Practical case Studies on transiting to Ind AS
At
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Case Study 1

- **Question:**

  Prime Limited is in the business of manufacturing steel at its plant in Odissa. It has vehicles in plant that ply employees and visitors within plant premises. On 1st January 2010 it exchanges its two year old car X with a book value of Rs. 13,00,000 and a fair value of Rs. 14,50,000 with a vendor for cash of Rs. 2,00,000 and similar two year old Car Y which has a fair value of Rs. 12,50,000. Company policy is to depreciate all vehicles over its useful life of 12 years on SLM basis.

  On January 1st 2012 it exchanges surplus land with a book value of Rs. 10 Crores for cash of Rs. 2 Crores and machinery valued at Rs. 9 Crores. The machinery will optimize the steel purity post installation in the existing plant set up in January 1st 2000 and company expects an increase in sales due to better purity. The new machinery component has a useful life of 20 years. The Company is depreciating its steel plant over its useful life of 20 years on SLM basis. Prime limited follows calendar year for closing its financial statements.

  What is the value of vehicle and new machinery component as on December 31st 2012?

Solution 1 - Ind AS 16 : PPE

- **Vehicle:**

  The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange; it is in the same position as it was before the transaction. There is no profit or loss in the transaction.

  The entity recognises Car Y received at the book value of car X, less cash received. Therefore, it recognises cash of INR 200,000 and Car Y as property, plant and equipment with a carrying value of INR 11,00,000/-

  Car Y will be depreciated over its remaining useful life of 10 years and thus depreciation for 3 years would be INR 3,30,000/-, WDV as on December 31st 2012 is INR 7,70,000/-

Solution 1 - Ind AS 16 : PPE…

- **Machinery**

  The transaction has commercial substance as the new machinery component will add to quality of the product and thus gives an advantage over competitors. The machinery component would be recorded at INR 9 Cr and profit of Rs 1 Cr on sale of land. Assuming Nil residual value, the component will be depreciated over the remaining useful life of the parent asset ie Plant, over a period of 9 years. WDV of the component as on December 31 2012 is INR 8 Crs. (9 Crs less depreciation of Rs 1 Cr)

  IND AS 16→ Para 24 and 25

Case Study 2

- **Question:**

  On January 1 2010, Aries India was awarded a 3G licence at a cost of Rs. 3,000 Crores. License allows the entity to immediately start the data services or transfer it to some other operator. The entity did not have sufficient infrastructure to roll out the services at that time and had begun work of constructing network infrastructure which it expects to complete by March 31, 2011. The costs of Mobile towers is Rs. 2,000 crores, Cables is 600 Crores and other Rs. 400 Crores. Aries India is planning to finance the total project cost of Rs. 6,000 crores by a mix of domestic and foreign debt.

  Aries India is a wholly owned subsidiary of Aries UK ltd. It raises USD 600 million through a Bond issue in UK @ coupon of LIBOR + 200 bps fixed for the tenure. It downstreams the same to Aries India equivalent to Rs. 3,000 crores on January 1, 2010 for acquiring licence as an intercompany loan bearing LIBOR + 500 bps for the tenure of 5 years. It utilised its ECB limits and hence raises the balance debt from domestic market at 11% for funding balance cost of the project.

  During 2010 financial year, it incurred Rs. 200 crores every month and utlised the domestic banking limits it had tied up for financing the project.

Case Study 2 …

- **Question: (Contd.)**

  Exchange rate as on January 1, 2010 was USD 50 and at closing on December 31, 2010 was USD 55, LIBOR for the period was 3%.

  1. Identify the qualifying assets for capitalising borrowing cost.
  2. What is the amount of borrowing cost eligible for capitalization in Aries India Limited

Solution 2 – Ind AS 23 : Borrowing Cost

- **1. Qualifying asset**

  The license has been exclusively acquired to operate the wireless network. The fact that the licence can be used or licensed to a third party is irrelevant. The acquisition of the license is the first step in a wider investment project (developing the network). The network investment meets the definition of a qualifying asset under Ind AS 23.

  Similarly, Infrastructure costs are also qualifying assets under Ind AS23 and are eligible borrowing cost capitalization.

  IND AS 23 → Para 7

Solution 2 – Ind AS 23 : Borrowing Cost…

- **2. Interest cost for capitalization in Aries India**

  Borrowing for license = USD 600 million.

  Interest at 8% (3+5) for 12 months = USD 48 million .i.e. Rs 252 crores (48 million *52.5 avg rate)

  Exchange fluctuation = 600 million * (55-50) = Rs 300 crores loss

  Benchmarking domestic borrowing cost @ 11% = 330 crores.

  Forex eligible for capitalisation = Rs.78 Crs (330 crs – 252 crs)

  Hence, amount of Borrowing Cost is Rs330 crores (252Crs+78Crs)

  IND AS 23 → Para 6A

Case Study 3

- **Question:**

  S is engaged in wind energy generation. B purchases wind energy from S based on the following terms and conditions:

  - S will construct a power generation facility. The capacity of the facility will be 50,000 MWh per year
  - S will sell 89% of the output to B
  - Term of the contract is 20 years
  - Price is fixed per year ranging between a minimum of Rs. 4 per unit to a maximum of Rs. 6 per unit
  - S has given a guarantee that the facility will be in operating condition and ready to generate power at least 85% of the year; If S fails to meet this condition, S will pay B damages for the amount of availability below 85% threshold.

  Whether the above arrangement contains an element of lease? What would be your answer if the purchase price was determined to increase / decrease based on annual change in the consumer price index?

Solution 3 – Ind AS 17 : Leases - Arrangement in the nature of lease

- **Leases - Arrangement in the nature of lease**

  Since the price of the output is fixed per unit (though different during individual years), one of the two conditions for an arrangement to be classified as lease is not satisfied. Accordingly, the arrangement does not contain an element of lease.

  If the purchase price was determined to increase / decrease based on annual change in the consumer price index, the arrangement would likely be classified as in the nature of lease, since the price of the output is not fixed per unit.

  IND AS 17 → Appendix C

Case Study 4

- **Question:**

  Entity P is engaged in real estate leasing business. It collects substantial amounts of interest free refundable lease deposits from its tenants. Assume the lease is non-cancellable.

  How should the initial and subsequent accounting for these deposits be done?

  Assume Lease Deposit of Rs. 100 payable after 3 years, FV of such deposit at initial recognition is Rs. 80.

  Amortised cost at end of Y1 is 86, Y2 is 93 and Y3 is 100.

  Plot Accounting entries for the same

Solution 4 - Leases - Interest free rental deposits

- **Leases - Interest free rental deposits**

  Ind AS 109 required every financial asset to be measured at its fair value on initial recognition (with the adjustment of transaction costs for instruments measured at amortised cost).

  Therefore, the non-current receivables should be measured on initial recognition at fair value

  i.e. at present value in this case.

  Subsequent to the initial recognition, the deposit will be measured at amortised cost using the effective interest method.

  The unwinding of the discount over the tenure of the deposit will recognised as a finance cost. The difference between fair value on initial recognition and the transaction price (i.e., the proceeds received) should be recognised as advance lease income which should be recognised in profit or loss (using straight line method).

  Because of the above mentioned accounting, the cumulative impact on profit or loss will be zero, however, there will be impact on the individual period's profit or loss.

Solution 4 - Leases - Interest free rental deposits …

- **Accounting Entries**

1.Initial Recognition

Bank Account Dr.	100	
To Lease Deposit		80
To Advance Lease income		20

(Initial recognition of lease deposit at FV)

2.Subsequent Measurement

	Y1	Y2	Y3	Total
Finance Cost	6	7	7	20
To Lease Deposit	6	7	7	20
(Subsequent recognition at amortised cost)				
Advance Lease Income	6.67	6.67	6.67	20
To P&L Account	6.67	6.67	6.67	20

Case Study 5

- **Question:**

  Entity A, a homebuilder, is selling apartment units in a new building for which construction has not yet commenced. The estimated time to complete construction is 18 months. Entity A has concluded that the point of revenue recognition is delivery of the apartment to the customers which is also when title is passed. The cash sales price upon completion of construction is Rs. 500,000. Customers are offered a discount of Rs. 75,000 on the cash sales price if they pay in full in advance; therefore, the price for customers paying in advance is Rs. 425,000.

  How should the transaction be recognised and measured at initial recognition. How should this transaction be measured subsequently? What journal entries should be passed?

Solution 5 – Ind AS 18 – Revenue

- **Revenue – Sale transaction constitutes a financing transaction**

  Assume that Entity A has concluded after analysis of the contract that the advance payment represents a financing transaction; that is, its customers are providing financing to pay for construction costs. On the basis of interest rates in the market, Entity A has concluded that an annual rate of approximately 10 per cent reflects the rate at which Entity A and its customer would have entered into a separate financing transaction. Consequently, Entity A imputes a discount rate of approximately 10 per cent to discount the cash sales price (i.e. Rs. 500,000) to the 'advance' sales price (i.e. Rs. 425,000).

  When an advance cash payment is received from a customer, Entity A recognises a contract liability of Rs. 425,000. Subsequently, Entity A accrues interest on the liability balance to accrete the balance to Rs. 500,000 over the 18-month period. Entity A capitalises the interest in accordance with Ind AS 23 Borrowing Costs. When control of the apartment transfers to the customer, Entity A recognises Rs. 500,000 as revenue.

  The following journal entries illustrate how Entity A should account for the significant financing component.

Solution 5 – Ind AS 18 – Revenue…

Solution: (Contd…)

- **Revenue – Sale transaction constitutes a financing transaction**

Particulars	Dr.	Cr.
Step 1: Recognise a contract liability for the CU425,000 received at contract inception		
-Cash	425,000	
- Contract liability		425,000
Step 2: Over the 18 months from contract inception to transfer of asset		
-Finance Cost	75,000	
- Contract liability		75,000
Step 3: On Capitalizing Finance cost		
Inventories	75,000	
-Finance Cost		75,000
Step 4: On transfer of control of the asset		
-Contract liability	500,000	
-Revenue		500,000

Case Study 6

- **Question:**

  A company purchases raw material from it supplier at Rs. 60 lakhs on deferred payment basis for three years. The incremental borrowing rate for the Company for a similar tenor is 11% . How will the said purchase price be accounted for?

Solution 6 - Ind AS - 2

Solution:

The purchase price would be equal to the present value of Rs. 60 lakhs discounted at the purchaser's incremental borrowing rate of 11%

Purchase price = Rs. 60 lakhs / (1+11%)3 = Rs. 45.07 lakhs

Accordingly the discount of Rs. 14.93 lakhs would have to be unwound over the deferred payment period as finance cost.

Ind AS 2 → Para 18

Case Study 7

- **Question:**

  Facts

  An entity is committed to a plan to sell a building and has started looking for a buyer for that building. The entity will continue to use the building until another building is completed to house the office staff located in the building. There is no intention to relocate the office staff until the new building is completed.

  Required

  Would the building be classified as held for sale?

Solution 7 - Ind AS 105

Solution:

The building will not be classified as held for sale as it is not available for immediate sale nor is the sale highly probable .

Ind AS 105 → Para 6, 7 and 8.

Case Study 8

- **Question:**

  Facts

  An entity is reorganizing its business activities. In one location, it is stopping the usage of certain equipment because the demand for the product produced by that equipment has reduced significantly. The equipment is to be maintained in good working order, and it is expected that it will be brought back into use if the demand increases. Additionally, the entity intends to close three out of five manufacturing units. The manufacturing units constitute a major activity of the entity. All the work within the three units will end during the current year, and as of the year-end all work will have ceased.

  Required

  How will the piece of equipment and the closure of the manufacturing units be treated in the financial statements for the current year?

Solution 8 - Ind AS 105

Solution:

The equipment will not be treated as abandoned, as it will subsequently be brought back into usage. (para 13)

The manufacturing units will be treated as discontinued operations.

Ind AS 105 → Para 32 a to b

Case Study 9

- **Question:**

  A Company operates several petrol pumps. The Management has approved a reorganisation plan which involves closure of 8 petrol pumps out of a total of 20 which yield a revenue of approximately 60%, which plan has been publicly announced without identifying the specific pumps due to confidentiality issues.

  a) Does a restructuring event get triggered?

  b) Advise the company of the likely costs which would fall within the definition of restructuring costs?

Solution 9 - Ind AS - 37

Solution:

As per the Standard, a constructive obligation arises only when the entity has a detailed plan for restructuring and announces it to those affected by it. In the above case, the management has not identified / disclosed the specific pumps which are to be closed and hence a provision for restructuring costs is not triggered.

Ind AS 37 → Para 70 and 72

Case Study 10

- **Question:**

  Discuss whether CSR obligations under the Companies Act, 2013 could trigger a constructive obligation?

Solution 10 - Ind AS - 37

Solution:

In view of the specific provisions, if not a legal obligation, it could be argued that the Companies specifying the prescribed criteria atleast have a constructive obligation to incur the CSR expenditure.

The existing AS-29 does not specifically recognise the concept of constructive obligations and only requires provisions to be created on matters arising out of normal business practices, customs and a desire to maintain good business relations or to act in an equitable manner.

The disclosures in the Board Report and the web site could trigger a constructive obligation in line with the principles laid down in the Ind-AS since through a sufficiently specific current written statement, the entity has indicated to other

parties or to the general public that it will accept certain responsibilities and as a result it has created a valid expectation on the part of those parties that it would discharge those responsibilities. Accordingly, the Company could be required to create a provision for the short spend.

Ind AS 37 → Para 10

Case Study 11

- **Question:**

  While finalizing the financials for the year ended December 31, 2013, it was observed that the insurance premium expenses amounting to Rs. 45 lakhs were incorrectly charged to Profit or loss account in the financials for the year ended December 31, 2012 instead of recognizing the same as Prepaid expenses as at December 31, 2012 and charging them off as expenses in the year ended December 31, 2013. As per Ind AS 8, how this prior period error will be handled in the financials for the year ended December 31, 2013

Solution 11 - Ind AS 8

Solution:

Restating the comparative amounts for the prior period presented in which the error occurred. Therefore, prepaid expenses will be recognised as at 31st December, 2012 and opening balance of reserves as at 1.1.2013 will be restated and expenditure of Rs. 45 Lakhs will be accounted in the year ended December 31, 2013.

Case Study 12

- **Question:**

  On January 1, 2010, Robust Ltd. purchased heavy-duty equipment for Rs. 400,000. On the date of installation, it was estimated that the machine has a useful life of 10 years and a residual value of Rs. 40,000. Accordingly the annual depreciation worked out to Rs. 36,000 = [(Rs. 400,000 – Rs. 40,000) / 10]. On January 1, 2014, after four years of using the equipment, the company decided to review the useful life of the equipment and its residual value. Technical experts were consulted. According to them, the remaining useful life of the equipment at January 1, 2014, was seven years and its residual value was Rs. 46,000. Compute the revised annual depreciation for the year 2014 and future years.

Solution 12 - Ind AS 8

Solution:

Net book value January 1, 2014 = Rs. 400,000–(Rs.36,000 × 4 years)= Rs. 256,000

Revised annual depreciation for 2014 and future years= (Rs. 256,000 – Rs. 46,000) / 7 = Rs. 30,000

Revised annual depreciation = (Net book value at January 1, 2014 – revised residual value) /remaining useful life

Change in accounting estimate.

Case Study 13

- **Question:**

  Company A is granted a concession for the construction and operation of a toll road for 40 years. The price Company A is able to charge users is set by the grantor for the first three years of the arrangement. From the fourth year of operation of the toll road, Company A is able to charge users at a price it considers appropriate, based on its own strategy and business perspectives. However, the concession arrangement provides for a mechanism known as a 'congestion payment' whereby Company A will pay specified amounts to the grantor if there is congestion (i.e. traffic jams) in the use of the complementary public infrastructure (i.e. nearby roads).

  Is this arrangement within the scope of Appendix A to Ind AS 11?

Solution 13 - Service concession arrangements – Ind AS 11

Solution:

Service concession arrangements - Concession with unregulated prices and congestion payment

Appendix A to Ind AS 11 applies to public-to-private service concession arrangements if:

[Ind AS 11:A5]

a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price, and

b) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement.

In the given scenario, the grantor exercises absolute control over the pricing for an insignificant period of time in the context of the service concession arrangement as a whole. The congestion payment mechanism would need to be analysed to determine if it amounts to substantive regulation of the prices charged. If this mechanism is included in the contract solely to avoid excessively high prices, it may not be substantive because the operator has the freedom to charge what it wants within a reasonable range. The only limitation is that the operator cannot charge a price the market would not bear and in doing so create congestion on other roads. If the mechanism is considered non-substantive, the arrangement would fall outside the scope of Appendix A to Ind AS 11.

Case Study 14

- **Question:**

  Service concession arrangements - Price cap set by grantor

  Entity B (the operator) has entered into a service concession arrangement under which it will construct a road and operate that road for 30 years. The grantor does not specify the price that the operator can charge to users of the road, but it does specify the maximum price that can be charged (i.e. it imposes a 'price cap').

  Does the grantor's power to impose a price cap mean that the grantor 'controls or regulates' the price at which services are provided?

Solution 14 - Service concession arrangements – Ind AS 11

Solution:

In general, yes, provided that the capping mechanism is not considered to be non- substantive.

Appendix A:AG3 states that "for the purpose of condition Ind AS 11:A5(a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, contract or regulator, for example by a capping mechanism".

However, a cap set at a level such that it is very unlikely ever to take effect (e.g. stating that a road toll must not exceed Rs. 1,000 when the anticipated toll is Rs. 200) would be considered non-substantive. As a result, the grantor would not be considered to have control over the price and the arrangement would be outside the scope of Appendix A to Ind AS 11.

Case Study 15

- **Question :**

  Service concession arrangements - Application of Appendix A to Ind AS 11 when residual interest is returned to grantor at fair value

  Entity A (the operator) has entered into a service concession arrangement under which it will construct a bridge and operate that bridge for 30 years. It cannot sell the bridge to a third party unless the government (the grantor) agrees to the sale. At the end of the arrangement, the grantor is required to repurchase the bridge for its fair value at that time. The bridge has an estimated useful economic life of 50 years.

  Does the grantor control the residual interest in the infrastructure at the end of the term of the arrangement?

Solution 15 - Service concession arrangements – Ind AS 11

Solution:

Service concession arrangements - Application of Appendix A to Ind AS 11 when residual interest is returned to grantor at fair value

Yes. Ind AS 11:A5 states, in part, as follows. "This Appendix applies to public-to-private service concession arrangements if ... the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement."

According to Appendix A:AG6, situations in which the grantor controls the asset for the whole of its economic life are within the scope of Appendix A to Ind AS 11. Appendix A:AG4 states, in part, as follows. "For the purposes of condition (b) [of Ind AS 11:A5 as outlined at 2.2.1], the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement." In this scenario, the operator would not be able readily to sell or pledge the infrastructure even though it may be able to sell or pledge its economic interest in the residual value of the infrastructure.

Appendix A to Ind AS 11 applies a 'control' approach. In the circumstances described, the grantor has a continuing right of use of the infrastructure asset at the end of the term of the arrangement and, consequently, controls the use of the bridge throughout its economic life. This is the case even though the grantor has to pay fair value for the asset at the end of the term of the arrangement.

Thank You