INDAS – 34
INTERIM FINANCIAL REPORTING

(TOTAL NO. OF QUESTIONS – 9)

INDEX

RTPs QUESTIONS

Q1 (Nov. 19)

An entity reports quarterly, earns 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs 50,000 in each of the three remaining quarters. The entity operates in a jurisdiction in which its estimated average annual income tax rate is30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct. If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

SOLUTION

As per Ind AS 34 'Interim Financial Reporting', income tax expense is **recognised in each interim period** based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Accordingly, the management's contention that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is not correct.

The following table shows the correct income tax expense to be reported each quarter in accordance with Ind AS 34:

Period	Pre-tax earnings (in Rs)	Effective tax rate	Tax expense (in Rs)
First Quarter	1,50,000	30%	45,000
Second Quarter	(50,000)	30%	(15,000)
Third Quarter	(50,000)	30%	(15,000)
Fourth Quarter	(50,000)	30%	(15,000)
Annual	0		0

Note - tax expense for the year will be zero. But this needs to be accounted for and presented properly.

Q2 (Nov. 20 & Nov. 21)

An entity's accounting year ends on 31st December, but its tax year ends on 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at Rs10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

How the related tax charge would be calculated for the year 2019 and its quarters.

SOLUTION

Table showing computation of tax charge:

	Quarter ending31st March, 2019	Quarter ending30th June, 2019	Quarter ending 30th September, 2019	Quarter ending 31st December, 2019	Year ending 31st December, 2019
	Rs	Rs	Rs	Rs	Rs
Profit before tax	10,000	10,000	10,000	10,000	40,000
Tax charge	(2,500)	(3,000)	(3,000)	(3,000)	(11,500)
	7,500	**7,000**	**7,000**	**7,000**	**28,500**
Tax Rate	25%	30%	30%	30%	

Note: As per Ind AS 34, since an entity's accounting year is not the same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

Q3 (Nov. 22)

PQR Ltd. is preparing its interim financial statements for quarter 3 of the year. How the following transactions and events should be dealt with while preparing its interim financials:

(i) It makes employer contributions to government-sponsored insurance funds that are assessed on an annual basis. During Quarter 1 and Quarter 2 larger amount of payments for this contribution were made, while during the Quarter 3 minor payments were made (since contribution is made upto a certain maximum level of earnings per employee and hence for higher income employees, the maximum income reaches before year end).

(ii) The entity intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs that will be incurred for this work.

(iii) The company has a practice of declaring bonus of 10% of its annual operating profits every year. It has a history of doing so.

SOLUTION

Ind AS 34, Interim Financial Reporting states that an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements.

Ind AS 34, Interim Financial Reporting, further states that for assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end would not qualify at interim dates either. Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised otherwise not. The Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

Considering the above guidance, while preparing its interim financials, the transactions and events of the given case should be dealt with as follows:

(i) *If employer contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised using an estimated average annual effective contribution rate in its interim financial statements, even though a large portion of the payments have been made early in the financial year. Accordingly, it should work out an average effective contribution rate and account for the same accordingly, in its interim financials.*

(ii) *The cost of a planned overhaul expenditure that is expected to occur in later part of the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.*

(iii) *A bonus is anticipated for interim reporting purposes, if and only if,*

(a) *the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and*

(b) *a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance in this regard.*

A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements.

Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements. In the instant case, bonus liability of 10% of operating profit for the year to date may be accrued.

In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

MTP QUESTIONS

Q4 (APRIL 2021 - 5 Marks)

ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of Rs. 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

(i) *Bad debts of Rs. 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.*

(ii) *Additional depreciation of Rs. 4,50,000 resulting from the change in the method of depreciation.*

(iii) *Exceptional loss of Rs. 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.*

(iv) *Rs. 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore the fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.*

Analyze and ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors.

SOLUTION

In the instant case, the quarterly net profit has not been correctly stated. As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

i) *The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, Rs. 50,000 should be deducted from Rs. 20,00,000.*

ii) *Recognising additional depreciation of Rs. 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.*

iii) *Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of Rs. 28,000 incurred during the third quarter should be recognized in the same quarter. Hence Rs. 14,000 which was deferred should be deducted from the profits of third quarter only.*

iv) *As per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per Ind AS 34, the costs should be anticipated or deferred only when:*

- *a) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and*
- *b) costs are incurred unevenly during the financial year of an enterprise.*

Therefore, the treatment done relating to deferment of Rs. 5,00,000 is not correct as expenditures are uniform throughout all quarters.

Thus, considering the above, the correct net profits to be shown in the Interim Financial Report of the third quarter shall be Rs. 14,36,000 (Rs. 20,00,000 -Rs. 50,000 - Rs. 14,000 - Rs. 5,00,000).

Q5 (OCTOBER 2021 - 6 Marks)

Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income is Rs. 33,00,000

(inclusive of Estimated Capital Gains of Rs. 8,00,000)

Estimated Income -

Quarter I is Rs. 7,00,000,

Quarter II is Rs. 8,00,000,

Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and

Quarter IV is Rs. 6,00,000.

Tax Rates:

On Capital Gains – 12%

On Other Incomes – First Rs. 5,00,000 - 30%; Balance Income – 40%

SOLUTION

As per Ind AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	Rs.
Estimated annual income exclusive of estimated capital gain (33,00,000 – 8,00,000) (A)	25,00,000
Tax expense on other income:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 20,00,000	8,00,000
(B)	9,50,000
Weighted average annual income tax rate = $\frac{B}{A} = \frac{9,50,000}{25,00,000}$ = 38%	

Tax expense to be recognised in each of the quarterly reports

		Rs.
Quarter I - Rs. 7,00,000 x 38%		2,66,000
Quarter II - Rs. 8,00,000 x 38%		3,04,000
Quarter III - Rs. (12,00,000 - 8,00,000) x 38%	1,52,000	
Rs. 8,00,000 x 12%	96,000	2,48,000
Quarter IV - Rs. 6,00,000 x 38%		2,28,000
		10,46,000

QUESTIONS FROM PAST EXAM PAPERS

Q6 (November 18 – 5 Marks)

Navya Limited manufacturer of ceramic tiles has shown a net profit of Rs. 15,00,000 for the first quarter of 2018-2019. Following adjustments were made while computing the net profit:

(i) Bad debts of Rs. 1,64,000 incurred during the quarter. 75% of the bad debts have been deferred for the next three quarters (25% for each quarter).

(ii) Sales promotion expenses of Rs. 5,00,000 incurred in the first quarter and 90% expenses deferred to the next three quarters (30% for each quarter) on the basis that the sales in these quarters will be high in comparison to first quarter.

(iii) Additional depreciation of Rs. 3,50,000 resulting from the change in the method of depreciation has been taken into consideration.

(iv) Extra-ordinary loss of Rs. 1,36,000 incurred during the quarter has been fully recognized in this quarter.

Discuss the treatment required under Ind AS 34 and ascertain the correct net profit to be shown in the Interim Financial report of first quarter to be presented to the Board of Directors.

SOLUTION

As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

(i) Bad debts of Rs. 1,64,000 have been incurred during the current quarter. Out of this, the company has deferred 75% i.e. Rs. 1,23,000 to the next 3 quarters. This treatment is not correct as the expenses incurred during an interim reporting period should be recognised in the same period unless conditions mentioned in Ind AS 34 are fulfilled. Accordingly, Rs. 1,23,000 should be deducted from the net profit of the current quarter Rs. 15,00,000.

(ii) Deferment of sales promotion expenses of Rs. 4,50,000 is not correct. It should be charged in the quarter in which the expenses have been incurred. Hence, it should be charged in the first quarter only.

(iii) Recognising additional depreciation of Rs. 3,50,000 in the same quarter is correct and is in tune with Ind AS 34.

(iv) The treatment of extraordinary loss of Rs. 1,36,000 being recognised in the same quarter is correct.

Thus, considering the above, the correct net profits to be shown in the Interim Financial Report of the third quarter shall be Rs. 15,00,000 – Rs. 1,23,000 – Rs. 4,50,000 = Rs. 9,27,000.

Q7 (November 20 – 6 Marks) – (Similar to Q5)

Lal Ltd. provides you the following information for financial year 2019 — 20:

Estimated Income for the year ended March 31st, 2020:

Gross Annual income (inclusive of Estimated Capital Gains of ₹ 4,00,000)	₹16,50,000
Quarter I	₹3,50,000
Quarter II	₹4,00,000

Quarter III (including Estimated Capital Gains of ₹ 4,00,000)	₹6,00,000
Quarter IV	₹3,00,000

Tax Rates	On Other Income	First ₹ 2,50,000	20%
		Balance Income	30%
	On Capital Gains		12%

Calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income.

SOLUTION

As per Ind AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	Rs.
Estimated annual income exclusive of estimated capital gain (16,50,000 – 4,00,000) (A)	**12,50,000**
Tax expense on other income:	
20% on Rs. 2,50,000	50,000
30% on remaining Rs. 10,00,000	3,00,000
(B)	**3,50,000**
Weighted average annual income tax rate	**28%**

Tax expense to be recognised in each of the quarterly reports:

		Rs.
Quarter I - Rs. 3,50,000 x 28%		98,000
Quarter II - Rs. 4,00,000 x 28%		1,12,000
Quarter III - Rs. (6,00,000 - 4,00,000) x 28%	56,000	
Rs. 4,00,000 x 12%	48,000	1,04,000
Quarter IV - Rs. 3,00,000 x 28%		84,000
		3,98,000

Q8 (July 21 – 6 Marks)

Heavy Limited has a plant with normal capacity to produce 90,000 units of a product per annum and expected fixed production overhead for the year is Rs. 18,00,000. There are no quarterly / seasonal variations. Hence, normal expected production of each quarter is uniform. The actual production of the year is 87,000 units. The production details of each quarter are as under:

Quarter I: 20,000 units

Quarter II: 24,000 units

Quarter III: 23,500 units

Quarter IV: 19,500 units

Calculate the allocation of fixed production overhead for all the four quarters. Will the quarterly results affect annual results?

Give your answer as per Ind AS 34 read with Ind AS 2.

SOLUTION

Since it is considered that there is no quarterly / seasonal variation, then normal expected production for each quarter is 22,500 units (90,000 units / 4 quarters) and fixed production overheads for the quarter are Rs. 4,50,000 (Rs. 18,00,000 / 4 quarters).

Fixed production overhead to be allocated per unit of production in every quarter will be Rs. 20 per unit. (Fixed overheads / Normal production i.e. Rs. 4,50,000 / 22,500 units)

Particulars	Quarters			
	I	II	III	IV
Actual fixed production overheads on year to date basis (Rs.)	4,50,000	9,00,000	13,50,000	18,00,000
Actual production (Units)	20,000	24,000	23,500	19,500
Actual production year to date basis (Units)	20,000	44,000	67,500	87,000
Fixed overheads to be absorbed on year to date basis (Rs.) (actual units x 20)	4,00,000	8,80,000	13,50,000	17,40,000
Under recovery year to date (Rs.)	50,000	20,000	NIL	60,000

Quarter I:

Unallocated fixed production overheads Rs. 50,000 (i.e. Rs. 4,50,000 – Rs. 4,00,000) to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 .

Quarter II:

Since production increased in second quarter by 1,500 units (24,000 – 22,500) i.e. more than the normal expected production, hence Rs. 30,000 (1,500 units x Rs. 20 per unit) will be reversed by way of a credit to the statement of profit and loss of the 2 nd quarter and debit to cost of production / inventory cost.

Quarter III:

Earlier, Rs. 50,000 was not allocated to production / inventory cost in the I st quarter. Out of it, Rs. 30,000 was reversed in the 2nd quarter. To allocate entire Rs. 13,50,000 till third quarter to the production, as per Ind AS 34, remaining Rs. 20,000 (Rs. 50,000 – Rs. 30,000) will be reversed by way of a credit to the statement of profit and loss of the 3 rd quarter and debit to the cost of production / inventory cost.

Quarter IV:

Unallocated fixed production overheads Rs. 60,000 {i.e. Rs. 4,50,000 – (Rs. 20 x 19,500)} in the 4th quarter will be expensed as per the principles of Ind AS 2 and Ind AS 34 by way of a charge to the statement of profit and loss.

For the year:

The cumulative result of all the quarters would also result in unallocated overheads of Rs. 60,000, thus, meeting the requirements of Ind AS 34 that the quarterly results should not affect the measurement of the annual result.

Q9 (Dec 21 – 4 Marks) – (Similar to Q6)

PHARMA Limited manufactures automobile parts. PHARMA Limited has shown a net profit of Rs. 50,00,000 for the second quarter of 2020.21.

Following adjustments are made while computing the net profit:

1. *Bad debts of Rs. 2,60,000 incurred during the quarter. 40% of the bad debts have been deferred to the next quarter.*
2. *Additional depreciation of Rs. 5,20,000 resulting from the change in the method of depreciation.*
3. *Exceptional loss of Rs. 8,16,000 incurred during the second quarter. 60% of exceptional loss have been deferred to next quarter.*
4. *Rs. 4,70,000 expenditure on account of administrative expenses pertaining to the second quarter is deferred on the argument that the fourth quarter will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.*

Analyze and ascertain the correct net profit to be shown in the Interim Financial Report of second quarter to be presented to the Board of Directors.

SOLUTION

In the instant case, the quarterly net profit has not been correctly stated. As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

1. *The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, Rs. 1,04,000 should be deducted from Rs. 50,00,000.*
2. *Recognising additional depreciation of Rs. 5,20,000 in the same quarter is correct and is in tune with Ind AS 34.*
3. *Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of Rs. 8,16,000 incurred during the second quarter should be recognized in the same quarter. Hence Rs. 4,89,600 which was deferred should be deducted from the profits of the second quarter only.*
4. *As per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated or deferred only when:*

(i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of Rs. 4,70,000 is not correct as expenditures are uniform throughout all quarters.

Thus, considering the above, the correct net profits to be shown in the Interim Financial Report of the second quarter shall be Rs. 39,36,400 (Rs. 50,00,000 - Rs. 1,04,000 - Rs. 4,89,600 - Rs. 4,70,000).