Real Estate form the core of the Airport City concept. This concept is not only applied to Amsterdam Airport Schiphol but also – either in part or in full – to other airports, particularly through the Alliances &Participations business area. Our revenues derived from this broad range of activities are made up for the most part of airport charges, concession fees, parking fees, retail sales, rents and leases, and income from our international activities.

Amsterdam Airport Schiphol is an important contributor to the Dutch economy. It serves as one of the home bases for Air France-KLM and its Sky Team partners, from which these airlines serve their European and intercontinental destinations. Amsterdam Airport Schiphol offers a high-quality network serving 301 destinations.

**Strategy**

The maintenance and reinforcement of the Main Port’s competitive position, and that of Amsterdam Airport Schiphol in particular, is the single most important objective on which our strategy is focused. This strategy combines the airport’s socio-economic function with our entrepreneurial business operations. The interconnection and interaction between these two elements are crucial for the robust and future-proof development of Schiphol Group going forward. Corporate Responsibility is an integral part of this strategy and has been permeating increasingly all aspects of our operations.

**Stakeholders**

Schiphol Group has many stakeholders and their interests can be quite divergent. We do our utmost to conduct an active dialogue with all our stakeholders. In this, and in everything else that we do, our core values play a key role: reliability, efficiency, hospitality, inspiration and sustainability. Achieving the ambition to be Europe’s preferred airport calls for a culture driven by a desire to fulfil or, better yet, surpass the expectations of customers and local stakeholders.