

Ind AS 103

Business Combinations



ICAI Certificate Course on Ind AS

New Delhi

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History of the Standards

IFRS 3 (IFRS)

- Issued 1983 – IAS 22 Accounting for Business Combinations (issued by IASC)
- Revised 1998 – IAS 22 Business Combinations (IASC)
- 2004 – IFRS 3 Business Combinations (issued by IASB)

AS 14 (IGAAP)

- Issued 1994 – Accounting for Amalgamations

Ind AS 103 (Ind AS)

- Notified on 16th February 2015

Objective

The Standard establishes principles and requirements for how the acquirer:

- Recognises and measures in its financial statements **identifiable assets acquired, liabilities assumed** and any **non- controlling interest** in acquiree.
- Recognises and measures the **goodwill or gain on bargain purchase acquired** in the business combination
- Determines what information to disclose to evaluate nature and financial effect of business combination .



Scope

This Ind AS applies to a transaction or other events that meets the definition of a Business Combination. It does not apply to:-

- Accounting for Formation of a Joint Arrangements
- Acquisition of assets or group of assets that do not constitute business.
- The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in Ind AS 110, *Consolidated Financial Statements*, of an investment in a subsidiary that is required to be measured at fair value through profit or loss.



What is a Business Combination?

- An entity shall determine whether a transaction or other event is a business combination by applying the definition in this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business.
- If the asset acquired is not a business, then reporting entity shall account for the transaction or other event as an Asset acquisition.
- A business combination is a transaction or other event in which an acquirer obtains **CONTROL** of one or more **BUSINESS**.

for e.g.

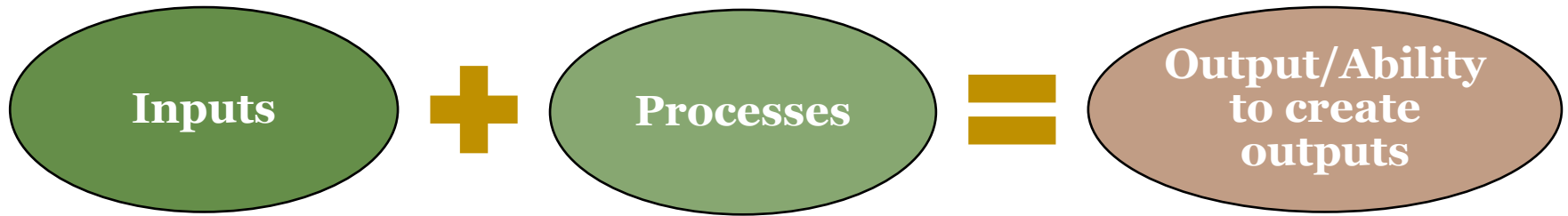
acquisition of shares or

net assets, legal mergers etc.

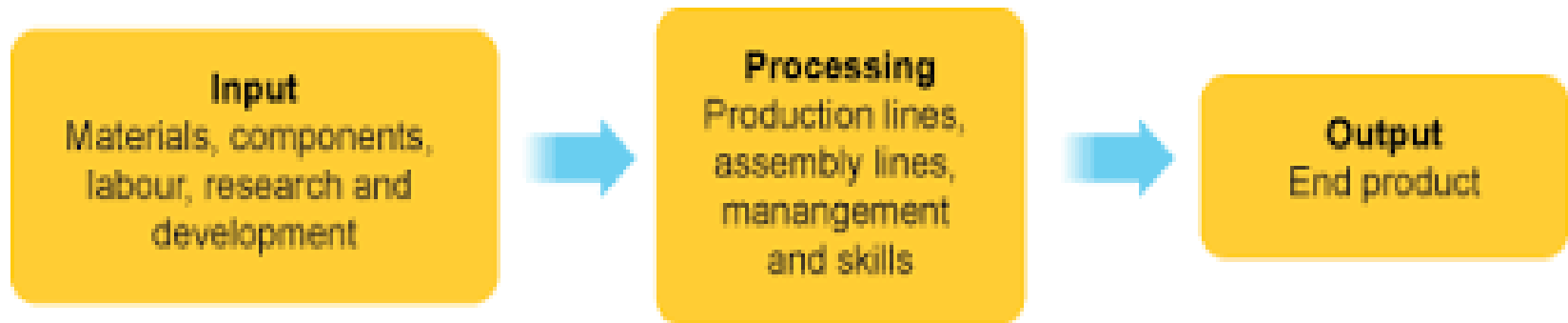


What is a Business?

- Business is integrated set of activities and assets capable of being conducted and managed to provide returns to investors.
- Integrated set of activities means:



- Returns could be in the form of Dividends, Low cost, Synergy benefits, Savings etc.



- Rebuttable presumption that a group of assets in which goodwill is present is a business.

Acquisition method

- An entity shall account for each business combination by applying the **Acquisition method**.
- Thus the acquirer recognises acquiree's identifiable assets, liabilities and contingent liabilities at their **fair values** at the acquisition date, and also recognises **goodwill**, which is subsequently tested for impairment (rather than amortised)



Steps - Acquisition method



Step 1: Identifying the **Acquirer**

Step 2: Determining the **Acquisition Date**

Step 3: Measure **consideration** transferred

Step 4: Recognition and Measurement of **Net Assets**

Step 5: Measure **NCI, goodwill or gain on a bargain purchase**

Step 1 - Identification of Acquirer



- For each Business combination one of the combining entities shall be identified as the acquirer.
- Acquirer is the entity that obtains control of business.
- To determine control we need to assess guidance given in Ind AS 110.

Step 1 - Identification of Acquirer

Additional factors to determine the Acquirer as per Ind AS 103

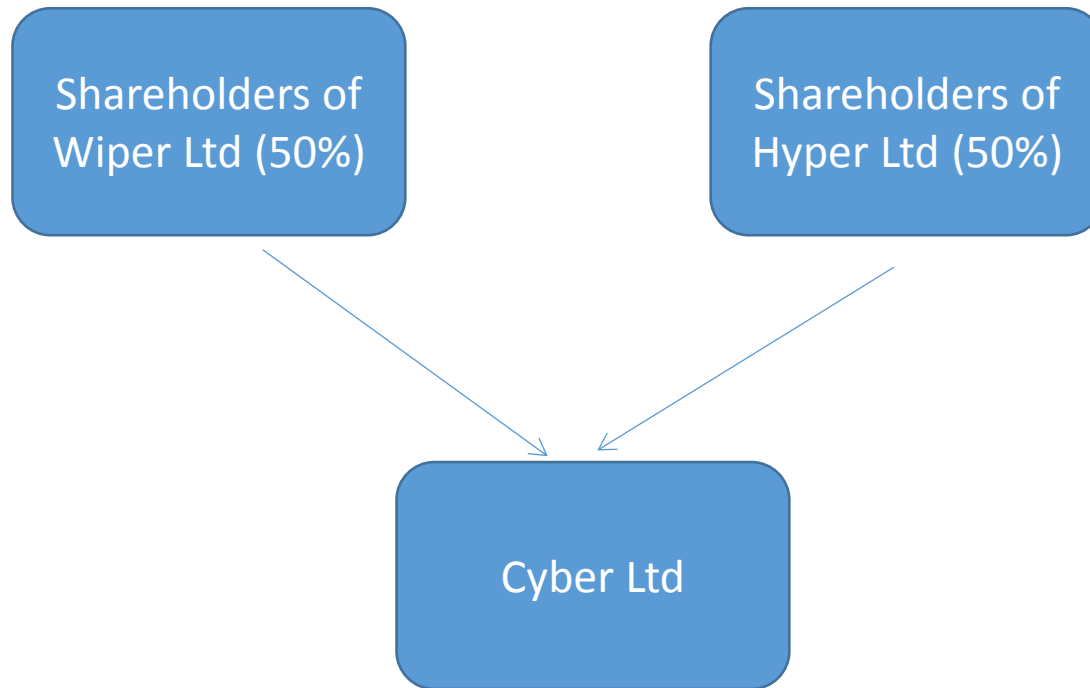


Usually the entity that transfers cash/ assets and assumed liabilities

Entity whose relative size is significantly greater than that of other combining entity

Composition of governing body/ senior management of the combined entity

Case Study 1– Identification of Acquirer



The chairman of Wiper Ltd is appointed as the chairman of Cyber Ltd.

Evaluate who is the acquirer of Cyber Ltd?

Case Study 2 – Identification of Acquirer

X, a public limited company, is to merge its operations with Z, a public limited company. The terms of the merger will be that Z will offer two of its shares for every one share of X. There will be no cash consideration. Z's market capitalization is \$500 million and X's is \$250 million. After the issue of shares, the board of directors will be comprised of only directors from Z. The group is to be named Z Group. Three months after the acquisition, 20% of X is sold.

Is it possible to identify an acquirer?

Solution :

It seems obvious that Z is the acquirer of X and not vice versa. Z is a much larger company and will dominate the business combination because of its control of the board of directors. Also the group is to be named the Z Group, which really confirms that Z is the acquirer. Additionally, part of X is sold after the acquisition, which again seems to indicate that Z acquired X.

Step 2 – Determine Acquisition date

- Acquirer shall identify the acquisition date.

i.e. The date on which it obtains control of the acquiree.

- Generally it is the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liability of the acquiree – closing date.



Step 3 - Measure Consideration transferred

- Consideration transferred in a business combination shall be measured at acquisition date fair value and includes:
 - Assets Transferred
 - Liabilities incurred to previous owners.
 - Equity Instruments issued
- Required to identify any items that are not part of the business combination and account for such items separately from business combination (e.g acquisition related costs)
- Contingent Consideration



Step 3 - Measure Consideration transferred

Contingent Consideration

- Obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met
- Recognised at **Fair value** at acquisition date
- The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity in accordance with Ind AS 32.

Case study 3- Measure Consideration



James has acquired 100% of the equity of Bang on December 31, 20X9. There are three elements to the purchase consideration. An immediate payment of \$10 million and two further payments of \$2 million if the return on capital employed (ROCE) exceeds 10% in each of the subsequent financial years ending December 31. James uses a discount rate of 7% in any present value calculations.

Compute the value of total consideration at the acquisition date.

Solution :

The two payments that are conditional upon reaching the target ROCE are contingent consideration and their fair value of $\$2 \times (1/1.07 + 1/1.07/1.07)$, that is, \$3.62 million will be added to the immediate cash payment of \$10 million to give a total consideration of \$13.62 million.

Step 4 : Recognition and Measurement of Net Assets

Recognition and Measurement of Identifiable Assets acquired and Liabilities assumed

- Recognition principle

- Must meet definition of assets or liabilities at acquisition date.
- Must be exchanged as part of acquisition.
- Recognise even those assets which were not recognised by the acquiree.

- Measurement principle

Measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.



Exception to recognition principle – Contingent Liability

Contingent liabilities as defined in Ind AS 37 comprise the following:

- a **possible obligation** that arises from past events whose existence will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the entity; or
- a **present obligation** that arises from past events but is not recognized because it is not probable that economic outflow will be required to settle the obligation or the amount of obligation can not be measured reliably.

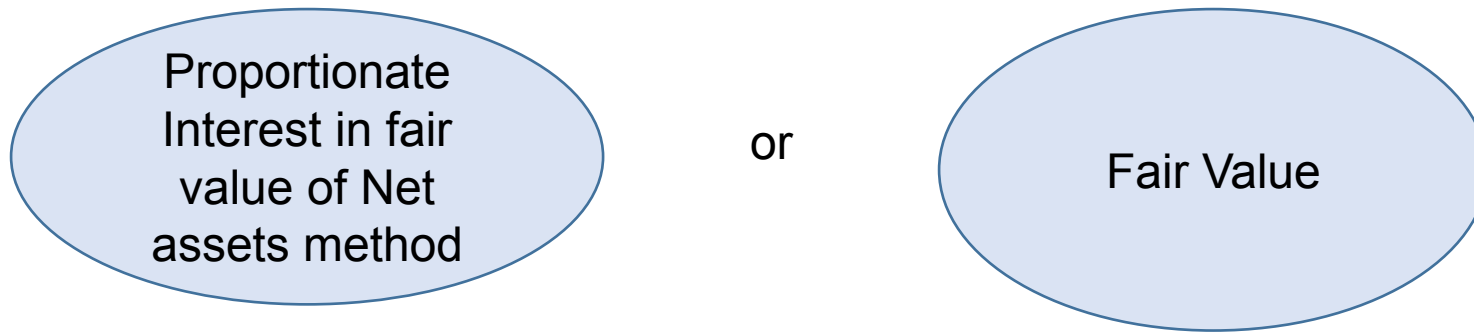
A contingent liability acquired is recognized if:

- It is a present obligation from a past event and;
- Fair value can be measured reliably



Step 5 – Non Controlling Interest

- NCI shall be measured either at:



- On a transaction-by-transaction basis

Step 5 : Determine Goodwill/ Gain on Bargain Purchase

▪ Goodwill

Acquirer shall recognise goodwill on the acquisition date as excess of (a) over (b) below :

(a) the aggregate of

- Fair value of consideration transferred.
- Recognised amount of any NCI in acquiree.
- Fair value of any previously held equity interest in the acquiree (for a business combination achieved in stages.

(b) Net of Acquisition date amounts of the Identifiable assets acquired and Liabilities assumed

Proportionate Interest Method of NCI:

Goodwill = Consideration transferred + NCI based on Net Assets – FV of Net Assets

Step 5 : Determine Goodwill/ Gain on Bargain Purchase

▪ Goodwill

Fair Value Method of NCI:

Goodwill = Consideration transferred + NCI at FV – FV of Net Assets

Such goodwill will be recognized as an Asset and subject to testing of annual impairment.

▪ Gain on Bargain Purchase

- When there is negative goodwill, it will be termed as Gain on Bargain Purchase.
- Bargain Purchase arises when FV of Net Assets and NCI exceeds Consideration transferred.
- In Case bargain purchase exists, the acquirer shall reassess measurement and identification and determine if the underlying reason exists for bargain purchase. If after reassessment still negative goodwill exists, then recognise such gain in Other comprehensive income and accumulate the same in Capital Reserve (carve out).

Carve - out : Bargain purchase gain arising on a business combination

IFRS 3 requires gain on bargain purchase to be recognised in the statement of profit and loss as income.

Since such gain occur at the time of acquiring a business, at present, these are considered to be of the nature of a capital profit and therefore recognised as capital reserve and not recognised in the statement of profit and loss. It has been felt that recognising such gains in the statement of profit and loss will result into recognition of unrealised gains, which may get distributed in the form of dividends. Moreover, such a treatment may lead to structuring through acquisitions, which may not be in the interest of the stakeholders of the company.

Therefore, departure has been made to accumulate such gains in equity as capital reserve as per the existing Accounting Standard (AS) 14, *Accounting for Amalgamations, notified under the Companies Act*.



Intangible Assets

- Recognized apart from goodwill
- Must be either:
 - Resulting from contractual or other legal rights OR
 - Capable of being separated or divided from the acquired enterprise and sold, transferred, licensed, rented or exchanged (regardless of intent)
- Examples
Trademarks, Customer lists, Order line, Patented technology etc.



Case Study 4 - Intangibles

Company A acquires company B deals in reputed brands of soaps and Shampoos which it has built after legacy of years of stability, quality and marketing.

However, since it is internally generated, it has not been recognized as assets

Whether company A can recognize these as assets?

Case Study 5 - Intangibles

Rahul Ltd. acquired Mehul Ltd. The acquiree has service contracts to supply certain items to railways.

Should these service contracts be treated as separate intangible asset?

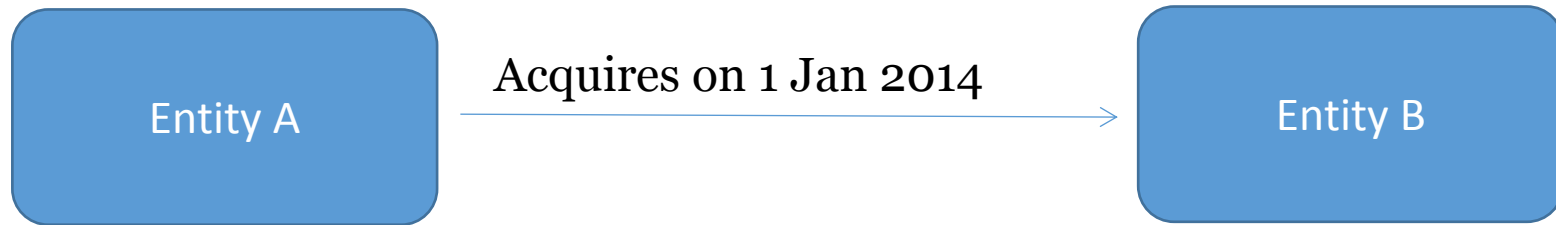
Measurement Period

Measurement period is the period after the acquisition date during which acquirer may adjust the provisional amounts recognised for a business combination.

- If new information obtained about facts and circumstances that existed at acquisition date.
- Ends when information obtained or determined not available.
- Cannot exceed one year.

After the measurement period ends the acquirer shall revise the accounting of business combination only to correct an error in accordance with Ind AS 8.

Measurement Period - Example



- Entity A seeks an independent valuation for items of PPE acquired
- Valuation was not complete at the time of issue of financial statements as on 31st March 2014
- Provisional Fair value of the assets was considered at 0.2 mn
- In July 2014, fair value obtained was 0.25 mn
- Thus, the financials of 2013-14 shall be restated
- Information received after 12 months, effect shall be taken in income statement. No adjustment will be made in Goodwill.

Use your brain...



Case Study 6 (Goodwill)

Mark has acquired a subsidiary on January 1, 20X9. The fair value of the net assets of the subsidiary was \$434 million. Mark acquired 70% of the shares of the subsidiary for \$429 million. The non controlling interest was fair valued at \$136 million.

Calculate goodwill using both methods allowed in Ind AS 103.

Solution..



Method 1 -Proportionate interest in Net Assets

Purchase consideration	429
NCI (30% × 434)	<u>130.2</u>
	559.2
Identifiable net assets-fair value	<u>(434)</u>
Goodwill	<u>125.2</u>

Method 2 -Fair Value

Purchase consideration	429
NCI	<u>136</u>
	565
Identifiable net assets—fair value	<u>(434)</u>
Goodwill	131

It can be seen that goodwill is effectively adjusted for the change in the value of the NCI, which represents the goodwill attributable to the NCI.

Use your brain...



Case Study 7 (Goodwill and NCI)

James acquires 80% of Cadbury for Rs 100,000. FV of Cadbury's net assets at time of acquisition equals Rs. 80,000

Required:

1. Calculate NCI and Goodwill as per
 - Proportionate Interest method
 - Fair Value method
2. Journal Entries in the books of James.

Solution..



Method 1 -Proportionate interest in Net Assets

Purchase consideration	100,000
NCI (20% × 80,000)	<u>16,000</u>
	116,000
Identifiable net assets-fair value	<u>(80,000)</u>
Goodwill	<u>36,000</u>

Journal entry

Net assets	Dr	80,000	
Goodwill	Dr	36,000	
Consideration	Cr		100,000
NCI	Cr		16,000

Solution..



Method 2 -Fair Value

Purchase consideration	100,000
FV of NCI ($100,000/80\%*20\%$)	25,000
FV of Net Assets	<u>(80,000)</u>
Goodwill	<u>45,000</u>

Journal entry

Net assets	Dr	80,000	
Goodwill	Dr	45,000	
Consideration	Cr		100,000
NCI	Cr		25,000

Use your brain...

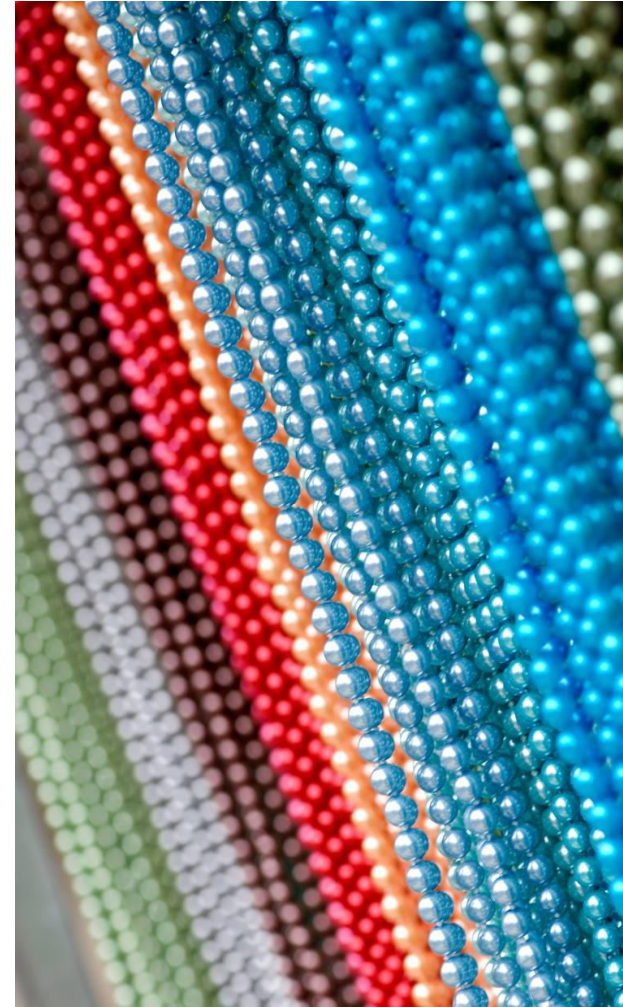


Case Study 8 (Goodwill)

On January 1, 201X, Doodlebug's Clothing and Accessories (Doodlebug) purchased a 100% interest in Halle's Fashion Accessories (HFA). Doodlebug issued 50,000 equity shares (\$1 par value) that were trading at \$30 on January 1 (the acquisition date).

The book value of HFA's net assets was \$750,000 on January 1. The fair value of net assets, exclusive of PP&E, was \$1 million. HFA's PP&E is particularly hard to value as there is no active market. Consequently, the assessment of the fair value of this PP&E under Ind AS is \$150,000.

Provide the acquisition journal entry under Ind AS 103.



Solution

Journal Entry :

Net assets (excluding PP&E)	\$1,000,000
PP&E	150,000
Goodwill	350,000
Equity Share Capital	\$50,000
Additional paid-in capital	1,450,000



Use your brain...



Case Study 9 (NCI)

Peter Piper's Peppers, Inc. (PPPI) acquired a 60% interest in Peter N's Tomatoes, Inc. (PNTI) on January 1, 201X. PPPI paid \$600 in cash for their interest in PNTI. The fair value of PNTI's assets is \$1,300, and the fair value of its liabilities is \$500.

Provide the journal entry for the acquisition using Ind AS, assuming that PPPI does not wish to report the NCI at fair value.



Solution

Journal Entry :

Acquired assets	\$1,300	
Goodwill	120 ⁽¹⁾	
Cash		\$600
Acquired liabilities		500
Non-controlling interests		320 ⁽²⁾

⁽¹⁾ $600 - (1,300 - 500 - 320)$

⁽²⁾ $40\% \times (1,300 - 500)$



Use your brain...



Case Study 10 (Contingent Liability)

XYZ Company acquired ABC Company on January 1, 201X. ABC is a defendant in a lawsuit as of January 1, 201X. The contingency is considered to be a present obligation and the fair value of the obligation can be reliably measured as \$23,000. As of the acquisition date it is not believed that an out flow of cash or other assets will be required to settle this matter.

What amount should be initially recorded under Ind AS for this contingent liability?



Solution

Preacquisition liabilities subject to contingencies are recognized as of the acquisition date if there is a present obligation (even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation) and the fair value of the obligation can be measured reliably, so a **liability of \$23,000 would be recorded.**



Use your brain..

Case Study 11

Charley Ltd acquires 80% share in Chaplin Ltd. for cash payment of \$100,000.

On the acquisition date, the aggregate value of Chaplin's identifiable assets and liabilities in line with Ind AS is \$110,000.

The fair value of non-controlling interest is \$25,000. This amount was determined with reference of market price of Chaplin's ordinary shares before the acquisition date.

Calculate NCI and goodwill as pr following approach:

- Proportionate shares of asset in acquiree
- Fair Value approach

Is there any difference if the net assets of Chaplin Ltd is \$150,000.



Step Acquisition - Meaning

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date.

For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B.

Ind AS 103 refers to such a transaction as a business combination achieved in stages or a step acquisition.



Step Acquisition - Accounting

- Acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in P&L or OCI, as appropriate.
- In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in OCI. If so, the amount that was recognised in OCI shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Case Study : Step Acquisition

Entity A acquired 15 % of Entity B in 2009 for Rs 10,000. In 2010, fair valued of shares of entity B is Rs 12,000, thus Rs 2,000 reported under OCI
In 2010, further acquired 60% stake, Consideration paid for Rs 60,000.
Entity A identifies the net assets of B as Rs. 80,000, value of 15% shares is Rs 12,500.

Hence, following will be transferred to P&L:

Gain on disposal of 15% investment (Rs 12500-12000)	500
Gain previously reported in OCI (Rs 12,000-10,000)	<u>2,000</u>
	<u>2,500</u>

Solution

A will measured goodwill as follows:

Fair Value of consideration given for controlling interest	60,000
Non-controlling interest (25% * Rs 80,000)	20,000
Fair Value of previously-held interest	<u>12,500</u>
	92,500
Less : Fair value of net assets of acquiree	<u>(80,000)</u>
Goodwill	<u>12,500</u>

Note: If we already have control of the acquiree (e.g. already own 75% of the equity and purchase the remaining 25%) then this is NOT a step acquisition.

Comprehensive case study

(Dip.IFRS ACCA & ICAI IFRS Exam)



Veer prepares consolidated financial statements to 30 September each year.

On 1 January 2014, Veer acquired 75% of the equity shares of Zara and gained control of Zara. Zara has 12 million equity shares in issue. Details of the purchase consideration are as follows:

- On 1 January 2014, Veer issued two shares for every three shares acquired in Zara. On 1st January 2014, the market value of an equity share in Veer was 6.50 and the market value of an equity share in Zara was 6.
- On 31 December 2014, Veer will make a cash payment of 7.15 million to the former shareholders of Zara who sold their shares to Veer on 1 January 2014. On 1 January 2014, Veer would have needed to pay interest at an annual rate of 10% on borrowings.
- On 31 December 2015, Veer may make a cash payment of \$30 million to the former shareholders of Zara who sold their shares to Veer on 1 January 2014. This payment is contingent upon the revenues of Veer growing by 15% over the two-year period from 1 January 2014 to 31 December 2015. On 1 January 2014, the fair value of this contingent consideration was 25 million. On 30 September 2014, the fair value of the contingent consideration was 22 million.

Comprehensive case study

(Dip.IFRS ACCA & ICAI IFRS Exam)



On 1 January 2014, the carrying values of the identifiable net assets of Zara in the books of that company totalled 60 million. On 1 January 2014, the fair values of these net assets totalled 70 million.

The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 30 September 2014, Zara had a poorer than expected operating performance. Therefore on 30 September 2014 it was necessary for Veer to recognise an impairment of the goodwill arising on acquisition of Zara, amounting to 10% of its total computed value.

Compute the impairment of goodwill and explain how this impairment should be recognised in the consolidated financial statements of Veer. You should do this under BOTH the methods permitted by Ind AS 103 for the initial computation of the non-controlling interest in Zara at the date of acquisition



Disclosure Requirements

Disclosures:

An acquirer should disclose information that enables users to evaluate the ***nature and financial effect of business combinations*** that were affected. This information will include:

- (a) The names and descriptions of the acquiree;
- (b) The acquisition date;
- (c) The percentage of voting equity instruments acquired;
- (d) Primary reasons for the business combination;
- (e) The cost of the combination and the components of that cost;
- (f) Details of operations that the entity has decided to dispose of;
- (g) The amounts recognised for each class of the acquiree's net assets at acquisition date together with their carrying amounts immediately prior to the combination;
- (h) The amount of any excess recognised in OCI/reserves as a result of negative goodwill;
- (i) A description of the factors contributing to the recognition of goodwill; and
- (j) The amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable. If impracticable, fact must be disclosed.



Comparison – IFRS Vs Ind AS Vs AS

IFRS 3 Vs Ind AS 103

Gain on Bargain Purchase : IFRS 3 requires such gain to be taken to Profit and Loss whereas a carve out is taken in Ind AS 103 on this and such gain is treated as Capital reserve only.

IFRS 3 excludes common control Business combinations from its scope whereas Ind AS 103 requires such combinations to be accounted using pooling of interest method.

Ind AS 103 Vs AS 14

Scope : Ind AS 103 defines a business combination which has a wider scope whereas AS 14 only deals with amalgamation.

Method of accounting : Ind AS 103 prescribe only **Acquisition method** for every business combination whereas Para 7 of AS 14 states two method of accounting for amalgamation i.e. **Pooling of interest method and Purchase method**.

Recognition of Net Assets acquired: Ind AS 103 requires the acquired identifiable assets liabilities and non-controlling interest to be recognised at **FV** under acquisition method. As per Para 12 of AS 14, there is a choice of **BV or FV**.

Goodwill: Under Ind AS 103, Goodwill is not amortised but tested for annual impairment in accordance with Ind AS 36. where as AS 14 requires that goodwill arising on amalgamation in the nature of purchase is amortised over a period not exceeding 5 years.

Ind AS 103 Vs AS 14

Common control transactions : Appendix C of Ind AS 103 deals with accounting for common control transactions, which prescribes a method of accounting different from Ind AS 103 i.e Pooling of interest method is to be used. Common control business combination includes transactions, such as transfer of subsidiaries or business, between entities within a group. Whereas, AS 14 does not prescribe accounting for such transactions different from other amalgamations

Contingent Consideration: Ind AS 103 deals with the contingent consideration in case of business combination, i.e., an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. The existing AS 14 does not provide specific guidance on this aspect.

Reverse acquisitions: Ind AS 103 deals with reverse acquisitions whereas the existing AS 14 does not deal with the same.

Ind AS 37

Provisions, Contingent Liabilities and Contingent Assets



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History of the Standards

IAS 37 (IFRS)

- Issued September 1998 – Provisions, Contingent Liabilities and Contingent Assets (issued by IASC)

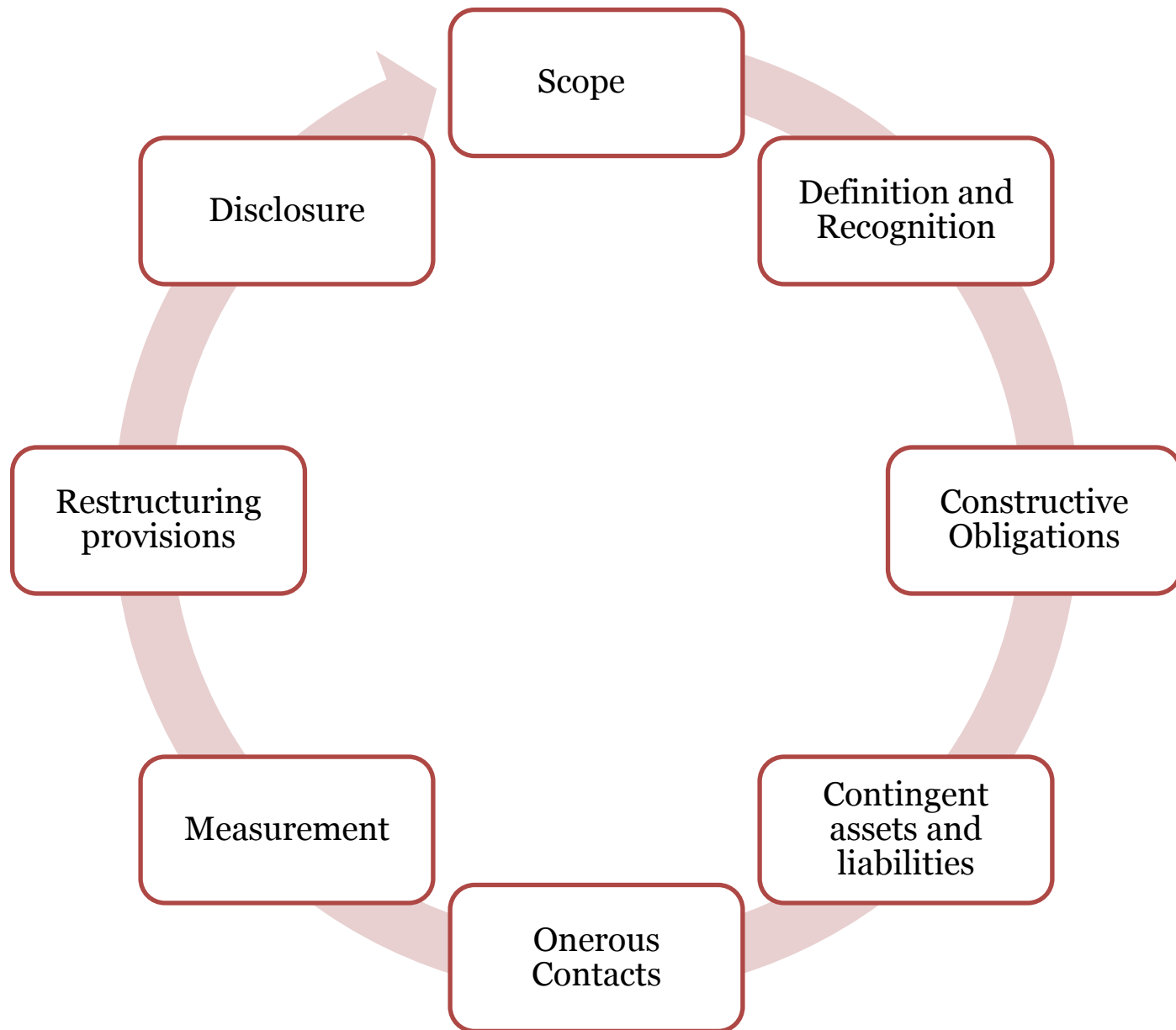
AS 29 (IGAAP)

- Issued 2003 & Revised in 2016 – Provisions, Contingent Liabilities and Contingent Assets

Ind AS 37 (Ind AS)

- Notified on 16th February 2015

Overview



Scope

This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets except :

- Executory contracts (other than onerous)
- those covered by other accounting standard
 - construction contracts (Ind AS 11)
 - income taxes (Ind AS 12)
 - employee benefits (Ind AS 19)
 - insurance contracts (Ind AS 104)



Key Definitions

- **Liability :**

- Present obligation as a result of past events
- settlement is expected to result in an outflow of resources

- **Provision :** a liability of uncertain timing or amount

- **Contingent Liability :**

- a possible obligation depending on whether some uncertain future event occurs or not occur which is not in the control of an entity, or
- a present obligation but outflow is not probable or the amount of obligation cannot be measured reliably

Key Definitions

- **Contingent Asset :**

- a possible asset that arises from past events, and
- whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

- **Probable :**

More likely than not

Guidance - Past Event

A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only due to:

- (a) Legal obligation

- (b) Constructive obligation

Recognition of Provision

A provision shall be recognised when:

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

probable that an ***outflow of resources*** embodying economic benefits will be required to settle the obligation

a ***reliable estimate*** can be made of the amount of the obligation

If these conditions are not met, no provision shall be recognised

Legal Obligation

A legal obligation is an obligation that derives from :

- *a contract*
- *legislation; or*
- *Other operation of law.*

Constructive Obligation

..is an obligation that derives from an entity's actions where:

- by an established pattern of past practice, published policies or statement, the entity has **indicated** to other parties that it will accept certain responsibilities *and*
- as a result, a **valid expectation** created on the part of those other parties that it will discharge those responsibilities.

Case Study -1 Constructive obligation

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Constructive obligation- Solution 1

Criteria 1: Present obligation as a result of a past obligating event

The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

Criteria 2: An outflow of resources embodying economic benefits in settlement

Probable, a proportion of goods are returned for refund

Conclusion : A provision is recognised for the best estimate of the costs of refunds.

Case Study 2 -Constructive obligation

On 9th Oct 2014, the board of ABC Ltd decided to close down a division making a particular product. A detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Constructive obligation- Solution 2

Criteria 1: Present obligation as a result of a past obligating event

The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

Criteria 2 : An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised at 31 March 2014 for the best estimate of the costs of closing the division

Case Study 3 -Probable

After a wedding in 2010, 10 people died as a result of food poisoning from products sold by Kim Catering Inc. (KCI). Legal proceedings started, seeking damages from the company. Up to the date of authorization of the financial statements for the year ended December 31, 2010, the company's lawyers advised that it was 40% probable that the company would not be found liable. However, when the company prepared its financial statements for the year ended December 31, 2011, its lawyers advised that, owing to developments in the case, it was 85% probable that the company would be found liable.

Assuming the attorneys can arrive at a reasonable estimate of the potential damages, should KCI recognize a provision as per Ind AS in 2010 and in 2011?



Probable - Solution

In 2010 and 2011, you recognize a provision for this situation. Using Ind AS, “probable” indicates that an outcome is more likely than not to occur (more than a 50% chance of occurring). Since this situation is above this threshold in both years, a provision would be required to be recognized.

Contingent Liabilities

- *possible obligation* that arises from past events
 - whose existence will be confirmed only by the occurrence or non-occurrence of one or more **uncertain future events**
 - not wholly within the **control** of the entity
- *present obligation* that arises from past events
(One of the criteria for recognizing provision) but provision is not recognised because:
 - **Not probable** of outflow of resources
 - the amount of the obligation **cannot be measured** with sufficient reliability.

An Entity shall NOT Recognise a contingent liability.

Contingent Assets

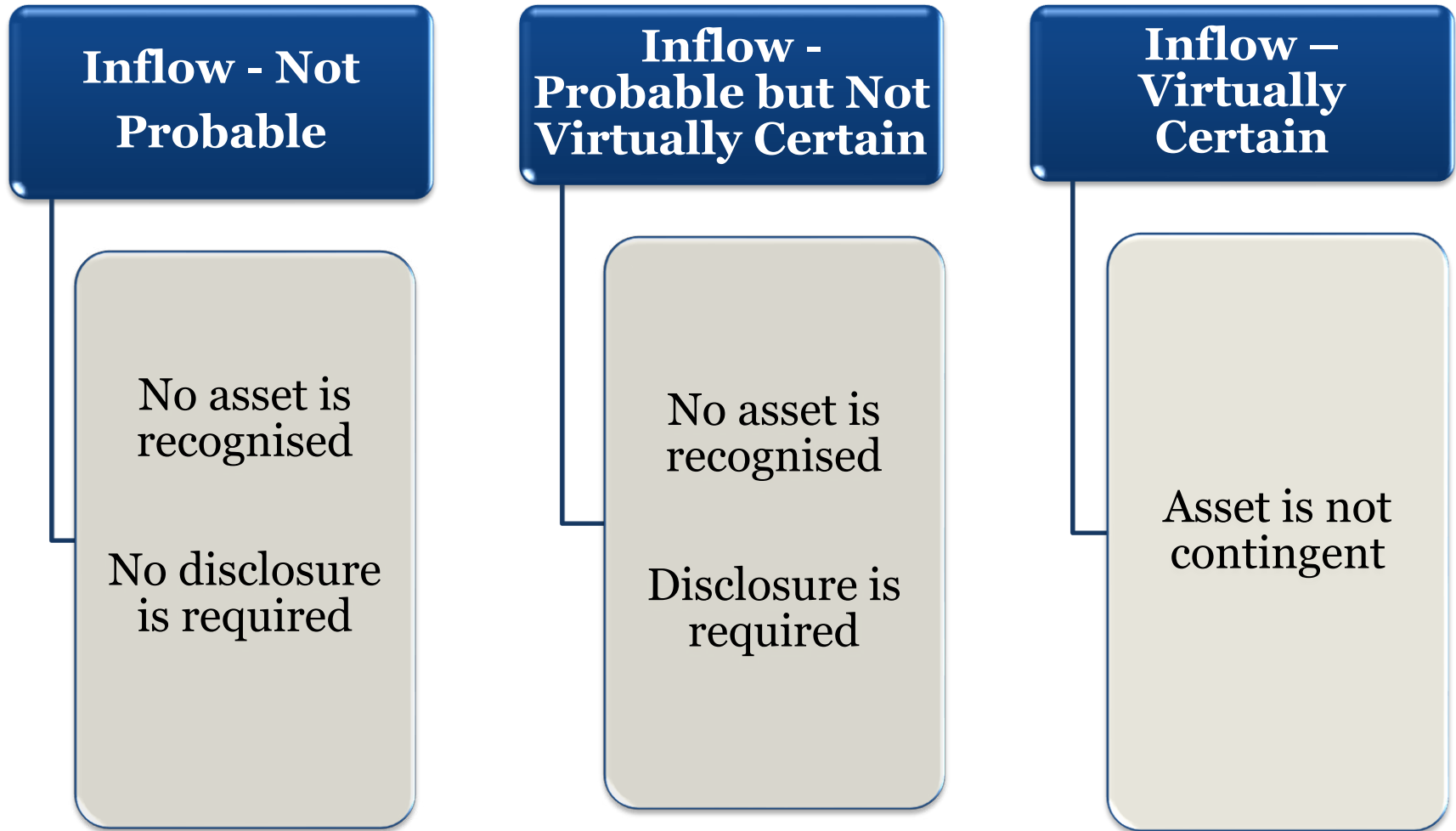
- ..is a possible asset that arises from past events
 - whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events
 - not wholly within the control of the entity.

Example:

A claim that an entity is pursuing through legal processes, where the outcome is uncertain.

An Entity shall NOT Recognise a contingent asset.

Contingent asset- Recognition and disclosure



Onerous contracts

..is a contract in which the

- unavoidable costs of meeting the obligations *exceed*
- the economic benefits expected to be received

- Unavoidable costs are the least net cost of exiting the contract i.e. Lower of cost of the breach of the contract and fulfilling it.
- *If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.*

Case Study 4 -Onerous contract

Aafat Ltd operates profitably from Kullu factory that it has leased under an operating lease. During Sep 2014, the entity relocates its operations to new factory in Manali. The lease on the Kullu factory continues for the next 4 years, it cannot be cancelled and can't be re-let to another user.

Onerous contract- solution

- **Present obligation as a result of a past obligating event**

The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

- **An outflow of resources embodying economic benefits in settlement**

When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the entity accounts for the lease under Ind AS 17)

- **Conclusion** - A provision is recognised for the best estimate of the unavoidable lease payments

Measurement

Provisions are measured at the *best estimate* of the expenditure required to settle the present obligation at the reporting date.

Provisions for one-off events (like restructuring, environmental clean-up, settlement of a lawsuit) are measured at the *most likely amount*.

Provisions for large populations of events (warranties, customer refunds) are measured at a *probability-weighted expected value*.

In determining best estimate, Consider management judgment, experience of similar transactions, evidences and related risks and uncertainties.

Where the effect of the time value of money is material, the provision is discounted to its present value.

Case Study 5 -Best estimate

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase.

If minor defects were detected in all products sold, repair costs of 1 million would result. If major defects were detected in all products sold, repair costs of 4 million would result.

The entity's past experience and future expectations indicate that, for the coming year, 75 per cent of the goods sold will have no defects, 20 per cent of the goods sold will have minor defects and 5 per cent of the goods sold will have major defects.

*An entity assesses the probability of an outflow for the warranty obligations as a whole. The expected value of the cost of repairs is:
(75% of nil) + (20% of 1mn) + (5% of 4mn) = 400,000*

Case study 6 – Discounting

The CFO of Out of Luck Company (OLC) has determined OLC needs a 100,000 provision for an item. The CFO is uncertain when OLC must make this payment but believes it will be in the end of next year.

The current pretax discount rate is 8%.

Show the required journal entries in light of the provisions of Ind AS 37



Discounting - Solution

The time value of money needs to be considered if it is material. Based on the information provided, the expected payment date is after one year.

The provision should be made as shown below:

$$100,000 / (1 + 8\%)$$

Provision for Legal expense	(PL)	92,593	
Legal Provisions	(BS)		92,593

Review of provisions

Review and adjust provisions at each reporting date and adjusted to reflect the current best estimate.

Outflow no longer probable - provision is reversed.

Provision shall only be used for the purpose for which they were originally recognized.

Reimbursements

- When some of the expenses is to be reimbursed from the third parties :
 - Recognised only when, it is virtually certain that reimbursement will be received.
 - Treated as a separate asset
 - It should not exceed the provision
 - Statement of P&L : Expense relating to a provision may be presented net of the reimbursement.

Case study 7



A manufacturer gives warranties at the time of sale to purchasers of its product. The manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within 3 years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

State whether provision is required to be made or not?

Case study 8



An entity in the oil industry causes contamination and operates in a country where there is no environmental legislation. However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy.

State whether provision is required to be made or not?

Case Study 9 - Onerous contracts

Company Best's (CB) Board approved a restructuring plan on November 1, 2009. On December 1, 2009, CB issued a press release announcing it was consolidating its facilities. The New Jersey facility to be shut down is currently leased. CB accounts for the facility as an operating lease with annual lease payments of \$10,000. CB is currently in the fifth year of a 10-year lease. The restructuring plan has committed CB to using the New Jersey facility through January 1, 2011, which completes the sixth year under the lease term, at which time the remaining lease rentals will be \$40,000 (\$10,000 per year for the remaining four years). Due to the specialization of the manufacturing process, there are no options to sublease the facility. The present value of the remaining lease rental at December 1, 2009, is \$45,000. The present value of the remaining lease rentals at January 1, 2011, is \$36,000.

As per Ind AS 37, when and what amount, if any, should be recorded for this operating lease? Show any required journal entries.



Onerous contracts example

The liability is recognized when the company has knowledge of and has committed to no longer use the facility (i.e., December 1, 2009).

Again, the general recognition provisions of Ind AS 37 apply:

- The entity has a present obligation as a result of a past event.
- It is probable that an outflow of resources will be required to settle the obligation.
- A reliable estimate can be made of the amount of the obligation.

On December 1, 2009, record the following journal entry:

Restructuring expense	\$45,000	
Operating lease liability		\$45,000

Restructuring

The following are examples of events that may fall under the definition of restructuring:

- (a) sale or termination of a line of business;
- (b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;
- (c) changes in management structure, for example, eliminating a layer of management; and
- (d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

Restructuring

A constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

- (i) the business or part of a business concerned;
- (ii) the principal locations affected;
- (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;
- (iv) the expenditures that will be undertaken; and
- (v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Restructuring

A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both:

- (a) necessarily entailed by the restructuring; and
- (b) not associated with the ongoing activities of the entity.

A restructuring provision **does not include** such costs as:

- (a) retraining or relocating continuing staff;
- (b) marketing; or
- (c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

Case study 10



On April 10, 2013, the board of an entity decided to close down a division. Before the end of the reporting period (31 March 2014) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

State whether provision is required to be made or not?



Disclosure Requirements

Disclosures

- Reconciliation for each class of provision:
 - opening balance
 - additions
 - used (amounts charged against the provision)
 - unused amounts reversed
 - unwinding of the discount, or changes in discount rate
 - closing balance
- A prior year reconciliation is not required.
- For each class of provision, a brief description of:
 - nature
 - timing
 - uncertainties
 - assumptions
 - reimbursement, if any.

Disclosures

- An entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:
 - (a) an estimate of its financial effect;
 - (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
 - (c) the possibility of any reimbursement

- Where an inflow of economic benefits is probable, an entity shall disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect.



Comparison – IFRS Vs Ind AS Vs AS

IFRS/Ind AS vs AS - Key Differences

Particulars	Ind AS	AS
Applicable Guidance	Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets.	AS 29: Provisions, Contingent Liabilities and Contingent Assets.
Discounting	Ind AS 37 require discounting of amount of provisions, if effect of time value of money is material.	AS 29 prohibits discounting of provisions except in case of decommissioning, restoration and similar liabilities recognised in cost of PPE. (amendment vide notification dated Mar 30, 2016)
Contingent Asset	Ind AS 37 require disclosure of contingent assets in the financial statements when the inflow of economic benefits is probable	The existing AS 29 notes the practice of disclosure of contingent assets in the report of the approving authority but prohibits disclosure of the same in the financial statement.

MCQ - 1

A provision shall be recognised when there is present obligation and a reliable estimate for the amount can be made.

State whether it is true or false with supportive reasons.



MCQ - 2

Onerous contracts are recognised at _____ of cost of exiting the contract and fulfilling it.

- (a) Lower
- (b) Higher
- (c) Equivalent



MCQ - 3

Ind AS 37 is applicable to :

- (a) Non-Onerous Executory contracts
- (b) Provision for income taxes
- (c) Provision for employee benefits
- (d) Onerous contracts



Ind AS 19

Employee Benefits



ICAI Certificate Course on Ind AS
New Delhi

Sep 17, 2017

History of the Standards

IAS 19 (IFRS)

- Issued 1983 – Accounting for Retirement benefits in Financial Statements of Employers (issued by IASC)
- Revised 1993 – Retirement benefits costs (IASC)
- Revised 1998 – Employee benefits (IASC)
- Revised 2011 - Employee benefits (issued by IASB)

AS 15 (IGAAP)

- Issued 1995 – Accounting for Retirement benefits in the financial statements of Employers
- Revised 2005 – Employee benefits

Ind AS 19 (Ind AS)

- Notified on 16th February 2015

Why?

- Every company has employees who get some benefits
- A portion of gains or losses hit OCI and not Profit or Loss Account

Objective

To prescribe the **accounting and disclosure** for employee benefits. This standard required an entity to recognise:

- **a liability** when an employee has provided service in exchange for employee benefits to be paid in the future; and
- **an expense** when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits



Scope

- This Standard shall be applied by an employer in accounting for all employee benefits, except those to which Ind AS 102, *Share-based Payment*, applies.
- This Standard does not deal with reporting by employee benefit plans.



Definition of Employee

- Ind AS 19 silent
- Employee may provide services to an enterprise on a
 - Full time
 - Part time
 - Permanent
 - Casual
 - Temporary basis
- Employees also include directors and other management personnel

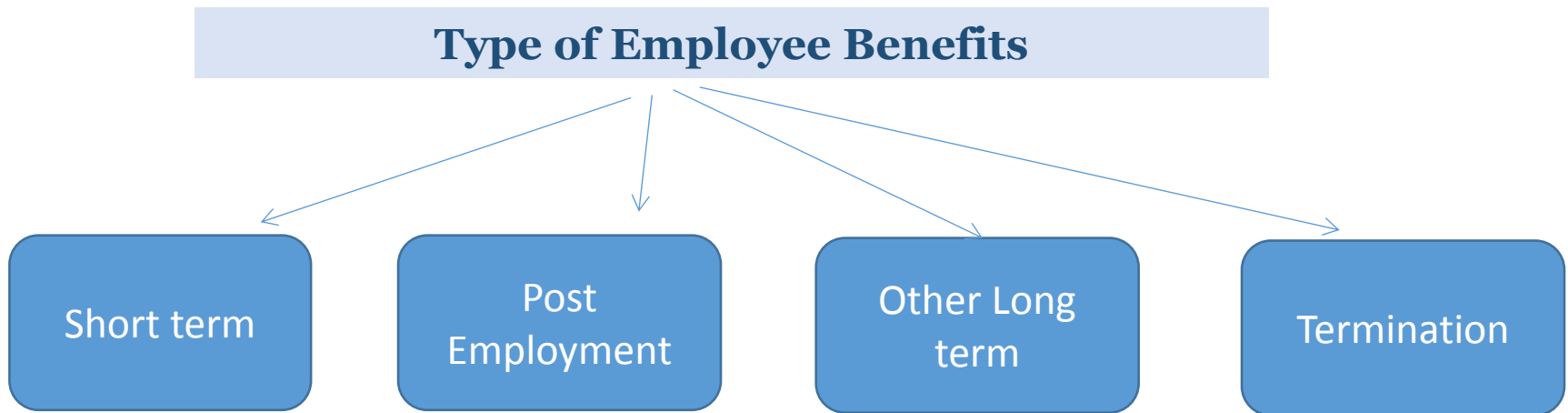
Benefits payable during & after Employment

- Wages, Salaries, Bonus
- Sick, Maternity, Paternity Leave
- Provident Fund Contribution
- Gratuity
- Perquisites
- Long term bonuses, Long service awards
- Loyalty awards
- VRS
- Pension etc.



Employee Benefits and Categories

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



Employee Benefits and Categories

Short Term

- Expected to be settled wholly before 12 months
- Wages, Salaries & Bonus

Post Employment benefits

- After completion of employment
- Gratuity, Pension and PF

Other Long Term benefits

- Residual category (settled after 12 months)
- Sabbatical leave, Jubilee benefits & Loyalty bonus

Termination benefits

- On Termination
- VRS, Notice pay

Short Term Employee Benefits

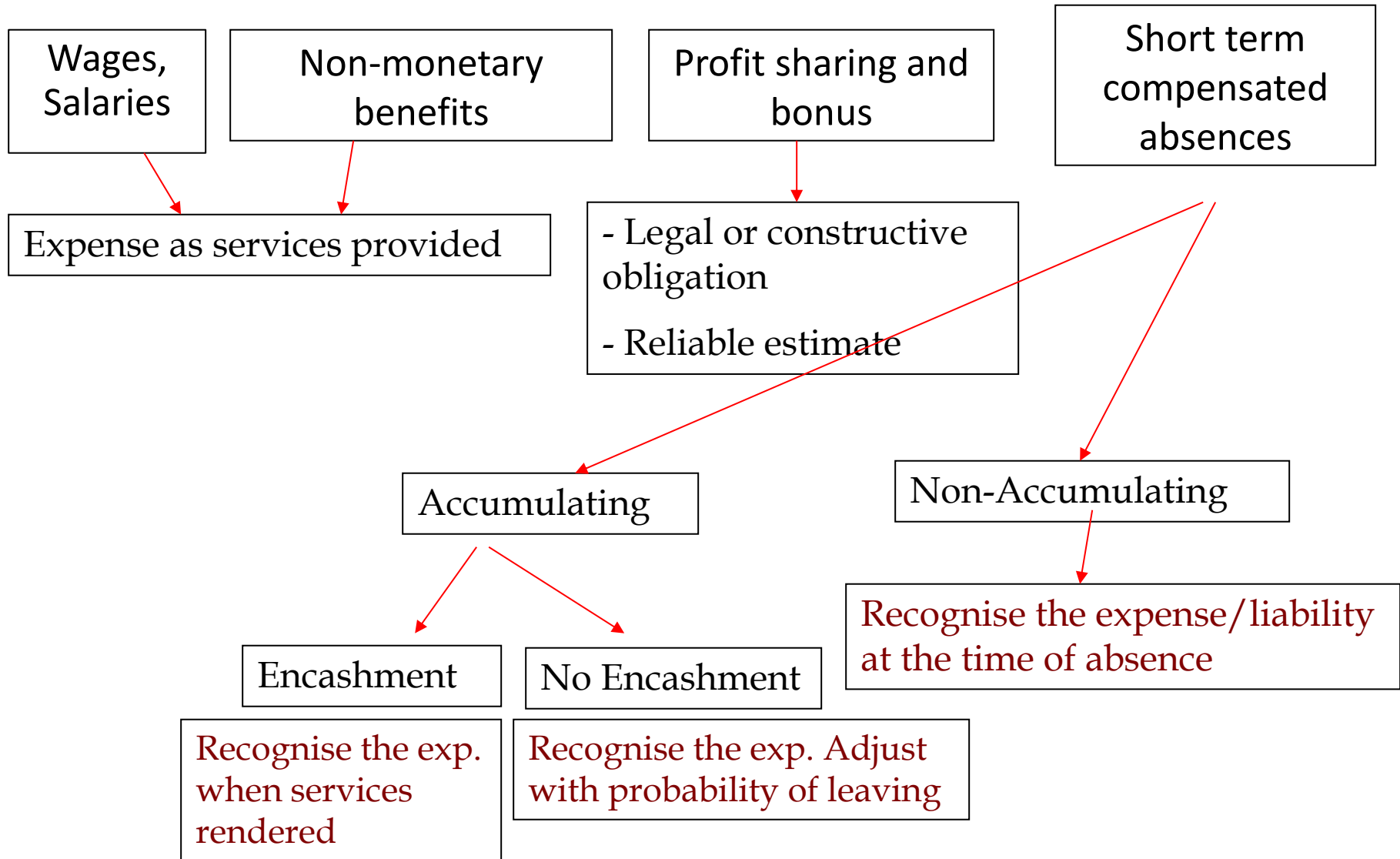
Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled ***wholly before twelve months*** after the end of the reporting period in which the employees render the related service.

- (a) wages, salaries and social security contributions;
- (b) paid annual leave and paid sick leave;
- (c) profit-sharing and bonuses; and
- (d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Short Term Employee Benefits - Wages, Salaries, Bonus

- Recognition straight forward
- Capitalisation of employee benefits if allowed by other standards
- Bonus payable if employee remain in service

Short Term EB - Recognition summary



Case Study -1

ABC Ltd. has a practice of paying a performance bonus to its sales staff. Past evidence indicates that the staff who meet their sales targets received a bonus of 10% of their current salary package at the year end. Sales staff who were not in service throughout the whole year received a bonus in proportion to their service period. The bonus are paid in the first quarter of the following year, to the sales staff who are still employed by the entity at the year end.

At the year end, seven of the sales staff meet their sales targets. Two of the seven began their employment halfway through the year and one of them left the entity at the year end.

Discuss recognition in accordance with Ind AS 19.

Solution : Employee benefit exp. to be recognised : 4 to receive 10%, 2 to receive 5%

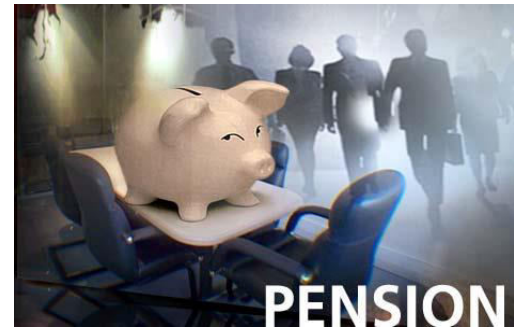
Case Study - 2

An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 Dec 20X1 the average unused entitlement is two days per employee.

The entity expects, on the basis of experience that is expected to continue, that 92 employees will take no more than five days of paid sick leave in 20X2 and that the remaining eight employees will take an average of six and a half days each.

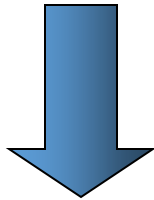
Solution : The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31 Dec 20X1 (one and a half days each, for eight employees). Therefore, the entity recognises a liability equal to twelve days of sick pay.

Post Employment Benefits



Defined contribution

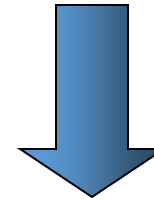
The entity pays agreed contributions into a plan and has no further liability



Accounted for on an accruals basis

Defined benefit

Benefit to be paid is certain and finance to be done accordingly



Accounted for using the projected unit credit method

Other Long Term Benefits

- **Examples**

- (a) Long term compensated absences
- (b) long term disability benefits
- (c) Profit sharing and bonus payable 12 months or more
- (d) deferred compensation paid 12 months or more after the end of the period in which it is earned

- **Recognition and Measurement**

- Same like post employment defined benefits except,

To recognise in Profit or Loss

- Service cost
- Net Interest Cost
- Remeasurements

Actuarial Valuation method

- An entity shall use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.
- Actuarial assumptions shall be unbiased and mutually compatible.

Actuarial Valuation

- How many of you have read an Actuarial Valuation Report?
- How many of you have **seen** an Actuarial Valuation Report?
- Requirement of Ind AS 19 to get an actuarial reports

Actuarial Valuation

- Ind AS 19 elaborates on how the following should be used for actuarial valuation
 - Assumptions
 - Mortality
 - Discount rate
 - Salaries, benefits and medical costs

Termination Benefits

What is meant by Termination Benefit?

Termination benefits are employee benefits payable as a result of either:

- an enterprise's decision to terminate an employee's employment before the normal retirement date; or
- an employee's decision to accept voluntary redundancy in exchange for those benefits (voluntary retirement)



Termination Benefits - Recognition

- An entity shall recognise a liability and expense for termination benefits at the earlier of the following dates:
 - (a) when the entity can no longer withdraw the offer of those benefits; and
 - (b) when the entity recognises costs for a restructuring that is within the scope of Ind AS 37 and involves the payment of termination benefits.

- An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal



Disclosure Requirements

Measurement and Disclosures with respect to Acturial valuation - Summary

Benefits	Actuarial Valuation	Disclosures
Short Term		
Post Employment		
Other Long Term		
Termination		

*Termination benefits payable after 12 months needs to be discounted



Comparison

Ind AS 19 Vs AS 15

Actuarial valuation is based on certain assumptions. Changes in these assumptions give rise to actuarial gains and losses, for example changes in estimates of salary or medical costs.

Existing AS 15 requires recognition of actuarial gains and losses immediately in the profit and loss but Ind AS 19 requires that the same shall be recognised in other comprehensive income and should not be recognised in profit or loss.

Use your brain...1

According to Ind AS 19 Employee benefits, which ONE of the following terms best describes benefits which are payable as a result of an entity's decision to end an employee's employment before the normal retirement date?

- (a) Defined benefit plans
- (b) Termination benefits
- (c) Defined contribution plans
- (d) Post-employment benefits



Use your brain...2

According to Ind AS 19 Employee benefits, which ONE of the following statements best describes 'other long-term employee benefits'?

- (a) Benefits which are payable after completion of employment
- (b) Benefits not falling due wholly within twelve months of the end of the period in which the service is rendered
- (c) Benefits payable as a result of an entity's decision to end an employee's employment before the normal retirement date
- (d) Benefits not expected to be settled wholly within twelve months of the end of the period in which the service is rendered



Use your brain...3

Under which category should the following items be accounted for according to Ind AS19 Employee Benefits?

(1) Lump sum benefit of 1% of the final salary for each year of service

(2) Actuarial gains

(a) Lump sum benefit - short term employee benefits

Actuarial gains - defined contribution plans

(b) Lump sum benefit - defined benefit plans

Actuarial gains - defined contribution plans

(c) Lump sum benefit - defined benefit plans

Actuarial gains - defined benefit plans

(d) Lump sum benefit - short term employee benefits

Actuarial gains - under defined benefit plans



Ind AS 105

Non Current Assets held for Sale and Discontinued operations (examples and case studies)



ICAI Certificate Course on Ind AS

Hotel Eros, New Delhi

Sep 17, 2017

Theoretical aspect for **Exam??**

What is meant by Non Current Assets held for sale?

What are criteria for classifying the asset or disposal group as held for sale?

Whether Asset temporarily taken out of use is termed as abandoned or classified as Held for Sale?

What are the measurement provisions for Assets which are classified as HFS?

Case study -1

A property is purchased for Rs 500,000 on 1 April 2013. The useful life of the property is 20 years (zero residual value). The property is measured subsequently at depreciated historical cost.

On 30 September 2015, it is decided that the property is to be classified as held for sale (classification criteria are met).

An impairment assessment on 30 September 2015 determines the recoverable value (based on value in use) to be Rs 400,000.

The fair value less costs to sell on 30 September 2015 is Rs. 390,000.

Requirement

- a) What is the carrying value of the property immediately before re-classification as held for sale on 30 September 2015?
- b) What are the required accounting entries in 2015 in respect of the re-classification of the asset as held for sale?

Case Study 2 -Disposal group

Following details are given for entity A.

	Carrying value at 31 Dec 2014 (\$m)
Goodwill	16
Property, plant and equipment	28
Inventory	20
Financial assets (profit of \$4m recognised in equity)	17
Financial liabilities	-14
	67

Under Ind AS, property, plant and equipment would be stated at \$26m, and inventory stated at \$18m. The fair value less costs to sell of the disposal group is \$47m. Assume that the disposal group qualifies as held-for-sale.

Show how the disposal group would be accounted for in the financial statements for the year ended 31 December 2014.

Case Study 3

At 30 June 2013, a decision was taken to classify property as held for sale (criteria are met). The property was originally acquired for 400,000. Cumulative depreciation to 30 June 2013 amounted to 110,000. An impairment loss of 35,000 was also recognised at 30 June 2013 because VIU was determined at that date to be 255,000.

Upon re-classification as held for sale, the FVLCS was assessed at 250,000. An additional impairment charge therefore arose under Ind AS 105 and the carrying value of the property was 250,000.

At the next reporting date, 31 December 2013, the FVLCS is reassessed at 265,000. The full amount of the gain, 15,000, is recognised in profit and loss because it is less than the cumulative impairment losses recognised to date (40,000).

Case study 3

If however, at 31 December 2013, the FVLCS was 300,000, then the gain of 50,000 would exceed the cumulative impairment losses (40,000).

In this circumstance, only 40,000 of the gain could be recognised in profit and loss and the carrying value of the property would be 290,000. If the property was subsequently sold for 300,000, a gain on disposal of 10,000 would be recognised at that point.

Changes to a plan of sale

- ❑ When the 'held for sale' criteria are no longer met, the asset should be removed from the held for sale category.

- ❑ Re-classify and re-measure at lower of:
 - Carrying amount before the asset was classified as HFS adjusted for depreciation, amortisation, revaluations that would have been recognised had the asset not been classified as held for sale; and
 - Recoverable amount at the date of change to plan

Case study 4

A property is purchased for 500,000 on 1 January 2011. The useful life of the property is 20 years (zero residual value). The property is measured subsequently at depreciated historical cost.

On 31 December 2012, it is decided that the property is to be classified as held for sale (classification criteria are met).

An impairment assessment on 31 December 2012 determines the recoverable value (based on VIU) to be 400,000.

The FVLCS on 31 December 2012 is 390,000.

At 31 December 2013, there is a change in plans and the property no longer meets the criteria to be classified as held for sale.

There is no change in the useful life of the property at any point. The recoverable value at 31 December 2013 is 385,000.

Requirement

Show how the property would be accounted for in 2012 and 2013.

Case Study 5: Available for Sale

An entity is committed to a plan to sell a factory. The production cycle is six months and pollutants are involved. The company must meet its existing orders. Dismantling the equipment and cleaning up the pollution will put the facility out of action for six months. Does the factory meet the criterion of “availability for immediate sale”?

Case Study 6 :Plan to sell – time to vacate

An entity is committed to a plan to sell its HQ and has initiated action to find a buyer.

Situation 1

The entity intends to transfer the building to a buyer after it vacates the building. The time to vacate is normal.

Situation 2

The entity will continue to use the building until a new HQ is built. The building will not be transferred until construction is completed.

True/ False

1. An entity can continue to depreciate an asset even if it classifies it as Non-Current Assets held for Sale as per Ind AS 105?
2. Assets classified as held for sale, must be presented under the appropriate Asset head with a separate disclosure in the note.
3. Under Ind AS 105, an entity is 'committed to distribute' the asset (or disposal group) to the owners i.e. the assets must be _____:
 - (a) Available for immediate distribution in their present condition and the distribution must be “highly probable”.
 - (b) Available for immediate distribution in their existing condition and the distribution must be “virtually certain”
 - (c) Available for immediate distribution in their existing condition and the distribution must be “reasonably certain”
 - (d) Available for immediate distribution in their present condition and the distribution must be “virtually certain”