ANALYSIS OF FINANCIAL STATEMENTS

(TOTAL NO. OF QUESTIONS – 5)

INDEX

RTPs QUESTIONS

Q1 (RTP Nov 18)

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31stMarch, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

A. One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period. Mr. Y own 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

B. The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amounts of depreciation charge to plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. Elucidate how all these treatments comply with the relevant Ind AS.

C. In the year to March, 2018, ABC Ltd. spent considerable amount on designing a new product. ABC Ltd. spent the six months from April, 2017 to September, 2017 researching into the feasibility of the product. Mr. X charged these research costs to profit or loss. From October, 2017, A Ltd. was confident that the product would be commercially successful and A Ltd. is fully committed to finance its future development. A Ltd. spent remaining part of the year in developing the product, which is expected to start from selling in the next few months. These development costs have been recognised as intangible assets in the Balance Sheet. State whether the treatment done by Mr. X is correct when all these research and development costs are design costs. Just if your answer with reference to relevant IndAS.

Provide answers to the queries raised by the managing director Mr. Y as per Ind AS.

Solution

Ongoing through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

a. *Related parties are generally characterised by the presence of control or influence between the two parties.Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.*

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

b. *The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class. Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.*

According to Ind AS 16, all assets having a finite useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.

Properties which are held for investment purposes are not accounted for under Ind AS 16, but under Ind AS 40 'Investment Property'. As per Ind AS 40, investment properties should be accounted for under a cost model. ABC Ltd. had applied the cost model and thus our investment properties are treated differently from the owner occupied property which is annually to fair value.

c. *As per Ind AS 38 'Intangible Assets', the treatment of expenditure on intangible items depends on how it arose. Internal expenditure on intangible items incurred during research phase cannot be recognised as an asset. Once it can be demonstrated that a development project is likely to be technically feasible, commercially viable, overall profitable and can be adequately resourced, then future expenditure on the project can be recognised as an intangible asset. The difference in the treatment of expenditure upto 30th September, 2017 and expenditure after that date is due to the recognition phase ie. research or development phase.*

Q2 (RTP Nov 20)

Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually became one of the directors of the company. A consultant was hired and he charged Rs. 30,000 for the incorporation of the company and to do other necessary statutory registrations. Rs. 30,000 is to be charged as an expense in the books after incorporation of the company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 2019.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 2020 as follows:

Statement of Profit and Loss

Particulars	Amount (Rs.)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	**11,00,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	**7,45,000**
Profit before tax (c) = (a)-(b)	3,55,000
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	1,12,500
Profit for the year (e) = (c) – (d)	**2,42,500**

Balance Sheet

Particulars	Amount (Rs.)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000

(c) Short Term Provisions	1,06,500
TOTAL	**5,21,000**
ASSETS	
(1) Non-Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non-Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	**5,21,000**

Additional information of Softbharti Pvt Ltd.:

- Deferred tax liability of Rs. 6,000 is created due to following temporary difference: Difference in depreciation amount as per Income tax and Accounting profit
- There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 2020 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	Rs. 1,00,000	Rs. 80,000

- Pre-incorporation expenses are deductible on a straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.
- Current tax is calculated at 30% on PBT - Rs. 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to Rs. 1,25,700.
- After the reporting period, the directors have recommended a dividend of Rs. 15,000 for the year ending 31st March, 2020 which has been deducted from reserves and surplus. Dividend payable of Rs. 15,000 has been grouped under 'other current liabilities' along with other financial liabilities.
- There are 'Government statutory dues' amounting to Rs. 15,000 which are grouped under 'other current liabilities'.
- The capital advances amounting to Rs. 50,000 are grouped under 'Other non-current assets'.
- Other current assets of Rs. 51,000 comprise Interest receivable from trade receivables.
- Current investment of Rs. 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is Rs. 50,000 as at 31st March, 2020.
- Actuarial gain on employee benefit measurements of Rs. 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 2020.

The financial statements for the financial year 2019-2020 have not been yet approved.

You are required to ascertain whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of

Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information.

Solution

If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification or set of standards on such companies.

In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly, the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. Have been presented as per accounting standards (AS).

Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.

The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS

for the year ended 31st March, 2020

Particulars	Amount (Rs.)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	**11,20,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses	**7,45,000**
Profit before tax	**3,75,000**
Current tax	1,25,700
Deferred tax (W.N.1)	4,800
Total tax expense	1,30,500
Profit for the year (A)	**2,44,500**
OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss: Remeasurements of net defined benefit plans	1,000
Tax liabilities relating to items that will not be reclassified to Profit or Loss Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	**700**
Total Comprehensive Income for the period (A+B)	**2,45,200**

BALANCE SHEET

as at 31st March, 2020

Particulars	(Rs.)
ASSETS	
Non-current assets	
Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans & advances)	40,000
Other non-current assets (capital advances) (refer note-2)	50,000
Current assets	
Inventories	80,000
Financial assets	
Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	**5,41,000**
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,45,200
Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Deferred Tax Liabilities (4800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statuary dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	**5,41,000**

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st March, 2020

A. EQUITY SHARE CAPITAL

	Balance (Rs.)
As at 31st March, 2019	-
Changes in equity share capital during the year	1,00,000
As at 31st March, 2020	1,00,000

B. OTHER EQUITY

	Reserves & Surplus
	Retained Earnings (Rs.)
As at 31st March, 2019	-
Profit for the year	2,50,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,51,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31st March, 2020	2,51,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (refer note-4)

Notes:

1. Current investments are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, Rs. 20,000 (50,000 – 30,000) increase in fair value of financial assets will be recognised in profit and loss.
2. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
3. Liabilities for which there is no contractual obligation to deliver cash or other financial assets to another entity, are not financial liabilities.
4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.
5. Other current financial liabilities:

	(Rs.)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 2019 - 2020 (Note – 4)	(15,000)
Reclassification of government statutory dues payable to 'other current liabilities'	(15,000)
Closing balance	**15,000**

Working Note:

Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 2019 – 2020:

Item	Carrying amount (Rs.)	Tax base (Rs.)	Difference (Rs.)	DTA / DTL @ 30% (Rs.)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
Current Investments	50,000	30,000	20,000	6,000-DTL
			Net DTA	**4,800-DTL**

Q3 (RTP May 21)

HIM Limited having net worth of Rs. 250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

Issue 1: As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was Rs. 5,00,000. The land was acquired for a consideration of Rs. 5,00,000. However, the fair value of land as on the date of transition was Rs. 8,00,000.

Issue 2: Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was Rs.4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was Rs.5,00,000.

Issue 3: Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal installments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is Rs. 1,80,000 as against the carrying amount of loan which at present equals Rs. 2,00,000.

Issue 4: The company has declared a dividend of Rs. 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by the board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Issue 5: The company had acquired intangible assets as trademarks amounting to Rs. 2,50,000. The company is assumed to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was Rs. 3,00,000. However, the company wants to carry the intangible assets at Rs. 2,50,000 only.

Issue 6: After consideration of possible effects as per Ind AS, the deferred tax impact is computed as Rs. 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustment.

Management wants to know the impact of Ind AS in the financial statements of the company for its general understanding. Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entries for each issue.

SOLUTION

1. Preliminary Impact Assessment on Transition to Transition to Ind AS in HIM Limited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation	Ind AS 101 allows an entity to elect to measure property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, the book value should be brought up to fair value. The resulting impact of fair valuation of land Rs.3,00,000 should be adjusted in other equity

Journal Entry on the date of transition

Particulars	Debits (Rs.)	Credit (Rs.)
Property Plant and Equipment Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)		3,00,000

Issue 2: Fair valuation of Financial Assets

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on company's financial statements
As per Accounting Standard, investments are measured at lower cost and fair value.	On transition, financial assets include investments measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	All financial assets (other than in subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTOCI) or at business model assessment and contractual cash flow. Since investments in mutual funds are designated at FVTPL, an increase of Rs.1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars	Debits (Rs.)	Credit (Rs.)
Investment in mutual funds Dr.	1,00,000	
To Retained earnings		1,00,000

Issue 3: Borrowings Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on company's financial statements
As per AS, such expenditure is charged to Profit and Loss account or capitalized as the case may be.	As per IND AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the value of the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is Rs. 1,80,000 as against its book value of Rs. 2,00,000. Accordingly, the difference of Rs. 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars	Debits (Rs.)	Credit (Rs.)
Borrowing / Loan payable Dr.	20,000	
To Retained earning		20,000

Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on company's financial statements
As per AS, provision for proposed dividend is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognised in the year in which it has been declared and approved.	Since dividend should be deducted from retained earnings during and approved. Therefore, the provision declared for the preceding year should be reserved (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment.

Journal Entry on the date of transition

Particulars	Debt (Rs.)	Credit (Rs.)
Provisions Dr.	30,000	
To Retained earnings		30,000

Issue 5: Intangible assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on company's financial statements
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/ trademark on a straight-line basis over a maximum of 10 years	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of	Consequently, there would be no impact as on the date of transition since the company intends to use the carrying amount instead of book value at the date of transition.

as per AS 26.	transition to use the carrying value as per previous GAAP.	

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on company's financial statements
As per AS, deferred taxes are accounted as per income statement approach	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On the date of transition to Ind AS, deferred tax liability would be increased by Rs. 25,000.

Journal Entry on the date of transition

Particulars	Debt (Rs.)	Credit (Rs.)
Retained earnings Dr.	25,000	
To Deferred tax liability		25,000

QUESTIONS FROM PAST EXAM PAPERS

Q4 (November 19 – 12 Marks)

Following are the Financial Statements of Abraham Ltd.:

Balance Sheet

Particulars	Note No.	As at 31stMarch,2019 (Rs in lakh)
EQUITY AND LIABILITIES:		
Shareholders' funds		
Share capital (shares of Rs 10 each)		1,000
Reserves and surplus	1	2,400
Non-current liabilities		
Long term borrowings	2	5,700
Deferred tax liabilities	3	400
Current liabilities		
Trade payables		300
Short-term provisions		300
Other current liabilities	4	200
Total		**10,300**
ASSETS		
Non-current assets		
Fixed assets		5,000
Deferred tax assets	3	700
Current assets		
Inventories		1,500
Trade receivables	5	1,100
Cash and bank balances		2,000
Total		**10,300**

Statement of Profit & Loss

Particular	Note No.	Year ended 31stMarch,2019 (Rs inlakh)
Revenue from operations		6,000
Expenses:		
Employee benefit expense		1,200
Operating costs		3,199
Depreciation		450
Total expenses		4,849
Profit before tax		1,151
Tax expense		201
Profit after tax		950

Notes to Accounts:

Note 1: Reserves and surplus **(Rs in lakh)**

Capital reserve	500
Surplus from P & L	

Opening balance	550	
Additions	950	1,500
Reserve for foreseeable loss		400
Total		**2,400**

Note 2: Long-term borrowings

Term loan from bank	5,700
Total	**5,700**

Note 3: Deferred tax

Deferred tax asset	700
Deferred tax liability	400
Total	**300**

Note 4: Other current liabilities

Unclaimed dividends	10
Billing in advance	150
Other current liabilities	40
Total	**200**

Note 5: Trade Receivables

Considered good (outstanding within 6 months)	1,065
Considered doubtful (due from past 1 year)	40
Provision for doubtful debts	(5)
Total	**1,100**

Additional information:

(i) Share capital comprises of 100 lakh shares of Rs 10each.

(ii) Term Loan from bank for Rs 5,700 lakh also includes interest accrued and due of Rs 700 lakh as on the reporting date.

(iii) Reserve for foreseeable loss is created against a service contract due within 6months.

(iv) Inventory should be valued at cost Rs 1,500 lakh, NRV as on date is Rs1,200 lakh.

(v) Adividendof10%wasdeclaredbytheBoardofdirectorsofthecompany.

(vi) Accrued Interest income of Rs 300 lakh is not booked in the books of the company.

(vii) Deferred taxes related to taxes on income are levied by the same governing tax laws.

Identify and report the errors and misstatements in the above extracts and prepare corrected Balance Sheet and Statement of Profit & Loss and where required the relevant notes to the accounts with explanations thereof.

SOLUTION

Following adjustments / rectifications are required to be done

1. Reserve for foreseeable loss for Rs 400 lakh, due within 6 months, should be a part of provisions. Hence it needs to be regrouped. If it was also part of previous year's comparatives, a note should be added in the notes to account on the regrouping done this year.
2. Interest accrued and due of Rs 700 lakh on term loan will be a part of current liabilities. Thus, it should be shown under the heading "Other Current Liabilities".
3. As per Ind AS 2, inventories are measured at the lower of cost and net real is able value. The amount of any write down of inventories to net realisable value is recognised as an expense in the period the write-

down occurs. Hence, the inventories should be valued at Rs 1,200 lakh and write down of Rs 300 lakh (Rs 1,500 lakh – Rs 1,200 lakh) will be added to the operating cost of the entity.

4. In the absence of the declaration date of dividend in the question, it is presumed that the dividend is declared after the reporting date. Hence, no adjustment for the same is made in the financial year 2018-2019. However, a note will be given separately in this regard (not forming part of item of financial statements).
5. Accrued income will be shown in the Statement of Profit and Loss as 'Other Income' and as 'Other Current Asset' in the Balance Sheet.
6. Since the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, these shall be set off, in accordance with IndAS12. Thenet DTA of Rs 300 lakh will be shown in the balance sheet.
7. As per Division II of Schedule III to the Companies Act, 2013, the Statement of Profit and Loss should present the Earnings per Equity Share.
8. In Ind AS, Assets are not presented in the Balance sheet as 'Fixed Asset'; rather they are classified under various categories of Non-current assets. Here, it is assumed as 'Property, Plant and Equipment'.
9. The presentation of the notes to 'Trade Receivables' will be modified as per the requirements of Division II of Schedule III.

Balance Sheet of Abraham Ltd. For the year ended 31stMarch, 2019

	Note No.	(Rs in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment		5,000
Deferred tax assets	1	300
Current assets		
Inventories		1,200
Financial assets		
Trade receivables	2	1,100
Cash and cash equivalents		2,000
Others financial asset (accrued interest)		300
TOTAL		**9,900**
EQUITY AND LIABILITIES		
Equity		
Equity share capital	3	1,000
Other equity	4	2,000
Non-current liabilities		
Financial liabilities		
Long-term borrowings	5	5,000
Current liabilities		
Financial liabilities		
Trade payables		300
Others	6	710
Short-term provisions (300 + 400)	7	700
Other current liabilities	8	190

TOTAL		9,900

Statement of Profit and Loss of Abraham Ltd.
For the year ended 31stMarch, 2019

	Note No.	(Rs in lakh)
Revenue from operations		6,000
Other income		300
Total income		6,300
Expenses		
Operating costs		3,199
Change in inventories cost	9	300
Employee benefits expense		1,200
Depreciation		450
Total expenses		5,149
Profit before tax		1,151
Tax expense		(201)
Profit for the period		950
Earnings per equity share		
Basic		9.5
Diluted		9.5
Number of equity shares (face value of Rs 10 each)		**100 lakh**

Statement of Changes in Equity of Abraham Ltd.
For the year ended 31stMarch, 2019

3. Equity Share Capital **(Rs in lakh)**

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1,000	0	1,000

4. Other Equity **(Rs in lakh)**

Particulars	Reserves & Surplus		Total
	Capital reserve	Retained Earnings	
Balance at the beginning of the year	500*	550	1,050
Total comprehensive income for the year		950	950
Balance at the end of the year	**500**	**1,500**	**2,000**

*Note: Capital reserve given in the Note 1 of the question is assumed to be brought forward from the previous year. However, alternatively, if it may be assumed as created during the year.

1. Deferred Tax **(Rs in lakh)**

Deferred Tax Asset	700
Deferred Tax Liability	400
	300

2. Trade Receivables **(Rs in lakh)**

Trade receivables considered good		1,065
Trade receivables which have significant increase in credit risk	40	
Less: Provision for doubtful debts	(5)	35
Total		**1,100**

5. Long Term Borrowings **(Rs in lakh)**

Term Loan from Bank (5,700 - 700)	5,000
Total	**5,000**

6. Other Financial Liabilities **(Rs in lakh)**

Unclaimed dividends	10
Interest on term loan	700
Total	**710**

7. Short-term provisions **(Rs in lakh)**

Provisions	300
Foreseeable loss against a service contract	400
Total	**700**

8. Other Current Liabilities **(Rs in lakh)**

Billing in Advance	150
Other	40
Total	**190**

9. Dividends not recognised at the end of the reporting period

At year end, the directors have recommended the payment of dividend of 10% i.e., Rs 1 per equity share. This proposed dividend is subject to the approval of shareholders in the ensuing annual general meeting.

Q5 (Nov. 20 Exam)

On 1 April 2020, Star Limited has advanced a housing loan of Rs. 15 lakhs to one of its employee at an interest rate of 6% per annum 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 market rate of similar loan for housing finance by banks is 10% per annum.

The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. Rs. 15 lakhs. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 90,000 (6% of Rs. 15 lakhs).

Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 2020 -2021 along with workings and applicable Ind AS.

You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance Sheet of Star Limited on 31 March 2021.

SOLUTION

The accounting treatment made by the accountant is not in compliance with Ind AS 109 'Financial Instruments'. As per Ind AS 109, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value. 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.

After initial recognition, an entity shall measure a financial asset either at amortised cost or at fair value through profit and loss or fair value through other comprehensive income.

Here, the loan given to employee is not at market rate. Hence, the fair value of the loan will not be equal to its initial loan proceeds. As per Ind AS 109, a financial instrument is initially measured and recorded in the books at its fair value. Further, interest income to be recognised in the Statement of Profit and Loss will be the finance income recognised at effective rate of interest i.e. @ 10% and not the rate of interest charged by the company i.e. @ 6%.

The correct accounting treatment as per Ind AS 109 will be as under:

For measuring the fair value or present value of the loan at initial recognition, market rate of interest of similar loan is considered (level I observable input) i.e. @ 10%, to discount the cash outflows.

The fair value of the loan shall be as follows:

Date	Outstanding loan	Principal	Interest Income @ 6%	Total inflow	Discount factor@ 10%	PV
31 March 2021	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31 March 2022	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31 March 2023	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31 March 2024	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31 March 2025	3,00,000	3,00,000	18,000	3,18,000	0.621	1,97,478
Fair value of the loan						**13,54,602**

As per Ind AS 19, employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for termination of employment. Difference of loan proceeds and present value of the loan (fair value) will be treated as prepaid employee cost irrespective of the fact that employee is not required to give any specific performance against this benefit. This is because employee is required to be in service of the company to continue availing the benefits of concessional rate of interest on housing loan. Practically, once the employee leaves the organisation, they have to repay the outstanding loan because the company provides the loan at concessional rate of interest only to its employees.

Hence, it is an employee benefit given by the company to its employees. This deemed employee cost of Rs. 1,45,398 (15,00,000 – 13,54,602) will be deferred and amortised over the period of loan on straight line basis.

Calculation of amortised cost of loan to employees

Financial year ending on 31 March	Amortised cost (opening balance)	Interest to be recognised @ 10%	Repayment (including interest)	Amortised cost (closing balance)
2021	13,54,602	1,35,460	3,90,000	11,00,062
2022	11,00,062	1,10,006	3,72,000	8,38,068
2023	8,38,068	83,807	3,54,000	5,67,875
2024	5,67,875	56,788	3,36,000	2,88,663
2025	2,88,663	29,337*	3,18,000	-

* 2,88,663 x 10% = Rs. 28,866. Difference of Rs. 471 (29,337 – 28,866) is due to approximation in computation.

Journal Entries to be recorded at every period end:

1. On 1 April 2020

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan to employee A/c Dr. Prepaid employee cost A/c Dr. To Bank A/c (Being loan asset recorded at initial fair value)	13,54,602 1,45,398	 15,00,000

2. On 31 March 2021

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Bank A/c Dr. To Finance income A/c (profit and loss) @10% To Loan to employee A/c (Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate @ 10%)	3,90,000	 1,35,460 2,54,540
Employee benefit cost (profit and loss) A/c Dr. To Prepaid employee cost A/c (1,45,398/5) (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	29,080	29,080

The Following housing loan balances should appear in the financial statements:

Extracts of Balance sheet of Star Ltd. as at 31 March 2021

__Non-current asset__	
Financial asset	

Loan to employee (11,00,062 – 3,72,000 + 1,10,006)	8,38,068
Other non-current asset	
Prepaid employee cost	87,238
Current asset	
Financial asset	
Loan to employee (3,72,000-1,10,006)	2,61,994
Other current asset	
Prepaid employee cost	29,080

Deferred tax on temporary differences arising on the above-mentioned account balances (appearing in the balance sheet) should be recognised. However, in the absence of any tax rate in the question no deferred tax has been recognised.