# IND AS 23
## Borrowing Cost

<table>
<thead>
<tr>
<th>TOPICS</th>
<th>PG.</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Objective</td>
<td>1</td>
</tr>
<tr>
<td>II. Scope</td>
<td>1</td>
</tr>
<tr>
<td>III. Borrowing Cost (Meaning)</td>
<td>1</td>
</tr>
<tr>
<td>Exchange difference to the extent considered as interest cost</td>
<td>1</td>
</tr>
<tr>
<td>IV. Qualifying Asset</td>
<td>2</td>
</tr>
<tr>
<td>V. Recognition &amp; Measurement</td>
<td>3</td>
</tr>
<tr>
<td>Commencement of capitalisation</td>
<td>3</td>
</tr>
<tr>
<td>Cessation of capitalisation</td>
<td>4</td>
</tr>
<tr>
<td>Suspension of capitalisation</td>
<td>4</td>
</tr>
<tr>
<td>Capitalisation Rate</td>
<td>5</td>
</tr>
<tr>
<td>VI. Disclosures</td>
<td>5</td>
</tr>
<tr>
<td>VII. Practical Questions</td>
<td>6</td>
</tr>
</tbody>
</table>
I. **Objective**

The Core principle is that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

II. **Scope**

1. An entity shall apply this Standard in accounting for borrowing costs.
2. The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.
3. An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
   i. A qualifying asset measured at fair value, for example, a biological asset or
   ii. Inventories that are manufactured / otherwise produced, in large quantities on a repetitive basis.

III. **Borrowing Cost**

1. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs may include:
   a. Interest expense calculated using effective interest method as described in Ind AS 109
   b. Interest in respect of lease liabilities recognised in accordance with Ind AS 116.
   c. Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. (Para 6e).
2. Exchange difference to the extent considered as interest cost.
   a. The exchange difference should be the difference arising from foreign currency and functional currency in relation to principle of foreign currency borrowing.
   b. Though in above paragraphs exchange difference is mentioned, adjustment to interest cost will be done only if there is foreign exchange loss. Foreign exchange gain if any should not be adjusted unless it is reversal of reversal of previous adjustment.
c. The adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not **exceed** the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency. *i.e.* 

*adjustment should be lower of*

i. **Exchange loss** or

ii. **Difference between borrowing cost in functional and foreign currency.**

d. where there is an unrealised exchange loss which is treated as an adjustment to interest and **subsequently** there is a realised or unrealised **gain** in respect of the settlement or translation of the same borrowing, the gain to the **extent of loss** previously recognised as an adjustment should also be recognised as an adjustment to interest. *i.e.*

*reversal should be lower of*

i. **Exchange loss previously adjusted to borrowing cost.**

ii. **Exchange gain.**

**IV. Qualifying Assets**

1. A qualifying asset is an asset that necessarily takes a **substantial period of time** to get ready for its intended use or sale.

2. Substantial period of time is not defined in standard, it is to be understood on case to case basis.

3. Generally, **inventory** is not considered as qualifying asset as they are produced on repetitive basis in a short duration, however if an inventory requires a substantial period of time to come in a **saleable condition** it will be classified as qualifying asset. *E.g.* **wine, rice, cheese etc.**

4. If the asset is **ready** for its indented use then it shall **not** be classified as qualifying asset. However if the assets acquired with an **intention** to be used in **relation** to a bigger asset or **project** then though the asset is ready for its intended use it will be classified as qualifying asset and **capitalisation** of borrowing cost will continue till the bigger asset or the project does not get ready for its intended use.
5. Any borrowing cost incurred in relation to qualifying asset, till it is not ready for its intended use or sale should be capitalised, this is because the qualifying asset under construction asset do not generate any present benefit and hence it won’t be appropriate to debit borrowing cost to P&L, as matching concept cannot be followed. Hence, capitalisation has effect of deferring the borrowing cost over the useful life of asset in form of depreciation against, benefit derived from use of asset.

V. Recognition & Measurement

1. Borrowing cost should be capitalised only when they are
   i. directly attributable to acquisition, construction, production of a qualifying asset and
   ii. it is probable that they will result in future economic benefit to the entity and
   iii. cost can be measured reliability.

2. If any of the above conditions are not satisfied, the borrowing cost will be written off in year of incurrence.

3. The borrowing cost are directly attributable only when the borrowing cost would be avoided if the expenditure on qualifying asset had not been done.

4. The borrowing cost should be net of any interest income earned from temporarily investing the borrowed funds.

5. Commencement of capitalisation: Capitalisation begins, when all conditions are met:
   i. Entities incurs expenditure for asset.
   ii. Entity incurs borrowing cost.
   iii. Undertakes activities, necessary to prepare the asset for its intended use or sale.

6. Expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with asset. Average carrying amount of asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of expenditures to which the capitalisation rate is applied in that period.
7. Activities that are necessary to prepare the asset for its intended use or sale encompasses more than just physical construction of asset. They include technical & administrative work required to prior to commencement of work, such as activities associated with obtaining permits prior to physical construction i.e. active development should be done towards making asset ready for its intended use or sell, but not necessarily physical construction.

5. Cessation of capitalisation:
   a. The entity shall cease the capitalisation once substantially all activities necessary to make the asset ready for intended use for sale are complete, however if minor modification or administrative work are the only work pending then it would indicate that the asset is ready for its intended use or sale.
   b. If the construction of qualifying assets is done in parts and each such part is capable of being used independently of other parts then capitalisation of each part should cease once that part is ready for its intended use or sale.

6. Suspension of capitalisation:
   a. An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset i.e. activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.
   b. An entity also does not suspend capitalising borrowing costs when a temporary delay is a necessity part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.
7. **Capitalisation rate**

   a. To the extent that an entity borrows funds *specifically* for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as *actual* borrowing costs incurred on that borrowing during the period.

   b. To the extent that an entity borrows funds *generally* and uses them for the purpose of obtaining a qualifying asset, entity shall determine the amount of borrowing costs eligible for capitalisation as determined by applying *capitalisation rate* to *expenditures* on that asset.

   c. The capitalisation rate shall be the *weighted average* of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period.

   d. The amount of borrowing costs that an entity capitalises during a period shall *not exceed* the amount of *actual* borrowing costs it incurred during that period.

   e. In determining amount of borrowing costs eligible for capitalisation of a period, any investment *income* earned on such funds is *deducted* from borrowing costs incurred.

   f. In case there is no issue expenses involved in raising the borrowing the capitalisation rate is coupon rate. However, in case there are *issue expenses*, they form *part* of calculating *effective interest rate*.

**VI. Disclosure**

1. Amount of borrowing costs capitalised during the period; and

2. Capitalisation rate used to determine borrowing costs eligible for capitalisation.
VII. **Practical Questions**

**Foreign Exchange difference considered to be interest cost**

Q1. A Ltd. took a foreign loan of US $ 1,00,000 on 1\(^{st}\) April 2019 @ 5% annual interest rate. On that date i.e. on 1\(^{st}\) April 2019 the exchange rate was 1$ = ₹ 50. On 31/3/2020 exchange rate is 1$ = ₹ 57. Comparable Indian interest rate on such loan was 12% p.a. Ascertain borrowing cost that may or may not be capitalized & foreign exchange loss.

Q2. Sun Co-operative society Ltd. had borrowed a sum of US$ 12.5 million at the commencement of the financial year 2019-2020 for its solar energy project at LIBOR (London bank Offered rate of 1%) + 4%. The interest is payable at the end of the respective financial year. The loan was availed at the then rate of ₹ 45 to the US dollar while the rate as on 31\(^{st}\) March 2020 is ₹ 48 to the US$. Had Sun Co-operative society Ltd. borrowed the rupee equivalent in India, the interest would have been 11%. You are required to compute ‘Borrowing cost’ also showing the amount of exchange difference as per prevailing IND AS.

Q3. X borrowed loan for $ 100000 @ 5% p.a. on 1/4/18. Exchange rate on that date was 1$ = ₹ 50. On 31/3/2019 exchange rate was 1$ = ₹ 54. Similar loan in Indian is @ 10% p.a. On 31/3/2020 exchange rate was 1$ = ₹ 42. Show under IND AS 23 treatment of exchange differences for y/e 31/3/2019 and 31/3/2020.

**Qualifying Asset**

Q4. A Company capitalizes interest cost on loan taken for purchase of investments each year. State whether the treatment is correct?

Q5. When the construction of a huge power project is under progress, several DG sets would be required. Though, they are otherwise capable of being used on their own, in the given
situation, they will be used only when the entire power project is commissioned. In such instances, how would the borrowing cost be capitalized? Do we treat the entire project as a qualifying asset or each individual DG set as a qualifying asset? Should we cease capitalization of borrowing costs relevant to the DG sets when they are installed or when the entire power project is commissioned?

Q6. Does License fees paid for a telecom circle to the Central Government constitute a qualifying asset for capitalizing the borrowing cost? Can the interest paid on borrowings for financing the license fees capitalized up to the time the telecom operation were commenced?

Q7. Sweet & Co., is a sugar company. Due to the regulations by the Central Government, the company cannot decide the quantity to be sold in the market. It is regulated on the basis of the release orders issued by the Central Government and quantity to be sold is also notified by the Central Government on a monthly basis. Because of the seasonal nature of production, the company has to carry large inventories throughout the year. The average holding period of the sugar stock is generally 12 – 15 months. In the years when there is a surplus stock of sugar, the government creates a buffer stock and reimburses the carrying charges to the sugar factory for the inventory to be carried by the sugar mill. Sweet & Co. incurs high interest costs since borrowings are required to meet the large demand for the working capital and payment to the sugar cane producers. Interest costs are the second largest item in the profit and loss account of the company, next to raw materials consumed. Can interest costs be capitalized to cost of inventory?

Q8. Borrowing cost on the loans taken specifically to construct captive power plant is being capitalized even after the commencement of commercial production. The management argues that the borrowing cost is attributable solely and exclusively to the captive power plant and therefore should be capitalized. Give your opinion.
Q9. The main object of the company is to undertake plantation activities, raising of teak and other forestry operations. It takes about 10 to 15 years for the teak trees to grow. The company has issued debentures for the fund to meet all the expenses. The company included all cost of plants and interest paid in the valuation of stock of teak. Give comments. Would your answer change under IND AS?

**Commencement Date**

Q10. X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

15th May, 20X1: Loan interest relating to the project starts to be incurred
2nd June, 20X1: Technical site planning commences
19th June, 20X1: Expenditure on the project started to be incurred
18th July, 20X1: Construction work commences Identify commencement date.

Q11. Marine Transport Limited ordered 3 ships for its fleet on 1st April, 20X0. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 20X7. On 1st March, 20X2, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis. Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended 31st March, 20X1 or 31st March, 20X2.

**Capitalisation rate**

Q12. Advise X limited on the weighted average cost of borrowing and the interest cost to be capitalized based on the following. Total Borrowings and interest costs of X Limited for the year ending 31st March 2020 are as follows: -
<table>
<thead>
<tr>
<th>Borrowings</th>
<th>Date of borrowings</th>
<th>Amount (in ‘000)</th>
<th>Interest (in ‘000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>18% Bank Loan</td>
<td>01-05-2018</td>
<td>1000</td>
<td>180</td>
</tr>
<tr>
<td>14% Debentures</td>
<td>01-10-2019</td>
<td>2000</td>
<td>140</td>
</tr>
<tr>
<td>16% Term Loan</td>
<td>01-07-2019</td>
<td>3000</td>
<td>360</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>6000</strong></td>
<td><strong>680</strong></td>
</tr>
</tbody>
</table>

Qualifying assets in which these borrowed funds are utilized are:

<table>
<thead>
<tr>
<th>Assets</th>
<th>₹ ‘000</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory Shed</td>
<td>2500</td>
<td>12 Months</td>
</tr>
<tr>
<td>Plant 1</td>
<td>1500</td>
<td>9 Months</td>
</tr>
<tr>
<td>Plant 2</td>
<td>1000</td>
<td>7 Months</td>
</tr>
</tbody>
</table>

Q13. XYZ Company limited has undertaken a significant expansion program for its manufacturing facilities by borrowings. The details are as follows:

Details of Capital Expenditure

<table>
<thead>
<tr>
<th>Facility</th>
<th>Amount</th>
<th>₹Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant A</td>
<td>34,00,00,000</td>
<td>Specific borrowings of ₹ 24,00,00,000</td>
</tr>
<tr>
<td>Plant B</td>
<td>20,00,00,000</td>
<td>Specific borrowings of ₹ 600,00,000</td>
</tr>
<tr>
<td>Plant C</td>
<td>4,00,00,000</td>
<td>No specific borrowings</td>
</tr>
<tr>
<td>Plant D</td>
<td>4,00,00,000</td>
<td>No specific borrowing</td>
</tr>
<tr>
<td>Corporate Offices</td>
<td>8,00,00,000</td>
<td>No specific borrowings</td>
</tr>
</tbody>
</table>

Facility expansion commenced on 01/06/2019 for all facilities. As of 31/03/2020, the status of completion of these facilities were as follows:

- Plant A was completed on 31st December 2019
- Plant B was completed on 30th November 2019
- Plant C is still under construction as of 31st March 2020
- Plant D was completed as of February 28th 2020
- Corporate offices were still under construction as of March 31st 2020

Details of debt of XYZ limited are as follows:
1. ₹ 20,00,00,000 11% p.a. secured debentures raised on July 1\textsuperscript{st} 2013 redeemable in four equal installments commencing July 1\textsuperscript{st} 2015.

2. ₹ 15,00,00,000 secured working capital loan obtained on April 1, 2015. The loan carries an interest of 14% p.a. This loan was partially repaid on December 31, 2015 in the amount of ₹ 5,00,00,000.

3. Loan from financial institutions amounting to ₹ 3000,00,000 bearing interest at 14% p.a. obtained for construction of Plants A and B obtained on May 1 2015.

4. Loans from financial institutions amounting to ₹ 2700,00,000 bearing interest at 8% p.a. obtained on June 1\textsuperscript{st} 2015.

None of the loans were fully repaid during 31\textsuperscript{st} March 2016.

Required: - Capitalization of interest in accordance with IND AS 23.

Q14. AD Softex made the following borrowings:

<table>
<thead>
<tr>
<th>Borrowing</th>
<th>Date of Borrowing</th>
<th>Amount</th>
<th>Period</th>
<th>Related expenses</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>15% Term loan</td>
<td>01.01.2015</td>
<td>6,00,000</td>
<td>5 years</td>
<td>50,000</td>
<td>General</td>
</tr>
<tr>
<td>14.5% Term loan</td>
<td>01.07.2015</td>
<td>4,00,000</td>
<td>5 years</td>
<td>20,000</td>
<td>Purchase of P&amp;M</td>
</tr>
<tr>
<td>14% Term loan</td>
<td>01.10.2015</td>
<td>5,00,000</td>
<td>5 years</td>
<td>40,000</td>
<td>General</td>
</tr>
</tbody>
</table>

Qualifying assets (12m construction period) for which borrowing was initiated are:

- Factory shed: ₹ 1,00,000
- Plant & Machinery: ₹ 9,00,000
- Other fixed asset: ₹ 1,00,000
- Total: ₹ 11,00,000

Assume that the project is ready for commercial production as on 01.01.2016. How would the borrowing cost be capitalized for the year ending December 2015. Show solution under IND AS 23.
Q15. Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2015 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. The weighted average cost of capital is 13% p.a. The accountant of Rainbow Ltd. capitalized interest of ₹ 19.50 crores for the accounting period ending on 31.3.2016. Due to surplus fund out of ₹ 150 crores an income of ₹ 3.5. crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

Q16. Alpha Ltd. on 1st April, 20X1 borrowed 9% ₹ 30,00,000 to finance construction of two qualifying assets. Construction started on 1st April, 20X1. Loan facility was availed on 1st April, 20X1 & was utilized as below with balance funds invested temporarily at 7%.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Factory Building</th>
<th>Office Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/04/20x1</td>
<td>5,00,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td>01/10/20x1</td>
<td>5,00,000</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

Calculate the cost of the asset and the borrowing cost to be capitalized.

Q17. Beta Ltd had the following loans in place at the end of 31st March, 20X2:

<table>
<thead>
<tr>
<th>Loan</th>
<th>01/04/20X1</th>
<th>31/03/20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>18% Bank Loan</td>
<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td>16% term Loan</td>
<td>3000</td>
<td>3000</td>
</tr>
<tr>
<td>14% Debenture</td>
<td>0</td>
<td>2000</td>
</tr>
</tbody>
</table>

14% debenture was issued to fund the construction of Office building on 1st July, 20X1 but the development activities has yet to be started. On 1st April, 20X1, Beta Ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: ₹ 500,000 on 1st April, 20X1 and ₹ 2,500,000 on 1st January, 20X2. Calculate the borrowing cost that can be capitalised for the plant.
Q18. A Ltd. borrowed 10% Debentures of ₹ 100 crores at year 0. An issue expense on the said borrowing was ₹10 crore which will be immediately amortised in its P&L statement. Loan period is for 5 years. Calculate effective rate of interest.

Q19. XYZ limited, has undertaken a project for expansion of capacity details of which are

<table>
<thead>
<tr>
<th>Plan</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>April, 2019</td>
<td>2,00,000</td>
</tr>
<tr>
<td>May, 2019</td>
<td>2,00,000</td>
</tr>
<tr>
<td>June, 2019</td>
<td>10,00,000</td>
</tr>
<tr>
<td>July, 2019</td>
<td>1,00,000</td>
</tr>
<tr>
<td>August, 2019</td>
<td>2,00,000</td>
</tr>
<tr>
<td>September, 2019</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

The company pays to its branches at the rate of 12% p.a., interest being debited on a monthly basis. During the half year, company had ₹ 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of ₹ 10 lakhs from 01.09.2019. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure was incurred on the first day of each month. Calculate, Interest to be capitalized and give reasons wherever necessary assuming that board of directors have decided that any capital expenditure taking more than 3m as a substantial period of time.

Q20. Given below are relevant data as regards a construction contract: ₹ in lakhs

| Expenditure incurred till 31.3.2019 | 450 |
| Interest cost capitalized for the year 2018-2019 @ 12% p.a. | 24 |
| Amount specifically borrowed till 31.3.2019 | 200 |
| Assets transferred to construction site during 2018-2019 | 100 |
| Cash payment for assets | 78 |
| Progress payments received | 300 |
| New borrowings during 2019-2020 @ 12% p.a. | 200 |

The company intends to capitalize total borrowing cost of ₹ 48 lakhs. Is it correct?
## TOPICS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Objective</td>
<td>1</td>
</tr>
<tr>
<td>II. Scope</td>
<td>1</td>
</tr>
<tr>
<td>III. Definition</td>
<td>1</td>
</tr>
<tr>
<td>Control</td>
<td>1</td>
</tr>
<tr>
<td>Significant Influence</td>
<td>2</td>
</tr>
<tr>
<td>Close Member of Family</td>
<td>2</td>
</tr>
<tr>
<td>KMP</td>
<td>2</td>
</tr>
<tr>
<td>Government Related Entity</td>
<td>2</td>
</tr>
<tr>
<td>Related Party Relationship</td>
<td>2</td>
</tr>
<tr>
<td>IV. Non Related Party</td>
<td>3</td>
</tr>
<tr>
<td>V. Identification of Related Party Transaction</td>
<td>4</td>
</tr>
<tr>
<td>VI. Disclosures</td>
<td>4</td>
</tr>
<tr>
<td>VII. Disclosure Exemptions</td>
<td>6</td>
</tr>
<tr>
<td>VIII. Practical Questions</td>
<td>7</td>
</tr>
</tbody>
</table>
I. **Objective**

To ensure that necessary disclosures are done in the financial statements about the influence of related parties, their transactions and outstanding balances, including commitments on the financial position and performance of entity, further it also ensures equity of information.

II. **Scope**

This Standard shall be applied in:

1. identifying related party relationships and transactions;
2. identifying outstanding balances, including commitments, between an entity & its related parties;
3. identifying the circumstances in which disclosure of the items in (a) & (b) is required;
4. determining the disclosures to be made about those items.

These disclosures are done in consolidated and separate financial statements of a parent or investors with joint control of, or significant influence over, an investee presented in accordance with Ind AS 110, Consolidated Financial Statements, or Ind AS 27, Separate Financial Statements. This Standard also applies to individual financial statements.

III. **Definitions**

1. **Related Parties:** Two parties are said to be related if at any time during the reporting period one party either controls or has a significant influence over other party.

2. **Related party transactions** are transfer of resources, services, or obligation between a reporting entity and the related party regardless of whether price is charged / not.

3. **Control** by an entity is considered to exercise over the other entity when
   - One entity controls more than the 50% of voting power is the other entity Or
   - If one entity controls the composition of board of directors of other entity Or
   - If one entity exercise control over other entity by agreement or by statute.

   *(The definition of control as per IND AS 110 is applicable to this standard)*
4. **Significant influence**: an entity is said to exercise a significant influence over other when the former can *participate in financial & operating* decision making of latter entity. *(if an entity possesses more than equal to 20% but less then equal to 50% of voting power in the other entity then it is said to have significant influence)*

5. **Close member of family** of a person are those family members, who may be expected *to Influence or be influenced* by person in their dealings with entity including.
   a. That person's children, spouse or domestic partner, brother, sister, father, mother.
   b. Children of that person's spouses or domestic partner
   c. is dependent of that person or that person's spouses or domestic partner.

6. **Key Managerial personnel or key Management personnel** are person's having *authority & responsibility* for planning, directing and controlling the activities of the entity directly or indirectly, including any director (whether executive or otherwise) of that entity.

7. **Government related entity** are those entities which are controlled, Jointly controlled or have a significant influence of a government.

8. **Related party relationships**: 
   a. A *person or close member* of that person's family is related to reporting entity, if that person:
      i. Has *control* or *joint* control of reporting entity.
      ii. Has *significant influence* over reporting entity
      iii. Is a member of *KMP* of reporting entity or of *parent* of reporting entity.
b. An entity is related entity if any of the following conditions apply:

i. The entity and the reporting entity are members of same group.
   (It covers relationship of parent, subsidiaries and fellow subsidiaries)

ii. One entity is an associate or Joint venture of another entity Or an associate or Joint venture of a member of a group of which the other entity's is a member

iii. Both the entities are joint venture of same third party.

iv. The entity is a Joint Venture of third entity and other entity is associate of same third entity.

v. The entity is a post employment benefit plan for the benefit of employee of either reporting entity, or entities related to reporting entities. If reporting entity if itself such a plan then the sponsoring employers are also related to reporting entity.
vi. Entity is controlled or Jointly controlled
   by person identified in part a.

vii. A person Identified in Part a .1 (above)
   has significant Influence over the
   entity or is a member of KMP of entity or
   of parent of entity.

viii. Entity or any member of group of which
      it is a part, provides KMP Services to
      the reporting entity or to the parent of
      reporting entity.

Gist of above Definition.

a. If two entities are both subject to control / Joint Control by same third entity or person
   than both the entities are related to each other.

b. If entity 1 or a person controls the 2nd entity and the same entity 1 or a person has
   significant influence over 3rd entity, then 2nd and 3rd entities are related to each other.

c. If 2 entities are both subject to significant influence by same entity or person, then 2
   entities are not related to each other.

IV. Non related party

1. Two entities simply because they have a Director or other member of KMP in
   common or because a member of KMP of one entity has significant influence in
   another entity.

2. Two Co - ventures simply because they share Joint control of Joint Venture.

3. Provider of a finance, Trade unions, public utilities with whom the entity deals in its
   normal course of business

LECTURE NO:  DATE: / / 13.3
4. A major customer, suppliers, franchises, distributors, general agent with whom the entity transacts a significant volume of business are not considered to be related simply by virtue of **economic dependency**.

V. **Identification of Related party transaction**

The related party disclosures are required if the relationship existed at **any time** during the **reporting period**. i.e. **it is not necessary that the relationship should be in existence on the reporting date**. However, the related party transactions to be disclosed should **pertain** to the period during which the **relationship** was in **existence**, this is because, only these transactions are the one which are influenced by the relationship is any transactions, after the relationship and will be consider to be between two independent entities which are not related to each other’s.

VI. **Disclosures**

1. **Control Based relationship:** If the relationship is based on control then the **relationship** should be disclosed **irrespective** of whether, there were any transactions between two related parties.

   This is because though there may be no transactions between them, the entire operations of the controlled entity are controlled by the controlling entity i.e. the control may not allow the subsidiary company to be independent in its financial and operating decision making.

   e.g. A parent Co. may restrict its subsidiary from doing R & D or selling goods to a particular client etc. thus disclosure of the name of related party will facilitate the reader in appraising the entity’s prospects.

2. **Significant influence Based relationship:** If the relationship is based on significant influence, then the **relationship** should be disclosed **only if** there were transactions between them during the period relationship existed i.e. **the relationship should be disclosed only if there are transactions between them**.
As there is only significant influence and not control over all the operations of the investee it cannot be said that all the transactions or operations of investee are influenced by the investor entity, however the transactions between the two entities may be influenced by the relationship and hence the related party relationship is to be disclosed only if there are transactions between them.

3. In relation to related party transactions following shall be disclosed.
   a. Amount of transaction
   b. Amount of outstanding balances including commitments and:
      i. their terms & conditions, whether they are secured and nature of consideration to be provided in settlement. And
      ii. Details of any guarantees given or received.
   c. Provision for Doubtful Debt, related to amount of outstanding balance and
   d. Expense *recognised* in the period in respect of *bad & doubtful debt* due from related parties.
   e. A disclosures that related party transaction were made on terms equivalent to those that prevail in *arms length* transactions are made, only if such terms can be *substantiated*.

4. The aforesaid disclosures shall be made separately for each of the following categories:
   a. the parent;
   b. entities with joint control or significant influence over the entity;
   c. subsidiaries;
   d. associates;
   e. joint ventures in which the entity is a joint venturer;
   f. key management personnel of the entity or its parent; and
   g. other related parties
5. An entity shall disclose **KMP compensation** in total and for each of the following categories: (SPOT - S)
   a. Short Term employee Benefits
   b. Post Employment Benefits
   c. Other Long Term Benefits
   d. Termination Benefits
   e. Share Based Payments.

6. Amounts incurred by the entity for the provision of KMP services that are provided by a separate management entity shall be disclosed.

7. **Aggregations**
   
   Items of **similar nature** may be disclosed in aggregate except when a separate disclosure is necessary for understanding the effects of related party transaction of Financial Statements. However, this is **not** done in such a way that is **obscures** the importance of significant transactions. e.g **purchase or sale of asset should not be aggregate with purchase or sale of goods. Examples of grouping of transactions.**
   
   1. Purchase or sale of Goods.
   2. Purchase or sale of property or other assets
   3. Rendering or receiving services
   4. Lease transaction
   5. Transfer of R&D
   6. Provisions of guarantees or collaterals

VII. **Disclosures Exemption**

1. A reporting entity is **exempt** from disclose requirement in relation to related party transaction and outstanding balances with **Government** that controls or Jointly controls or has a significant influence over the reporting entity and **other entity** that is related party because, the **same** government has a control or Joint control or significant control over both the entities.
However the following should be disclosed by the entity in relation to above

a. **Name** of the government and the nature of relationship with reporting entity &

b. following information

i. the nature and amount of each individually significant transaction and

ii. for collectively significant transaction qualitative/quantitative indication of the extent.

2. Related party disclosure requirements as laid down in this standard **do not** apply in circumstances where providing such disclosures would **conflict** with the reporting entities **duties of confidentiality** as specifically required by statute or a regulator or a similar competent authority governing the entity i.e. if statute or a regulator or a similar competent authority prohibits the entity to disclose certain information which is required to be disclosed as per this standard, disclosure of such information is not warranted. **For example: Bank are not allowed to disclose the transactions of their client as per RBI Act, hence the Disclosure requirement of this IND AS are not applicable to transaction between client and Bank.**

3. Intra group related party transaction and outstanding balances are eliminated except for those between an investment entity and its subsidiary measured at the fair value through profit and loss in the preparation of CFS.

**VIII. Practical Questions**

Q1. X Ltd. holds 80% of the Equity share capital of Y Ltd. Mr. A is the KMP in X Ltd. and Mr. B is KMP in Y Ltd. Y Ltd. has a transaction with both Mr. A and Mr. B. Analyse related party in the SFS of X Ltd., SFS of Y Ltd and CFS of group X under IND AS.

Q2. J Ltd., a listed company owned 60% of shares in K Ltd. B Ltd a listed company owned remaining 40% in K Ltd. B’s had acquired the shares in K on 1/1/2017. K sold a factory
to B on 30/11/2017. On 1st March 2018, J purchased further 30% shares in K from B Ltd. J also purchased on 1/3/2018 25% shares of B Ltd. On 30/6/2018 K sold vehicles to B Ltd. Discuss disclosure requirements under IND AS 24 for the year ending 31/12/2017 and year ending 31/12/2018.

Q3. A Limited has two associates, B Limited and C Limited, and owns 25% of voting power of B Limited and 30% of voting power of C Limited. Would B Ltd be considered related party in the financial statements of C Limited?

Q4. P Limited owns 70% of the voting power of Q Limited. Q Limited in turn owns 50% of the voting interest in R Limited. Further, P Limited also directly owns 15% of the voting interest in Ra Limited. Would P Ltd. be deemed to have control over R Limited, or would it only be considered as exercising significant influence?

Q5. Please identify the related parties in respect of all the enterprises mentioned under IND AS 24, if: X Limited holds 51% of Y Limited, Y Limited holds 51% of Z Limited & O Limited holds 49% of Z Limited.

Q6. Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited. Examine related party relationships of various entities.

Q7. X ltd sold goods to its associate company for the first quarter ending 30/06/2017. After that the related party relation cease to exists. However, goods were supplied as was supplied to any other customer. Decided whether transaction for the entire year are to be disclosed.
Q8. Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.

Required

a. Examine related party relationships from the perspective of C Limited for A Limited.

b. Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

c. Will outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

d. Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited.

Q10. Mr. X has an investment in A Limited and B Limited.

Required

1. Examine when can related party relationship be established
   from the perspective of A Limited’s financial statements:
   from the perspective of B Limited’s financial statements:

2. Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited

Q11. If a majority of directors of one company constitutes the majority of the board of another company in their individual capacity as professional (and not by virtue of their being directors in the first company), can it be considered that the companies are related?

Q12. Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1. Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

Q13. Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Ltd. and Ms. Y has an investment in B Ltd.. Required
(a) Examine when can a related party relationship is established, from the perspective of A Ltd.’s financial statements:

(b) Examine when can related party relationship is established, from the perspective of B Ltd.’s financial statements:

(c) Will A Ltd. and B Ltd. be related parties if Mr. X has only significant influence over A Ltd. and Ms. Y also has significant influence over B Ltd.:

Q14. A Ltd. has both (i) joint control over B Ltd. and (ii) joint control or significant influence over C Ltd. Required

(a) Examine related party relationship from the perspective of C Ltd.’s financial statements.

(b) Examine related party relationship from the perspective of B Ltd.’s financial statements.

Q15. ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 20X1. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 20X1 to 31st May 20X1 totalled Rs. 8,00,000. Following the share purchase by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months’ credit (previously ABC Ltd. was only allowed one month’s credit, XYZ Ltd.’s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 20X1 to 31st March 20X2 totalled Rs. 60,00,000. On 31st March 20X2, the trade receivables of XYZ Ltd. included Rs. 18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show (where possible by quantifying amounts) how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31st March 20X2 as per Ind AS. You are required to mention the disclosure requirements as well.