After studying this chapter, you would be able to:

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

Analysis of Financial Statements

Characteristics of good financial statements
- True and fair view
- Relevance
- Understand ability
- Consistency
- Regulatory Compliance
- Universality

Best Practices
- Compliance
- Complete
- Simple and specific
- Transparency
- Materiality
- Integration of Notes
- Disclosure of significant accounting
- Disclosures of key estimates and judgements
- Integrated approach

Illustration
- Based on Ind AS
1. INTRODUCTION

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

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

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

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

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

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

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

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

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

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

3. CHARACTERISTICS OF GOOD FINANCIAL STATEMENTS

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

The key features to any set of financial statements are:

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

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

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

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

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

6. **Universality:** Last but not the least; the financial statements should be comparable both within the industry and outside. So financial statements by two different companies should look in similar lines if both are engaged in, say, manufacturing steel. Likewise, the financials of a company manufacturing steel in India should be comparable to the set of financial statements of a company based out of US engaged in the similar line of business.

The need to have the above key characteristics have brought the accounting bodies world over to come together to have a set of common standards for better integration and harmonization of accounting principles and practices.
4. BEST PRACTICES - APPLICABLE TO ALL COMPANIES

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

1. Compliance

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

   **Example:**
   Usage of the term ‘remaining maturity’ instead of ‘original maturity’ while describing cash and cash equivalents.

2. Complete

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

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

3. Simple and specific

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

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

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

- Make your policies clear and specific.
- Ensure that there should not be any vague or ambiguous notes, with no further information or explanation which may lead to misinterpretation of information.
- Reduce generic disclosures and focus on company specific disclosures that explain how the company applies the policies.

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

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

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

5. **Materiality**

- The lack of clarity in how to apply the concept of materiality is perceived to be one of the main drivers for overloaded financial statements. Make effective use of materiality to enhance the clarity and conciseness of your financial statements.

- Information should only be disclosed if it is material. It is material if it could influence users’ decisions which are based on the financial statements.

- Your materiality assessment is the ‘filter’ in deciding what information to disclose and what to omit.

- Once you have determined which specific line items require disclosure, you should assess what to disclose about these items, including how much detail to provide and how best to organise the information.

**Example: Capital Commitments**

A company has committed to purchase several items of property, plant and equipment. Individually each purchase is immaterial. However, the total amounts to a material commitment for the company and therefore some disclosure should be made regarding this commitment.

**Example: New Revenue Stream**

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

6. **Integration of Notes**

- Notes cover the largest portion of the financial statements. They are an effective tool of communication and have the greatest impact on the effectiveness of your financial statements.

- Group notes into categories, place the most critical information more prominently or a combination of both.
Integrate your main note of a line item with its accounting policy and any relevant key estimates and judgements.

**Example: Inventories**

1. **Accounting Policy**

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

2. **Significant Estimation of Uncertainty**

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

3. **Inventories consist of the following:**

<table>
<thead>
<tr>
<th>Description</th>
<th>31st March, 20X2</th>
<th>31st March, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw materials and consumables</td>
<td>7,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Merchandise</td>
<td>11,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Total</td>
<td>18,000</td>
<td>15,000</td>
</tr>
</tbody>
</table>

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

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

7. **Disclosure of Significant Accounting Policies**

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

**Example:**

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

8. **Disclosures of Key Estimates and Judgements**

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

9. **Integrated Approach**

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

**Example:**

CSR disclosures, as required by the Companies Act, 2013. in section 134 and Schedule VII.
5. CASE STUDIES BASED ON IND AS

Case Study 1

On 1st April, 20X1, Pluto Ltd. has advanced a loan for ₹10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. ₹10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. ₹40,000 (₹10 lakhs x 4%).

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

Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on Financial Instruments and Ind AS 19 ‘Employee Benefits’.

Para 11 (c) (i) of Ind AS 32 ‘Financial Instruments : Presentation’ states that:

“A financial asset is any asset that is:
(c) a contractual right:
   (i) to receive cash or…..”

Further, paragraph 5.1.1 of Ind AS 109 states that:

“at initial recognition, an entity shall measure a financial asset or financial liability at its fair value”.

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 states that:

“The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or reduction of income unless it qualifies for recognition as some other type of asset”.

Further, paragraph 5.2.1 of Ind AS 109 states that:

“After initial recognition, an entity shall measure a financial asset at:
(a) amortised cost;
(b) fair value through other comprehensive income; or  
(c) fair value through profit or loss.

Further, paragraph 5.4.1 of Ind AS 109 states that:

“Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset”

Paragraph 8 of Ind AS 19 states that:

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

The Accountant of Pluto Ltd. has recognised the staff loan in the balance sheet at ₹ 10 lakhs being the amount disbursed and ₹ 40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

a) Calculation of Fair Value of the Loan

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Inflow</th>
<th>Discounting Factor (10%)</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2,40,000</td>
<td>0.909</td>
<td>2,18,160</td>
</tr>
<tr>
<td>2</td>
<td>2,32,000</td>
<td>0.826</td>
<td>1,91,632</td>
</tr>
<tr>
<td>3</td>
<td>2,24,000</td>
<td>0.751</td>
<td>1,68,224</td>
</tr>
<tr>
<td>4</td>
<td>2,16,000</td>
<td>0.683</td>
<td>1,47,528</td>
</tr>
<tr>
<td>5</td>
<td>2,08,000</td>
<td>0.621</td>
<td>1,29,168</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>8,54,712</strong></td>
</tr>
</tbody>
</table>

Staff loan should be initially recorded at ₹ 8,54,712.

b) Employee Benefit Expense

Loan Amount – Fair Value of the loan = ₹ 10,00,000 – ₹ 8,54,712 = ₹ 1,45,288

₹ 1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.
Amortisation table:

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening balance of Staff Advance (a)</th>
<th>Interest (10%) (b) = (a x 10%)</th>
<th>Repayment (c)</th>
<th>Closing balance of Staff Advance (d) = a + b - c</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>8,54,712</td>
<td>85,471</td>
<td>2,40,000</td>
<td>7,00,183</td>
</tr>
<tr>
<td>2</td>
<td>7,00,183</td>
<td>70,018</td>
<td>2,32,000</td>
<td>5,38,201</td>
</tr>
<tr>
<td>3</td>
<td>5,38,201</td>
<td>53,820</td>
<td>2,24,000</td>
<td>3,68,021</td>
</tr>
<tr>
<td>4</td>
<td>3,68,021</td>
<td>36,802</td>
<td>2,16,000</td>
<td>1,88,823</td>
</tr>
<tr>
<td>5</td>
<td>1,88,823</td>
<td>19,177 (b.f.)</td>
<td>2,08,000</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Balance Sheet extracts showing the presentation of staff loan as at 31st March, 20X2

Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Non-Current Assets</th>
<th>Current Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Financial Assets</td>
<td></td>
</tr>
<tr>
<td>(i)</td>
<td>Loan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5,38,201</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>Financial Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Loans (7,00,183 - 5,38,201)</td>
<td>1,61,982</td>
</tr>
</tbody>
</table>

Case Study 2

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

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

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

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

Balance Sheet extracts as on 31st March, 20X4

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td></td>
</tr>
<tr>
<td>Other Current Assets</td>
<td></td>
</tr>
<tr>
<td>Assets classified as held for sale</td>
<td>3,50,000</td>
</tr>
</tbody>
</table>

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

Solution

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

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

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

Paragraph 7 of Ind AS 105 states that:

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

Further, paragraph 8 of Ind AS 105 states that:

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

Paragraph 13 of Ind AS 105 states that:

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

Paragraph 14 of Ind AS 105 states that:

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

Paragraph 55 of Ind AS 16 states that:

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

Going by the guidance given above,

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

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

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

<table>
<thead>
<tr>
<th>Calculation of carrying amount as on 31st March, 20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price of Plant</td>
</tr>
<tr>
<td>Less: Accumulated depreciation (6,00,000/ 10 Years) x 3 Years</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Less: Impairment loss</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Balance Sheet extracts as on 31st March, 20X4

<table>
<thead>
<tr>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Current Assets</td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
</tr>
</tbody>
</table>
Working Note:
Fair value less cost to sell of the Plant = ₹ 3,50,000
Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. ₹ 3,50,000
Impairment loss = Carrying amount – Recoverable amount
Impairment loss = ₹ 4,20,000 - ₹ 3,50,000 = ₹ 70,000.

Case Study 3
On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter’s Ltd.’s warehouse. This inventory had been manufactured prior to 31st March, 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

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

<table>
<thead>
<tr>
<th></th>
<th>₹ lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>8.00</td>
</tr>
<tr>
<td>Net realisable value (9.6 -2)</td>
<td>7.60</td>
</tr>
<tr>
<td>Inventories (lower of cost and net realisable value)</td>
<td>7.60</td>
</tr>
</tbody>
</table>

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

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

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

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

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

Further, paragraph 6 of Ind AS 2 defines:

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

Further, paragraph 9 of Ind AS 2 states that:

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

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

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

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

<table>
<thead>
<tr>
<th>₹ lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
</tr>
<tr>
<td>Net realisable value</td>
</tr>
<tr>
<td>Inventories (lower of cost and net realisable value)</td>
</tr>
</tbody>
</table>

Case Study 4

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

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

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

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

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

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

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

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

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Property 1</th>
<th>Property 2</th>
<th>Property 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Factory</td>
<td>Factory</td>
<td>Let-Out</td>
</tr>
<tr>
<td>Purchase price</td>
<td>15,000</td>
<td>10,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Market value 31.03.20X2</td>
<td>16,000</td>
<td>11,000</td>
<td>13,500</td>
</tr>
<tr>
<td>Life</td>
<td>10 Years</td>
<td>10 Years</td>
<td>10 Years</td>
</tr>
<tr>
<td>Subsequent Measurement</td>
<td>Cost Model</td>
<td>Revaluation Model</td>
<td>Revaluation Model</td>
</tr>
</tbody>
</table>

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

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

Required:

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

2. On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of ₹ 10 lakhs to the customer. However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ₹ 12 lakhs to the customer on 15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2.
3. Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for ₹ 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years.

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

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

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

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

The total consideration to be received from such sale is at ₹ 10 Lakhs and hence, the management has recognised the revenue from sale of goods for ₹ 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

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

Answers

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

   **Property ‘1’ and ‘2’**

   Para 6 of Ind AS 16 ‘Property, Plant and Equipment’ defines:

   “Property, plant and equipment are tangible items that:

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

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

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Paragraph 29 of Ind AS 16 states that:

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

Further, paragraph 36 of Ind AS 16 states that:

“If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued”.

Further, paragraph 39 of Ind AS 16 states that:

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

Further, paragraph 52 of Ind AS 16 states that:

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

Para 6 of Ind AS 40 ‘Investment property’ defines:

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

(a) use in the production or supply of goods or services or for administrative purposes; or
(b) sale in the ordinary course of business”.

Further, paragraph 30 of Ind AS 40 states that:

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

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

“An entity shall disclose the fair value of investment property”.

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

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

(a) property, plant and equipment;
(b) investment property;

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

(a) presented all three properties in balance sheet as ‘property, plant and equipment’;
(b) applied different accounting policies to Property ‘1’ and ‘2’;
(c) revaluation is charged in statement of profit and loss as profit; and
(d) applied revaluation model to Property ‘3’ being classified as Investment Property.

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

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

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

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

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

<table>
<thead>
<tr>
<th>Assets</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
</tr>
<tr>
<td>Property ‘1’</td>
<td>13,500</td>
</tr>
<tr>
<td>Property ‘2’</td>
<td>9,000</td>
</tr>
<tr>
<td>Investment Properties</td>
<td></td>
</tr>
<tr>
<td>Property ‘3’</td>
<td>10,800</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Assets</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
</tr>
<tr>
<td>Property ‘1’</td>
<td>16,000</td>
</tr>
</tbody>
</table>
The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and shown as a separate column in Statement of Changes in Equity.

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

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

“Provision is a liability of uncertain timing or amount.

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

Further, paragraph 14 of Ind AS 37, states:

“A provision shall be recognised when:

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

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

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

Further, paragraph 36 of Ind AS 37, states:

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

Further, paragraph 3 of Ind AS 10 ‘Events after the Reporting Period’ defines:

“Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding
Two types of events can be identified:

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

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

Further, paragraph 8 of Ind AS 10 states that:

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

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

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

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

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

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

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

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

Further, paragraph 1 (c) of Ind AS 41 ‘Agriculture’, states:

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

Further, paragraph 1 (c) of Ind AS 41 ‘Agriculture’, states:
“If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met”.

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

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

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

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

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Current liabilities</td>
<td></td>
</tr>
<tr>
<td>Other Non-Current Liabilities</td>
<td></td>
</tr>
<tr>
<td>Government Grants</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Consideration (Installment)</th>
<th>Present value factor</th>
<th>Present value of consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time of sale</td>
<td>3,33,333</td>
<td>-</td>
<td>3,33,333</td>
</tr>
<tr>
<td>End of 1st year</td>
<td>3,33,333</td>
<td>0.949</td>
<td>3,16,333</td>
</tr>
<tr>
<td>End of 2nd year</td>
<td>3,33,334</td>
<td>0.901</td>
<td>3,00,334</td>
</tr>
<tr>
<td></td>
<td>10,00,000</td>
<td></td>
<td>9,50,000</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Dr. 3,33,333</td>
<td></td>
</tr>
<tr>
<td>Trade Receivable</td>
<td>Dr. 6,16,667</td>
<td></td>
</tr>
<tr>
<td>To Sale</td>
<td></td>
<td>9,50,000</td>
</tr>
</tbody>
</table>

### Recognition of interest expense and receipt of second installment

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Dr. 3,33,333</td>
<td></td>
</tr>
<tr>
<td>To Interest Income</td>
<td></td>
<td>33,053</td>
</tr>
<tr>
<td>To Trade Receivable</td>
<td></td>
<td>3,00,280</td>
</tr>
</tbody>
</table>

### Recognition of interest expense and payment of final installment

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Dr. 3,33,334</td>
<td></td>
</tr>
<tr>
<td>To Interest Income (Balancing figure)</td>
<td></td>
<td>16,947</td>
</tr>
<tr>
<td>To Trade Receivable</td>
<td></td>
<td>3,16,387</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>As at 31st March, 20X2</th>
<th>As at 31st March, 20X3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of Goods</td>
<td>9,50,000</td>
<td>-</td>
</tr>
<tr>
<td>Other Income (Finance income)</td>
<td>33,053</td>
<td>16,947</td>
</tr>
</tbody>
</table>

### Statement of Profit and Loss (extracts)

for the year ended 31st March, 20X2 and 31st March, 20X3

<table>
<thead>
<tr>
<th></th>
<th>As at 31st March, 20X2</th>
<th>As at 31st March, 20X3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Receivables</td>
<td>3,16,387</td>
<td>XXX</td>
</tr>
</tbody>
</table>