

# **Compendium of Indian Accounting Standards**

(Indian Accounting Standards as on April 1, 2018)  
(Volume I)



**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

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\* Prior to constitution of NFRA on October 01, 2018, National Advisory Committee on Accounting Standards

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# Foreword

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During last 4 decades, world has witnessed tremendous convergence of global economies and commerce leading to heightened co-operation and partnership among governments, regulators and international bodies. In the backdrop of globalization and liberalization, where world has become an economic village, financial standards assume a critical role. At the dawn of 21<sup>st</sup> century, this has led to emergence of international standard setting body called International Accounting Standards Boards of IASC Foundation (now called IFRS Foundation).

Adoption/convergence with IFRS Standards gained a significant momentum around 2005 when major economies such as European Union (EU) and Australia transitioned to IFRS framework. Around 2007-08, IFRS Standards received further fillip when China, Canada announced their intention to adopt/converge with IFRS Standards and US SEC decided to accept IFRS based financial statements of foreign issuers.

Since beginning, ICAI is the critical constituent in the Standards Setting process of this nation. During years 2000-02, ICAI shaped accounting framework in India by issuing many new Accounting Standards (ASs) in line with prevailing international framework. Soon after, India geared up towards a set of ASs that are close to globally recognised IFRS way back in year 2006, and published a concept paper on the path of convergence with IFRS issued by the IASB. ICAI believes that implementation of Ind AS, converged with IFRS Standards that are currently required in more than 140 jurisdictions and permitted in many more, is in the best interest of our nation & economy. This path breaking accounting reform initiative enabled Government of India in partnering with G20 nations to advocate implementation of a single set of high quality accounting standards across the globe in September 2009.

The implementation of Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) by Indian Companies is a monumental step in the accounting history of India. I am proud to say that the mission of ICAI in enabling the nation with high quality globally accepted financial reporting framework has been achieved during last two years. As of today, large majority of our Public Interest Entities present their financial statements under Ind AS Framework. Banks and Insurance Entities are expected to join the process soon i.e. from 1<sup>st</sup> April, 2019 and 1<sup>st</sup> April, 2020, respectively. On financial reporting front, ICAI has

set in a strong culture of global co-operation and partnership. In recent times, our efforts/involvement in international forums has increased manifold.

The Accounting Standards Board and its Ind AS Implementation Group have been making unrelenting efforts in making the transition from Indian GAAP to Ind AS smooth through its various initiatives which includes issuance of publication, educational materials on Ind AS, and these efforts further extend to organising regular training programmes, workshops, seminars on Ind AS to educate various stakeholders in effective implementation of Ind AS. In this direction publication of this first Compendium of Ind AS which provides a compilation of all the Ind AS that are effective as on April 01, 2018 is noteworthy.

My sincere appreciation to CA. S.B. Zaware, Chairman, Accounting Standards Board (ASB) and also gratefully acknowledge the contribution of the entire professional resources involved in the formulation of Indian Accounting Standards particularly all the Council Members, the members of the Board and Convenors and members of the Study Group.

I hope that this publication would be immensely useful to the members of the Institute in discharging their duties, preparers of financial statements under Ind AS and other stakeholders.

**New Delhi**  
**December 17, 2018**

**CA. Naveen N.D. Gupta**  
**President**

# Preface

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Dear Reader,

General purpose Financial Statements offers the most useful information of the financial position, performance and financial health of an entity. The central part of the financial statements lies in adherence to a set of robust financial reporting standards, which can be complex in structure but simple in purpose. They set what needs to be recognised and measured in the financial information communicated to the stakeholders—essentially setting the content of the financial statements—and then the format of that information. A set of high-quality reporting standards is a key underpinning of financial stability. In sum, it serves like the proverbial famous canary in the coal mine. It provides an early warning system to detect changes in the company's risks and its performance.

Since the formation of Accounting Standards Board in 1977, the ICAI has endeavoured to enable the Nation with a set of financial reporting standards comparable to the best in the world. During last decade or so, ICAI had initiated few critical steps on this path; the most significant one being moving with the idea of convergence with IFRS Standards in 2006-07. We are delighted to state that in year 2015, India witnessed a monumental leap forward in the Financial Reporting Standards Framework for Public Interest Entities (PIEs) i.e. implementation of Indian Accounting Standards (Ind AS) converged with IFRS Standards. The herculean efforts involved in rolling out principle based Ind AS, a set of standards that are comparable to global framework, are nothing short of astounding. The Ministry of Corporate Affairs (MCA) notified a set of 39 Ind AS on 16 February, 2015, based on recommendations of ICAI along with the implementation roadmap. The roadmap provided implementation of Ind AS by corporates voluntarily from 1<sup>st</sup> April, 2015 and mandatorily in a phased manner (phase I-from 1<sup>st</sup> April, 2016 and phase II-from 1<sup>st</sup> April, 2017). Subsequently, implementation roadmap for Banks (from 1<sup>st</sup> April 2019), Insurance companies (from 1<sup>st</sup> April 2020)\*, and NBFCs (in a phased manner, phase I-from 1<sup>st</sup> April, 2018 and phase II-from 1<sup>st</sup> April, 2019) were rolled out.

Ind AS provides new accounting framework for financial reporting which is fundamentally different in many areas from existing Accounting Standards (AS) notified by MCA in 2006. Ind AS comprises 39 standards providing

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\* Dates as deferred by RBI and IRDAI for Banks and Insurance Companies, respectively.

extensive guidance in various areas for reporting the financial results by the entities. Ind AS framework is robust and comprehensive. Ind AS has certain standards applicable to specific/ unique transactions, such as, Regulatory deferral accounts, Agriculture etc. Also, five (5) standards (Ind AS 103, 110, 111, 112 and 28) specifically deal with the aspects related to the subject of business combination (amalgamation/consolidation/acquisition). A dedicated standard (Ind AS 101) provides transition related guidance and exemptions to the entities reporting under Ind AS regime. A set of 3 Ind AS (Ind AS 107, 109 and 32) provide extensive guidance on accounting of financial instruments that includes some of the most complex kind of instruments. An important aspect to note is Ind AS are not industry specific, though some appear like that because few standards may have comparatively higher impact or relevance to specific industry. Another crucial standard is Ind AS 115 that provides a robust comprehensive step model for revenue recognition across varied sectors.

Ind AS are based on IFRS standards\* which have dynamic framework that keeps evolving with changing business environment and needs of users, therefore, keeps on changing periodically. It is intended that Ind AS Framework remains converged with IFRS at all times. A successful convergence effort entails timely updation of Ind AS by keeping pace with the changes in IFRS framework. Hence, we strive to keep amending/ issuing new Ind AS as soon as changes happen in IFRS Standards. To achieve this objective, since principle notification of Ind AS, for (4) amendment rules have been issued so far. In the 1<sup>st</sup> amendment rules notified in year 2016, revenue standard (Ind AS 115) was replaced by 2 standards on the subject (Ind AS 11 and 18) due to international deferral of IFRS 15. Furthermore, certain other amendments made by IFRS Standards were also included. In year 2017, 2<sup>nd</sup> amendment rules made clarificatory changes to 2 Ind AS (Ind AS 7 and Ind AS 102) consistent with the amendments made by IASB. Thereafter, in March 2018, in 3<sup>rd</sup> amendment rules Ind AS 115 was re-instated which comprehensively deals with revenue related aspects. In addition, other amendments included clarificatory guidance, annual improvement cycles etc. In September, 2018, 4<sup>th</sup> round of amendments to Ind AS was issued with regard to recording and presentation of certain government grants.

Keeping close track of these amendments and referring thereto as a separate document is a cumbersome and tedious task, therefore, for ease of reference for stakeholders', there is a need felt to publish a compilation of up-to date Ind AS.

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\* Ind ASs have certain carve-outs and carve-ins vis-a-vis IFRS Standards.

Large number of members of the Institute, irrespective of size of their profession, are rendering auditing and accounting services to the entities required to follow Ind AS. We acknowledge that our stakeholders include a vast array of companies, other organisations, employees, auditors, preparers, academics and students, and many others. Therefore, for the benefit of those, there is a strong need to have a consolidated manual of Ind AS up to-date as of each year. This publication brings a comprehensive version of IFRS converged Ind AS encompassing all the rounds of amendments issued by MCA till date that are effective for accounting periods beginning on or after 1<sup>st</sup> April, 2018.

To make this version, more understandable to the readers, an intentionally descriptive footnote is located at the relevant paragraphs, clearly indicating the changes made by the MCA amendment Rules. These footnotes do not form part of the standard and are purely added to enable users to easily locate the erstwhile provisions.

I am thankful to all stakeholders and members of the Board for their contribution in the functioning of the Board especially in formulation/ revision of Ind AS. I am also obliged for the support of various regulators in the activities of the Board and their invaluable contributions. I am thankful to Honourable President CA. Naveen N.D. Gupta for his direction and guidance in effective functioning of the Board. I am also thankful to Vice-President, CA. Praful Prem Sukh Chhajed and CA. M.P. Vijay Kumar, Vice- Chairman of the Board, for their consistent guidance and assistance.

I wish to place on record my appreciation to Secretarial team of Accounting Standards Board for their continuous endeavour and efforts for carrying out the activities of Board. I would like to thank CA. Vidhyadhar Kulkarni, Secretary, ASB, CA. Parminder Kaur, Deputy Secretary, CA. Sonia Minocha, Assistant Secretary and CA. Nikita Bothra, Executive Officer for bringing out this Compendium of Indian Accounting Standards.

We are indeed delighted to bring you the first edition of our compilation of Indian Accounting Standards (Ind AS) titled as **Compendium of Ind AS**, bounded in 2 Volumes that covers notified Ind AS applicable as on April 01, 2018.

We hope readers find this publication useful and of continued interest.

**New Delhi**  
**December 17, 2018**

**CA. S. B. Zaware**  
**Chairman**  
**Accounting Standards Board**

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## Indian Accounting Standard (Ind AS) 101

# First-time Adoption of Indian Accounting Standards<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Ind AS is to ensure that an entity's *first Ind AS financial statements*, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:
  - (a) is transparent for users and comparable over all periods presented;
  - (b) provides a suitable starting point for accounting in accordance with *Indian Accounting Standards (Ind ASs)*; and
  - (c) can be generated at a cost that does not exceed the benefits.

## Scope

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- 2 An entity shall apply this Ind AS in:
  - (a) its first Ind AS financial statements; and
  - (b) each interim financial report, if any, that it presents in accordance with Ind AS 34, *Interim Financial Reporting*, for part of the period covered by its first Ind AS financial statements.
- 3 An entity's first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs, in accordance with Ind ASs notified under the Companies Act, 2013

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## *Ind AS 101*

and makes an explicit and unreserved statement in those financial statements of compliance with Ind ASs.

- 4 [Refer to Appendix 1]
- 4A [Refer to Appendix 1]
- 4B [Refer to Appendix 1]
- 5 This Ind AS does not apply to changes in accounting policies made by an entity that already applies Ind ASs. Such changes are the subject of:
  - (a) requirements on changes in accounting policies in Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*; and
  - (b) specific transitional requirements in other Ind ASs.

## **Recognition and measurement**

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### **Opening Ind AS Balance Sheet**

- 6 An entity shall prepare and present an *opening Ind AS Balance Sheet* at the *date of transition to Ind ASs*. This is the starting point for its accounting in accordance with Ind ASs subject to the requirements of paragraphs D13AA and D22.

### **Accounting policies**

- 7 **An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D.**
- 8 An entity shall not apply different versions of Ind ASs that were effective at earlier dates. An entity may apply a new Ind AS that is not yet mandatory if that Ind AS permits early application.

**Example: Consistent application of latest version of Ind ASs**

**Background**

The end of entity A's first Ind AS reporting period is 31 March 2017. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 21). Therefore, its date of transition to Ind ASs is the beginning of business on 1 April 2015 (or, equivalently, close of business on 31 March 2015). Entity A presented financial statements in accordance with its *previous GAAP* annually to 31 March each year up to, and including, 31 March 2016.

**Application of requirements**

Entity A is required to apply the Ind ASs effective for periods ending on 31 March 2017 in:

- (a) preparing and presenting its opening Ind AS balance sheet at 1 April 2015; and
- (b) preparing and presenting its balance sheet for 31 March 2017 (including comparative amounts for the year ended 31 March 2016), statement of profit and loss, statement of changes in equity and statement of cash flows for the year to 31 March 2017 (including comparative amounts for the year ended 31 March 2016) and disclosures (including comparative information for the year ended 31 March 2016).

If a new Ind AS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that Ind AS in its first Ind AS financial statements.

- 9 The transitional provisions in other Ind ASs apply to changes in accounting policies made by an entity that already uses Ind ASs; they do not apply to a *first-time adopter's* transition to Ind ASs, except as specified in Appendices B–D.
- 10 Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:
  - (a) recognise all assets and liabilities whose recognition is required by Ind ASs;
  - (b) not recognise items as assets or liabilities if Ind ASs do not

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permit such recognition;

- (c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and
- (d) apply Ind ASs in measuring all recognised assets and liabilities.

11 The accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind ASs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs.

12 This Ind AS establishes two categories of exceptions to the principle that an entity's opening Ind AS Balance Sheet shall comply with each Ind AS:

- (a) paragraphs 14–17 and Appendix B prohibit retrospective application of some aspects of other Ind ASs.
- (b) Appendices C–D grant exemptions from some requirements of other Ind ASs.

### **Exceptions to the retrospective application of other Ind ASs**

13 This Ind AS prohibits retrospective application of some aspects of other Ind ASs. These exceptions are set out in paragraphs 14–17 and Appendix B.

#### **Estimates**

14 **An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.**

15 An entity may receive information after the date of transition to Ind

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ASs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with Ind AS 10, *Events after the Reporting Period*. For example, assume that an entity's date of transition to Ind ASs is 1 April 2015 and new information on 15 July 2015 requires the revision of an estimate made in accordance with previous GAAP at 31 March 2015. The entity shall not reflect that new information in its opening Ind AS Balance Sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 March 2016.

- 16 An entity may need to make estimates in accordance with Ind ASs at the date of transition to Ind ASs that were not required at that date under previous GAAP. To achieve consistency with Ind AS 10, those estimates in accordance with Ind ASs shall reflect conditions that existed at the date of transition to Ind ASs. In particular, estimates at the date of transition to Ind ASs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.
- 17 Paragraphs 14–16 apply to the opening Ind AS Balance Sheet. They also apply to a comparative period presented in an entity's first Ind AS financial statements, in which case the references to the date of transition to Ind ASs are replaced by references to the end of that comparative period.

### **Exemptions from other Ind ASs**

- 18 An entity may elect to use one or more of the exemptions contained in Appendices C-D. An entity shall not apply these exemptions by analogy to other items.
- 19 [Refer to Appendix 1]

### **Presentation and disclosure**

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- 20 This Ind AS does not provide exemptions from the presentation and disclosure requirements in other Ind ASs.

### **Comparative information**

- 21 An entity's first Ind AS financial statements shall include at least three Balance Sheet, two Statements of profit and loss, two Statements of cash flows and two Statements of changes in equity and related notes, including comparative information for all statements presented.

### **Non-Ind AS comparative information and historical summaries**

- 22 Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information in accordance with Ind ASs. This Ind AS does not require such summaries to comply with the recognition and measurement requirements of Ind ASs. Furthermore, some entities present comparative information in accordance with previous GAAP as well as the comparative information required by Ind AS 1. In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:
- (a) label the previous GAAP information prominently as not being prepared in accordance with Ind ASs; and
  - (b) disclose the nature of the main adjustments that would make it comply with Ind ASs. An entity need not quantify those adjustments.

### **Explanation of transition to Ind ASs**

- 23 **An entity shall explain how the transition from previous GAAP to Ind ASs affected its reported Balance sheet, financial performance and cash flows.**
- 23A [Refer to Appendix 1]
- 23B [Refer to Appendix 1]

### **Reconciliations**

- 24 To comply with paragraph 23, an entity's first Ind AS financial statements shall include:
- (a) reconciliations of its equity reported in accordance with

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previous GAAP to its equity in accordance with Ind ASs for both of the following dates:

- (i) the date of transition to Ind ASs; and
  - (ii) the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.
- (b) a reconciliation to its total comprehensive income in accordance with Ind ASs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP.
- (c) if the entity recognised or reversed any impairment losses for the first time in preparing its opening Ind AS Balance Sheet, the disclosures that Ind AS 36, *Impairment of Assets*, would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to Ind ASs.
- 25 The reconciliations required by paragraph 24(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the Balance Sheet and Statement of profit and loss. If an entity presented a Statement of cash flows under its previous GAAP, it shall also explain the material adjustments to the Statement of cash flows.
- 26 If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 24(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.
- 27 Ind AS 8 does not apply to the changes in accounting policies an entity makes when it adopts Ind ASs or to changes in those policies until after it presents its first Ind AS financial statements. Therefore, Ind AS 8's requirements about changes in accounting policies do not apply in an entity's first Ind AS financial statements.
- 27A If during the period covered by its first Ind AS financial statements an entity changes its accounting policies or its use of the exemptions

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contained in this Ind AS, it shall explain the changes between its first Ind AS interim financial report and its first Ind AS financial statements, in accordance with paragraph 23, and it shall update the reconciliations required by paragraph 24(a) and (b).

- 27AA If an entity adopts the first time exemption option provided in accordance with paragraph D7AA, the fact and the accounting policy shall be disclosed by the entity until such time that those items of Property, plant and equipment, investment properties or intangible assets, as the case may be, are significantly depreciated, impaired or derecognised from the entity's Balance Sheet.
- 28 If an entity did not present financial statements for previous periods, its first Ind AS financial statements shall disclose that fact.

**Designation of financial assets or financial liabilities**

- 29 An entity is permitted to designate a previously recognised financial asset as a financial asset measured at fair value through profit or loss in accordance with paragraph D19A. The entity shall disclose the fair value of financial assets so designated at the date of designation and their classification and carrying amount in the previous financial statements.
- 29A An entity is permitted to designate a previously recognised financial liability as a financial liability at fair value through profit or loss in accordance with paragraph D19. The entity shall disclose the fair value of financial liabilities so designated at the date of designation and their classification and carrying amount in the previous financial statements.

**Use of fair value as deemed cost**

- 30 <sup>1</sup>If an entity uses fair value in its opening Ind AS Balance Sheet as *deemed cost* for an item of property, plant and equipment or an intangible asset (see paragraphs D5 and D7), the entity's first Ind AS financial statements shall disclose, for each line item in the opening Ind AS Balance Sheet:
- (a) the aggregate of those fair values; and

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<sup>1</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

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- (b) the aggregate adjustment to the carrying amounts reported under previous GAAP.

**Use of deemed cost for investments in subsidiaries, joint ventures and associates**

- 31 Similarly, if an entity uses a deemed cost in its opening Ind AS Balance Sheet for an investment in a subsidiary, joint venture or associate in its separate financial statements (see paragraph D15), the entity's first Ind AS separate financial statements shall disclose:
  - (a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
  - (b) the aggregate deemed cost of those investments for which deemed cost is fair value; and
  - (c) the aggregate adjustment to the carrying amounts reported under previous GAAP.

**Use of deemed cost for oil and gas assets**

- 31A If an entity uses the exemption in paragraph D8A(b) for oil and gas assets, it shall disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated.

**Use of deemed cost for operations subject to rate regulation**

- 31B If an entity uses the exemption in paragraph D8B for operations subject to rate regulation, it shall disclose that fact and the basis on which carrying amounts were determined under previous GAAP.

**Use of deemed cost after severe hyperinflation**

- 31C If an entity elects to measure assets and liabilities at fair value and to use that fair value as the deemed cost in its opening Ind AS Balance Sheet because of severe hyperinflation (see paragraphs D26–D30), the entity's first Ind AS financial statements shall disclose an explanation of how, and why, the entity had, and then ceased to have, a functional currency that has both of the following characteristics:
  - (a) a reliable general price index is not available to all entities with transactions and balances in the currency.
  - (b) exchangeability between the currency and a relatively stable

foreign currency does not exist.

**Interim financial reports**

- 32 To comply with paragraph 23, if an entity presents an interim financial report in accordance with Ind AS 34 for part of the period covered by its first Ind AS financial statements, the entity shall satisfy the following requirements in addition to the requirements of Ind AS 34:
- (a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include:
    - (i) a reconciliation of its equity in accordance with previous GAAP at the end of that comparable interim period to its equity under Ind ASs at that date; and
    - (ii) a reconciliation to its total comprehensive income in accordance with Ind ASs for that comparable interim period (current and year to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.
  - (b) In addition to the reconciliations required by (a), an entity's first interim financial report in accordance with Ind AS 34 for part of the period covered by its first Ind AS financial statements shall include the reconciliations described in paragraph 24(a) and (b) (supplemented by the details required by paragraphs 25 and 26) or a cross-reference to another published document that includes these reconciliations.
  - (c) If an entity changes its accounting policies or its use of the exemptions contained in this Ind AS, it shall explain the changes in each such interim financial report in accordance with paragraph 23 and update the reconciliations required by (a) and (b).
- 33 Ind AS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have

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access to the most recent annual financial statements. However, Ind AS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its most recent annual financial statements in accordance with previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it.

## **<sup>2</sup>Effective Date**

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<sup>2</sup> Heading and paragraphs 34-39AC inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

\* Refer Appendix 1

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- 39K \*
- 39L \*
- 39M \*
- 39N \*
- 39O \*
- 39P \*
- 39Q \*
- 39R \*
- 39S \*
- 39T \*
- 39U \*
- 39V \*
- 39W \*
- 39X As a consequence of issuance of Ind AS 115, *Revenue from Contracts with Customers*, paragraphs D1(m),(u), D22 and heading after paragraph D33 are amended, paragraphs D34-D35 are added and earlier paragraph D36 in context of 'Transfer of assets from customers' is deleted. An entity shall apply those amendments when it applies Ind AS 115.
- 39Y \*
- 39Z \*
- 39AA \*
- 39AB \*
- 39AC Appendix B, *Foreign Currency Transactions and Advance Consideration* of Ind AS 21 added paragraph D36 in context of foreign currency transactions and advance consideration and in paragraph D1, renumbered item (v) as (ua) and a new item (v) is added in its place. An entity shall apply that amendment when it applies Appendix B of Ind AS 21.

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\* Refer Appendix 1

## Appendix A

### Defined terms

*This appendix is an integral part of this Ind AS.*

<b>date of transition to Ind ASs</b>	The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in <b>first Ind AS financial statements</b>
<b>deemed cost</b>	An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
<b>fair value</b>	<i>Fair value</i> is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113.)
<b>first Ind AS financial statements</b>	The first annual financial statements in which an entity adopts <i>Indian Accounting Standards</i> (Ind ASs), by an explicit and unreserved statement of compliance with Ind ASs.
<b>first Ind AS reporting period</b>	The latest reporting period covered by an entity's <b>first Ind AS financial statements</b>
<b>first-time adopter</b>	An entity that presents its <b>first Ind AS financial statements</b> .
<b>Indian Accounting Standards (Ind ASs)</b>	Ind ASs are Accounting Standards prescribed under Section 133 of the Companies Act, 2013.
<b>opening Ind AS Balance Sheet</b>	An entity's Balance Sheet at the <b>date of transition to Ind ASs</b> .
<b>previous GAAP</b>	The basis of accounting that a <b>first-time adopter</b>

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used for its statutory reporting requirement in India immediately before adopting Ind AS's. For instance, companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements.

## Appendix B

### Exceptions to the retrospective application of other Ind ASs

*This appendix is an integral part of this Ind AS.*

- B1 An entity shall apply the following exceptions:
- (a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);
  - (b) hedge accounting (paragraphs B4–B6);
  - (c) non-controlling interests (paragraph B7);
  - (d) classification and measurement of financial assets (paragraphs B8-B8C);
  - (e) impairment of financial assets (paragraphs B8D-B8G);
  - (f) embedded derivatives (paragraph B9); and
  - (g) government loans (paragraphs B10–B12).

#### **Derecognition of financial assets and financial liabilities**

- B2 Except as permitted by paragraph B3, a first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind ASs. For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind ASs, it shall not recognise those assets and liabilities in accordance with Ind ASs (unless they qualify for recognition as a result of a later transaction or event).
- B3 Despite paragraph B2, an entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of the entity's choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for

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those transactions.

### **Hedge accounting**

- B4 As required by Ind AS 109, at the date of transition to Ind ASs an entity shall:
- (a) measure all derivatives at fair value; and
  - (b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.
- B5 An entity shall not reflect in its opening Ind AS Balance Sheet a hedging relationship of a type that does not qualify for hedge accounting in accordance with Ind AS 109 (for example, many hedging relationships where the hedging instrument is a stand-alone written option or a net written option; or where the hedged item is a net position in a cash flow hedge for another risk than foreign currency risk). However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate as a hedged item in accordance with Ind ASs an individual item within that net position, or a net position if that meets the requirements in paragraph 6.6.1 of Ind AS 109, provided that it does so no later than the date of transition to Ind ASs.
- B6 If, before the date of transition to Ind ASs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in Ind AS 109, the entity shall apply paragraphs 6.5.6 and 6.5.7 of Ind AS 109 to discontinue hedge accounting. Transactions entered into before the date of transition to Ind ASs shall not be retrospectively designated as hedges.

### **Non-controlling interests**

- B7 A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind ASs:
- (a) the requirement in paragraph B94 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
  - (b) the requirements in paragraphs 23 and B96 for accounting

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for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

- (c) the requirements in paragraphs B97–B99 for accounting for a loss of control over a subsidiary, and the related requirements of paragraph 8A of Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.

However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 in accordance with paragraph C1 of this Ind AS.

**Classification and measurement of financial assets**

- B8 An entity shall assess whether a financial asset meets the conditions in paragraph 4.1.2 or the conditions in paragraph 4.1.2A of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs.
- B8A If it is impracticable to assess a modified time value of money element in accordance with paragraphs B4.1.9B–B4.1.9D of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind ASs without taking into account the requirements related to the modification of the time value of money element in paragraphs B4.1.9B–B4.1.9D of Ind AS 109. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the date of transition to Ind ASs without taking into account the requirements related to the modification of the time value of money element in paragraphs B4.1.9B–B4.1.9D of Ind AS 109 until those financial assets are derecognized.
- B8B If it is impracticable to assess whether the fair value of a prepayment feature is insignificant in accordance with paragraph B4.1.12(c) of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the

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basis of the facts and circumstances that existed at the date of transition to Ind ASs without taking into account the exception for prepayment features in paragraph B4.1.12 of Ind AS 109. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the date of transition to Ind ASs without taking into account the exception for prepayment features in paragraph B4.1.12 of Ind AS 109 until those financial assets are derecognised.

- B8C If it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind ASs shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind ASs.

**Impairment of financial assets**

- B8D An entity shall apply the impairment requirements in Section 5.5 of Ind AS 109 retrospectively subject to paragraphs B8E, B8F and B8G of this Ind AS.
- B8E At the date of transition to Ind ASs, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised (or for loan commitments and financial guarantee contracts the date that the entity became a party to the irrevocable commitment in accordance with paragraph 5.5.6 of Ind AS 109) and compare that to the credit risk at the date of transition to Ind ASs (also see paragraphs B8EA–B8EB of this Ind AS).
- B8EA An entity should seek to approximate the credit risk on initial recognition by considering all reasonable and supportable information that is available without undue cost or effort. An entity is not required to undertake an exhaustive search for information when determining, at the date of transition to Ind ASs, whether there have been significant increases in credit risk since initial recognition. If an entity is unable to make this determination without undue cost or effort paragraph B8G of this Ind AS applies.

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- B8EB In order to determine the loss allowance on financial instruments initially recognised (or loan commitments or financial guarantee contracts to which the entity became a party to the contract) prior to the date of initial application, both on transition and until the derecognition of those items, an entity shall consider information that is relevant in determining or approximating the credit risk at initial recognition. In order to determine or approximate the initial credit risk, an entity may consider internal and external information, including portfolio information, in accordance with paragraphs B5.5.1–B5.5.6 of Ind AS 109.
- B8F When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:
- (a) the requirements in paragraph 5.5.10 and B5.5.22–B5.5.24 of Ind AS 109; and
  - (b) the rebuttable presumption in paragraph 5.5.11 of Ind AS 109 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.
- B8G If, at the date of transition to Ind ASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised (unless that financial instrument is low credit risk at a reporting date, in which case paragraph B8F(a) applies).

**Embedded derivatives**

- B9 A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph B4.3.11 of Ind AS 109.

## **Government loans**

- B10 A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, *Financial Instruments: Presentation*. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in Ind AS 109, *Financial Instruments*, and Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind ASs as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind ASs.
- B11 Despite paragraph B10, an entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government loan originated before the date of transition to Ind ASs, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.
- B12 The requirements and guidance in paragraphs B10 and B11 do not preclude an entity from being able to use the exemptions described in paragraphs D19–D19C relating to the designation of previously recognised financial instruments at fair value through profit or loss.

## Appendix C

### Exemptions for business combinations

*This appendix is an integral part of this Ind AS. An entity shall apply the following requirements to business combinations that the entity recognised before the date of transition to Ind ASs. This Appendix should only be applied to business combinations within the scope of Ind AS 103, Business Combinations.*

- C1 A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind ASs). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2010, it shall restate all business combinations that occurred between 30 June 2010 and the date of transition to Ind ASs, and it shall also apply Ind AS 110 from 30 June 2010.
- C2 An entity need not apply Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to Ind ASs. If the entity does not apply Ind AS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.
- C3 An entity may apply Ind AS 21 retrospectively to fair value adjustments and goodwill arising in either:
- (a) all business combinations that occurred before the date of transition to Ind ASs; or
  - (b) all business combinations that the entity elects to restate to comply with Ind AS 103, as permitted by paragraph C1 above.

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C4 If a first-time adopter does not apply Ind AS 103 retrospectively to a past business combination, this has the following consequences for that business combination:

- (a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.
- (b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to Ind ASs that were acquired or assumed in a past business combination, other than:
  - (i) some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph B2); and
  - (ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated Balance Sheet in accordance with previous GAAP and also would not qualify for recognition in accordance with Ind ASs in the separate Balance Sheet of the acquiree (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g)(i) below).

- (c) The first-time adopter shall exclude from its opening Ind AS Balance Sheet any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under Ind ASs. The first-time adopter shall account for the resulting change as follows:
  - (i) the first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with Ind AS 38, *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and

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non-controlling interests) as part of goodwill (unless it deducted goodwill directly from equity in accordance with previous GAAP, see (g)(i) and (i) below) or capital reserve to the extent not exceeding the balance available in that reserve.

- (ii) the first-time adopter shall recognise all other resulting changes in retained earnings.<sup>3</sup>
- (d) Ind ASs require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure these assets and liabilities on that basis in its opening Ind AS Balance Sheet, even if they were acquired or assumed in a past business combination. It shall recognise any resulting change in the carrying amount by adjusting retained earnings (or, if appropriate, another category of equity), rather than goodwill/capital reserve.
- (e) Immediately after the business combination, the carrying amount in accordance with previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost in accordance with Ind ASs at that date. If Ind ASs require a cost-based measurement of those assets and liabilities at a later date that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.
- (f) If an asset acquired, or liability assumed, in a past business combination was not recognised in accordance with

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<sup>3</sup> Such changes include reclassifications from or to intangible assets if goodwill was not recognised in accordance with previous GAAP as an asset. This arises if, in accordance with previous GAAP, the entity (a) deducted goodwill directly from equity or (b) did not treat the business combination as an acquisition or (c) recognised capital reserve in a business combination accounted for as an acquisition and the amount of reclassification mentioned in (i) above exceeds the balance available in that reserve.

previous GAAP, it does not have a deemed cost of zero in the opening Ind AS Balance Sheet. Instead, the acquirer shall recognise and measure it in its consolidated Balance Sheet on the basis that Ind ASs would require in the Balance Sheet of the acquiree. To illustrate: if the acquirer had not, in accordance with its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as Ind AS 17, *Leases*, would require the acquiree to do in its Ind AS Balance Sheet. Similarly, if the acquirer had not, in accordance with its previous GAAP, recognised a contingent liability that still exists at the date of transition to Ind ASs, the acquirer shall recognise that contingent liability at that date unless Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, would prohibit its recognition in the financial statements of the acquiree. Conversely, if an asset or liability was subsumed in goodwill/capital reserve in accordance with previous GAAP but would have been recognised separately under Ind AS 103, that asset or liability remains in goodwill/capital reserve unless Ind ASs would require its recognition in the financial statements of the acquiree.

- (g) The carrying amount of goodwill or capital reserve in the opening Ind AS Balance Sheet shall be its carrying amount in accordance with previous GAAP at the date of transition to Ind ASs, after the following two adjustments:
  - (i) If required by (c)(i) above, the first-time adopter shall increase the carrying amount of goodwill or decrease the carrying amount of capital reserve when it reclassifies an item that it recognised as an intangible asset in accordance with previous GAAP. Similarly, if (f) above requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill or capital reserve in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill or increase the carrying amount of capital reserve accordingly (and, if applicable, adjust deferred tax and non-controlling interests).

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- (ii) Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply Ind AS 36 in testing the goodwill for impairment at the date of transition to Ind ASs and in recognising any resulting impairment loss in retained earnings (or, if so required by Ind AS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to Ind ASs.
- (h) No other adjustments shall be made to the carrying amount of goodwill / capital reserve at the date of transition to Ind ASs. For example, the first-time adopter shall not restate the carrying amount of goodwill / capital reserve:
- (i) to exclude in-process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition in accordance with Ind AS 38 in the Balance Sheet of the acquiree);
  - (ii) to adjust previous amortisation of goodwill;
  - (iii) to reverse adjustments to goodwill that Ind AS 103 would not permit, but were made in accordance with previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to Ind ASs.
- (i) If the first-time adopter recognised goodwill in accordance with previous GAAP as a deduction from equity:
- (i) it shall not recognise that goodwill in its opening Ind AS Balance Sheet. Furthermore, it shall not reclassify that goodwill to profit or loss if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.
  - (ii) adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings.
- (j) In accordance with its previous GAAP, the first-time adopter may not have consolidated a subsidiary acquired in a past business combination (for example, because the parent did

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not regard it as a subsidiary in accordance with previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that Ind ASs would require in the subsidiary's Balance Sheet. The deemed cost of goodwill equals the difference at the date of transition to Ind ASs between:

- (i) the parent's interest in those adjusted carrying amounts; and
  - (ii) the cost in the parent's separate financial statements of its investment in the subsidiary.
- (k) The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect non-controlling interests and deferred tax.

C5 The exemption for past business combinations also applies to past acquisitions of investments in associates, interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes a business, as defined in Ind AS 103. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

## Appendix D

### Exemptions from other Ind ASs

*This appendix is an integral part of this Ind AS.*

- D1 An entity may elect to use one or more of the following exemptions:
- (a) share-based payment transactions (paragraphs D2 and D3);
  - (b) insurance contracts (paragraph D4);
  - (c) deemed cost (paragraphs D5–D8B);
  - (d) leases (paragraphs D9 and D9AA);
  - (e) [Refer to Appendix 1]
  - (f) cumulative translation differences (paragraphs D12 and D13);
  - (g) investments in subsidiaries, joint ventures and associates (paragraphs D14 and D15);
  - (h) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs D16 and D17);
  - (i) compound financial instruments (paragraph D18);
  - (j) designation of previously recognised financial instruments (paragraphs D19–D19C);
  - (k) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph D20);
  - (l) decommissioning liabilities included in the cost of property, plant and equipment (paragraphs D21 and D21A);
  - (m) <sup>4</sup> financial assets or intangible assets accounted for in accordance with Appendix D to Ind AS 115 Service Concession Arrangements (paragraph D22);
  - (n) borrowing costs (paragraph D23);

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<sup>4</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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- (o) [Refer to Appendix 1];
- (p) extinguishing financial liabilities with equity instruments (paragraph D25);
- (q) severe hyperinflation (paragraphs D26–D30);
- (r) joint arrangements (paragraphs D31-D31AL);
- (s) stripping costs in the production phase of a surface mine (paragraph D32);
- (t) designation of contracts to buy or sell a non-financial item (paragraph D33);
- (u) <sup>5</sup>revenue (paragraphs D34-D35);
- (ua) <sup>6</sup>non-current assets held for sale and discontinued operations (paragraph D35AA); and
- (v) <sup>7</sup>foreign currency transactions and advance consideration (paragraph D36).

An entity shall not apply these exemptions by analogy to other items.

### **Share-based payment transactions**

- D2 A first-time adopter is encouraged, but not required, to apply Ind AS 102 *Share-based payment* to equity instruments that vested before date of transition to Ind ASs. However, if a first-time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102. For all grants of equity instruments to which Ind AS 102 has not been applied (eg, equity instruments vested but not settled before date of transition to Ind ASs, a first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of Ind AS 102. If a first-time adopter modifies the terms or

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<sup>5</sup> Substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>6</sup> Renumbered vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>7</sup> Inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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conditions of a grant of equity instruments to which Ind AS 102 has not been applied, the entity is not required to apply paragraphs 26–29 of Ind AS 102 if the modification occurred before the date of transition to Ind ASs.

- D3 A first-time adopter is encouraged, but not required, to apply Ind AS 102 to liabilities arising from share-based payment transactions that were settled before the date of transition to Ind ASs.

### **Insurance contracts**

- D4 An entity shall apply Ind AS 104 Insurance Contracts for annual periods beginning on or after date of transition to Ind ASs. Earlier application is encouraged. If an entity applies this Ind AS 104 for an earlier period, it shall disclose that fact.

In applying paragraph 39(c)(iii), of Ind AS 104 an entity need not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies Ind AS 104. Furthermore, if it is impracticable, when an entity first applies Ind AS 104, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this Ind AS, the entity shall disclose that fact.

When an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as 'at fair value through profit or loss'. This reclassification is permitted if an insurer changes accounting policies when it first applies Ind AS 104 and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and Ind AS 8 applies.

### **Deemed cost**

- D5 An entity may elect to measure an item of property, plant and equipment at the date of transition to Ind ASs at its fair value and use that fair value as its deemed cost at that date.
- D6 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to Ind ASs as deemed cost at the date of the revaluation, if

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the revaluation was, at the date of the revaluation, broadly comparable to:

- (a) fair value; or
- (b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index.

D7 <sup>8</sup>The elections in paragraphs D5 and D6 are also available for:

- (a) Omitted<sup>9</sup>
- (b) intangible assets that meet:
  - (i) the recognition criteria in Ind AS 38 (including reliable measurement of original cost); and
  - (ii) the criteria in Ind AS 38 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

D7AA Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of this Ind AS. For this purpose, if the financial statements are consolidated financial statements, the previous GAAP amount of the subsidiary shall be that amount used in preparing and presenting consolidated financial statements. Where a subsidiary was not consolidated under previous GAAP, the amount required to be reported by the subsidiary as per previous GAAP in its individual financial statements shall be the previous GAAP amount. If an entity avails the option under this paragraph, no further adjustments to the

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<sup>8</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>9</sup> Refer Appendix 1

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deemed cost of the property, plant and equipment so determined in the opening balance sheet shall be made for transition adjustments that might arise from the application of other Ind ASs. This option can also be availed for intangible assets covered by Ind AS 38, Intangible Assets and investment property covered by Ind AS 40, *Investment Property*.

- D8 A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatization or initial public offering.
- (a) If the measurement date is at or before the date of transition to Ind ASs, the entity may use such event-driven fair value measurements as deemed cost for Ind ASs at the date of that measurement.
  - (b) If the measurement date is after the date of transition to Ind ASs, but during the period covered by the first Ind AS financial statements, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or if appropriate, another category of equity) at the measurement date. At the date of transition to Ind ASs, the entity shall either establish the deemed cost by applying the criteria in paragraphs D5–D7 or measure assets and liabilities in accordance with the other requirements in this Ind AS.
- D8A Under some GAAP's exploration and development costs for oil and gas properties in the development or production phases are accounted for in cost centers that include all properties in a large geographical area. A first-time adopter using such accounting under previous GAAP may elect to measure oil and gas assets at the date of transition to Ind ASs on the following basis:
- (a) exploration and evaluation assets at the amount determined under the entity's previous GAAP; and
  - (b) assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP. The entity shall allocate this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

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The entity shall test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to Ind ASs in accordance with Ind AS 106, *Exploration for and Evaluation of Mineral Resources*, or Ind AS 36 respectively and, if necessary, reduce the amount determined in accordance with (a) or (b) above. For the purposes of this paragraph, oil and gas assets comprise only those assets used in the exploration, evaluation, development or production of oil and gas.

- D8B Some entities hold items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. The carrying amount of such items might include amounts that were determined under previous GAAP but do not qualify for capitalisation in accordance with Ind ASs. If this is the case, a first-time adopter may elect to use the previous GAAP carrying amount of such an item at the date of transition to Ind ASs as deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. At the date of transition to Ind ASs, an entity shall test for impairment in accordance with Ind AS 36 each item for which this exemption is used. For the purposes of this paragraph, operations are subject to rate regulation if they are governed by a framework for establishing the prices that can be charged to customers for goods or services and that framework is subject to oversight and/or approval by a rate regulator (as defined in Ind AS 114, *Regulatory Deferral Accounts*).

### Leases

- D9 A first-time adopter may apply paragraphs 6-9 of the Appendix C of Ind AS 17 *Determining whether an Arrangement contains a Lease* to determine whether an arrangement existing at the date of transition to Ind ASs contains a lease on the basis of facts and circumstances existing at the date of transition to Ind AS, except where the effect is expected to be not material.
- D9A If a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by Appendix C of Ind AS 17 but at a date other than that required by D9 above, the first-time adopter need not reassess that determination when it adopts Ind ASs. For an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, that determination would

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have to have given the same outcome as that resulting from applying Ind AS 17, *Leases*, and Appendix C of Ind AS 17.

D9AA When a lease includes both land and building elements, a first time adopter may assess the classification of each element as finance or an operating lease at the date of transition to Ind ASs on the basis of the facts and circumstances existing as at that date. If there is any land lease newly classified as finance lease then the first time adopter may recognise assets and liability at fair value on that date; and any difference between those fair values is recognised in retained earnings.

D10-D11 [Refer to Appendix 1]

### **Cumulative translation differences**

D12 Ind AS 21 requires an entity:

- (a) to recognise some translation differences in other comprehensive income and accumulate these in a separate component of equity; and
- (b) on disposal of a foreign operation, to reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) from equity to profit or loss as part of the gain or loss on disposal.

D13 However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to Ind ASs. If a first-time adopter uses this exemption:

- (a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind ASs; and
- (b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind ASs and shall include later translation differences.

### **Long Term Foreign Currency Monetary Items**

D13AA A first-time adopter may continue the policy adopted for accounting

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for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

**Investments in subsidiaries, joint ventures and associates**

D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:

- (a) at cost; or
- (b) in accordance with Ind AS 109.

D15 If a first-time adopter measures such an investment at cost in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:

- (a) cost determined in accordance with Ind AS 27; or
- (b) deemed cost. The deemed cost of such an investment shall be its:
  - (i) fair value at the entity's date of transition to Ind ASs in its separate financial statements; or
  - (ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, joint venture or associate that it elects to measure using a deemed cost.

**Assets and liabilities of subsidiaries, associates and joint ventures**

D16 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

- (a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to Ind ASs, if no adjustments were made for consolidation procedures and for the effects of the

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business combination in which the parent acquired the subsidiary (this election is not available to a subsidiary of an investment entity, as defined in Ind AS 110, that is required to be measured at fair value through profit or loss); or

- (b) the carrying amounts required by the rest of this Ind AS, based on the subsidiary's date of transition to Ind ASs. These carrying amounts could differ from those described in (a):
  - (i) when the exemptions in this Ind AS result in measurements that depend on the date of transition to Ind ASs.
  - (ii) when the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in Ind AS 16 *Property, Plant and Equipment*, whereas the group may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

- D17 However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Notwithstanding this requirement, a non-investment entity parent shall not apply the exception to consolidation that is used by any investment entity subsidiaries. Similarly, if a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

### **Compound financial instruments**

- D18 Ind AS 32 *Financial Instruments: Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this Ind AS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind ASs.

### **Designation of previously recognised financial instruments**

- D19 Ind AS 109 permits a financial liability (provided it meets certain criteria) to be designated as a financial liability at fair value through profit or loss. Despite this requirement an entity is permitted to designate, at the date of transition to Ind ASs, any financial liability as at fair value through profit or loss provided the liability meets the criteria in paragraph 4.2.2 of Ind AS 109 at that date.
- D19A An entity may designate a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.1.5 of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs.
- D19B An entity may designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs.
- D19C For a financial liability that is designated as a financial liability at fair value through profit or loss, an entity shall determine whether the treatment in paragraph 5.7.7 of Ind AS 109 would create an accounting mismatch in profit or loss on the basis of the facts and circumstances that exist at the date of transition to Ind ASs.

### **Fair value measurement of financial assets or financial liabilities at initial recognition**

- D20 Despite the requirements of paragraphs 7 and 9 of this Ind AS, an entity may apply the requirements in paragraph B5.1.2A (b) of Ind AS 109 prospectively to transactions entered into on or after the date of transition to Ind ASs.

### **Decommissioning liabilities included in the cost of property, plant and equipment**

- D21 Appendix 'A' to Ind AS 16 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to Ind ASs. If a first-time adopter uses this exemption, it shall:
- (a) measure the liability as at the date of transition to Ind ASs in accordance with Ind AS 37;
  - (b) to the extent that the liability is within the scope of Appendix A of Ind AS 16, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and
  - (c) calculate the accumulated depreciation on that amount, as at the date of transition to Ind ASs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with Ind ASs.
- D21A An entity that uses the exemption in paragraph D8A(b) (for oil and gas assets in the development or production phases accounted for in cost centers that include all properties in a large geographical

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area under previous GAAP) shall, instead of applying paragraph D21 or Appendix A of Ind AS 16:

- (a) measure decommissioning, restoration and similar liabilities as at the date of transition to Ind ASs in accordance with Ind AS 37; and
- (b) recognise directly in retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to Ind ASs determined under the entity's previous GAAP.

**Financial assets or intangible assets accounted for in accordance with Appendix D, Service Concession Arrangements to Ind AS 115**

D22 <sup>10</sup>A first-time adopter may apply the following provisions while applying the Appendix D to Ind AS 115:

- (i) Subject to paragraph (ii), changes in accounting policies are accounted for in accordance with Ind AS 8, ie retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.
- (ii) If, for any particular service arrangement, it is impracticable for an operator to apply this Appendix retrospectively at the date of transition to Ind ASs, it shall:
  - (a) recognise financial assets and intangible assets that existed at the date of transition to Ind ASs;
  - (b) use the previous carrying amounts of those financial

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<sup>10</sup> Heading and opening paragraph substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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and intangible assets (however previously classified) as their carrying amounts as at that date; and

- (c) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.
- (iii) There are two aspects to retrospective determination: reclassification and remeasurement. It will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in an operator's Balance Sheet, but that retrospective remeasurement of service arrangement assets might not always be practicable. However, the fact should be disclosed.

### **Borrowing costs**

D23 [Refer to Appendix 1]

D24 [Refer to Appendix 1]

### **Extinguishing financial liabilities with equity instruments**

D25 A first-time adopter may apply the Appendix E of Ind AS 109 *Extinguishing Financial Liabilities with Equity Instruments* from the date of transition to Ind ASs.

### **Severe hyperinflation**

D26 If an entity has a functional currency that was, or is, the currency of a hyperinflationary economy, it shall determine whether it was subject to severe hyperinflation before the date of transition to Ind ASs. This applies to entities that are adopting Ind ASs for the first time, as well as entities that have previously applied Ind ASs.

D27 The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

- (a) a reliable general price index is not available to all entities with transactions and balances in the currency.
- (b) exchangeability between the currency and a relatively

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stable foreign currency does not exist.

- D28 The functional currency of an entity ceases to be subject to severe hyperinflation on the functional currency normalisation date. That is the date when the functional currency no longer has either, or both, of the characteristics in paragraph D27, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.
- D29 When an entity's date of transition to Ind ASs is on, or after, the functional currency normalisation date, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date at fair value on the date of transition to Ind ASs. The entity may use that fair value as the deemed cost of those assets and liabilities in the opening Ind AS Balance Sheet.
- D30 When the functional currency normalisation date falls within a 12-month comparative period, the comparative period may be less than 12 months, provided that a complete set of financial statements (as required by paragraph 10 of Ind AS 1) is provided for that shorter period.

### **Joint arrangements**

- D31 [Refer to Appendix 1]

### **Joint ventures - transition from proportionate consolidation to the equity method**

- D31AA When changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture at transition date to Ind ASs. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged.
- D31AB The balance of the investment in joint venture at the date of transition to Ind ASs, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at

initial recognition.

- D31AC A first-time adopter shall test investment in joint venture for impairment in accordance with Ind AS 36 at the date of transition to Ind ASs, regardless of whether there is any indication that the investment may be impaired. Any resulting impairment shall be recognised as an adjustment to retained earnings at the date of transition to Ind ASs. The initial recognition exception in paragraphs 15 and 24 of Ind AS 12 Income Taxes does not apply when the entity recognises an investment in a joint venture resulting from applying the transition requirements for joint ventures that had previously been proportionately consolidated.
- D31AD If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, an entity shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the entity shall recognise the corresponding liability. If the entity concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognise the corresponding liability but it shall adjust retained earnings at the date of transition to Ind ASs. The entity shall disclose this fact, along with its cumulative unrecognised share of losses of its joint ventures at the date of transition to Ind ASs.
- D31AE An entity shall disclose a breakdown of the assets and liabilities that have been aggregated into the single line investment balance at the date of transition to Ind ASs. That disclosure shall be prepared in an aggregated manner for all joint ventures at the date of transition to Ind ASs.
- D31AF After initial recognition at the date of transition to Ind ASs, an entity shall account for its investment in the joint venture using the equity method in accordance with Ind AS 28.

### **Joint operations—transition from the equity method to accounting for assets and liabilities**

- D31AG When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the date of transition to Ind ASs, derecognise the investment that was previously accounted for using the equity method and any other

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items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of Ind AS 28 and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.

- D31AH An entity shall determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in a specified proportion in accordance with the contractual arrangement. An entity measures the initial carrying amounts of the assets and liabilities by disaggregating them from the carrying amount of the investment at the date of transition to Ind ASs on the basis of the information used by the entity in applying the equity method.
- D31AI Any difference arising from the investment previously accounted for using the equity method together with any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of Ind AS 28, and the net amount of the assets and liabilities, including any goodwill, recognised shall be:
- (a) offset against any goodwill relating to the investment with any remaining difference adjusted against retained earnings at the date of transition to Ind ASs, if the net amount of the assets and liabilities, including any goodwill, recognised is higher than the investment (and any other items that formed part of the entity's net investment) derecognised.
  - (b) adjusted against retained earnings at the date of transition to Ind ASs, if the net amount of the assets and liabilities, including any goodwill, recognised is lower than the investment (and any other items that formed part of the entity's net investment) derecognised.
- D31AJ An entity changing from the equity method to accounting for assets and liabilities shall provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted against retained earnings, at the date of transition to Ind ASs.
- D31AK The initial recognition exception in paragraphs 15 and 24 of Ind AS 12 does not apply when the entity recognises assets and liabilities relating to its interest in a joint operation.

### **Transition provisions in an entity's separate financial statements**

- D31AL An entity that, in accordance with paragraph 10 of Ind AS 27, was previously accounting in its separate financial statements for its interest in a joint operation as an investment at cost or in accordance with Ind AS 109 shall:
- (a) derecognise the investment and recognise the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs D31AG – D31AI.
  - (b) provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted in retained earnings, at the date of transition to Ind ASs.

### **Stripping costs in the production phase of a surface mine**

- D32 A first-time adopter may apply the Appendix B of Ind AS 16 *Stripping Costs in the Production Phase of a Surface Mine* from the date of transition to Ind ASs. As at transition date to Ind ASs, any previously recognised asset balance that resulted from stripping activity undertaken during the production phase ('predecessor stripping asset') shall be reclassified as a part of an existing asset to which the stripping activity related, to the extent that there remains an identifiable component of the ore body with which the predecessor stripping asset can be associated. Such balances shall be depreciated or amortised over the remaining expected useful life of the identified component of the ore body to which each predecessor stripping asset balance relates. If there is no identifiable component of the ore body to which that predecessor stripping asset relates, it shall be recognised in opening retained earnings at the transition date to Ind ASs.

### **Designation of contracts to buy or sell a non-financial item**

- D33 Ind AS 109 permits some contracts to buy or sell a non-financial item to be designated at inception as measured at fair value through profit or loss (see paragraph 2.5 of Ind AS 109). Despite this requirement an entity is permitted to designate, at the date of transition to Ind ASs, contracts that already exist on that date as measured at fair value through profit or loss but only if they meet the requirements of paragraph 2.5 of Ind AS 109 at that date and the entity designates all similar contracts.

### **<sup>11</sup>Revenue**

- D34 <sup>12</sup>A first-time adopter may apply the transition provisions in paragraph C5 of Ind AS 115. In those paragraphs references to the 'date of initial application' shall be interpreted as the beginning of the first Ind AS reporting period. If a first-time adopter decides to apply those transition provisions, it shall also apply paragraph C6 of Ind AS 115.

- D34AA Omitted<sup>13</sup>

- D35 <sup>14</sup>A first-time adopter is not required to restate contracts that were completed before the earliest period presented. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with previous GAAP.

### **Non-current assets held for sale and discontinued operations**

- D35AA Ind AS 105 requires non-current assets (or disposal groups) that meet the criteria to be classified as held for sale, non-current assets

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<sup>11</sup> Substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>12</sup> Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and thereafter, inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>13</sup> Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>14</sup> Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and thereafter, inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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(or disposal groups) that are held for distribution to owners and operations that meet the criteria to be classified as discontinued and carried at lower of its carrying amount and fair value less cost to sell on the initial date of such identification. A first time adopter can:

- (a) measure such assets or operations at the lower of carrying value and fair value less cost to sell at the date of transition to Ind ASs in accordance with Ind AS 105; and
- (b) recognise directly in retained earnings any difference between that amount and the carrying amount of those assets at the date of transition to Ind ASs determined under the entity's previous GAAP.

**Foreign Currency Transactions and Advance Consideration**

- D36 <sup>15</sup>A first-time adopter need not apply Appendix B, *Foreign Currency Transactions and Advance Consideration* of Ind AS 21 to assets, expenses and income in the scope of that Appendix initially recognised before the date of transition to Ind AS Standards.

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<sup>15</sup> Paragraph and heading inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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## **Appendix E**

### **Short-term exemptions from Ind ASs**

[Refer to Appendix 1]

## **Appendix 1**

*Note: This Appendix is not a part of the Ind AS 101, First-time Adoption of Indian Accounting Standards. The purpose of this Appendix is only to highlight major differences between Ind AS 101 and corresponding International Financial Reporting Standard (IFRS) 1, First-time Adoption of International Financial Reporting Standards.*

### **Major differences between Indian Accounting Standard (Ind AS) 101 First-time Adoption of Indian Accounting Standards and IFRS 1**

1. Paragraph 3 of Ind AS 101 specifies that an entity's first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs in accordance with Ind ASs notified under the Companies Act, 2013 whereas IFRS 1 provides various examples of first IFRS financial statements.
2. Paragraph 4, 4A, 4B, 23A and 23B of IFRS 1 provide various examples of instances when an entity does not apply this IFRS. Ind AS 101 does not provide the same. In order to maintain consistency with paragraph numbers of IFRS 1, the paragraph number is retained in Ind AS 101.
3. IFRS 1 defines previous GAAP as the basis of accounting that a first-time adopter used immediately before adopting IFRS. However, Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its reporting requirement in India immediately before adopting Ind AS.

The change makes it mandatory for Indian entities to consider the financial statements prepared in accordance with existing notified Indian accounting standards as was applicable to them as previous GAAP when it transitions to Ind ASs.

4. Under IFRS 1, para C4(c) requires, the first-time adopter shall exclude from its opening Ind AS Balance Sheet any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under Ind ASs. The first-time adopter shall account for the resulting change in the retained earnings as at the transition date except in certain specific instances where it requires adjustment in the goodwill. In such specific instances where IFRS 1 allows adjustment in the goodwill, under Ind AS 101 it can be adjusted with the Capital reserve to the extent such

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adjustment amount does not exceed the balance available in Capital reserve.

5. Ind AS 101 in addition to exemptions provided under IFRS 1, also provides certain optional exemptions relating to the long-term foreign currency monetary items and service concession arrangements relating to toll roads. Accordingly, paragraphs 6 and D22 have been modified. Further a heading and paragraph D13AA have been added after paragraph D13.
6. Certain IFRS 1 exceptions to the retrospective application of other IFRS refer to transitional provisions of other IFRSs. However Ind ASs does not provide transitional provisions, accordingly transitional provisions in other IFRSs have been incorporated in the paragraphs B8A, B8B, B8D, B8E, B8EA and B8EB of Ind AS 101.
7. Certain exemptions in Appendix D of IFRS 1 refer to transitional provisions of other IFRSs. However Ind ASs do not provide transitional provisions, accordingly wherever considered an appropriate transitional provision in other IFRSs has been incorporated in the respective exemptions in Appendix D of Ind AS 101. The following paragraphs in IFRS 1 provide the transitional provisions of other IFRSs which are included in Ind AS 101:
  - (i) Paragraph D4 includes the transitional provisions of IFRS 4 *Insurance Contracts*;
  - (ii) Paragraph D9 includes the transitional provisions of IFRIC 4 *Determining whether an Arrangement contains a Lease*;
  - (iii) Paragraph D22 includes the transitional provisions of IFRIC 12 *Service Concession Arrangements*;
  - (iv) Paragraph D25 includes the transitional provisions of IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*;
  - (v) Paragraph D31 includes the transitional provisions of IFRS 11 *Joint Arrangements*;
  - (vi) Paragraph D32 includes the transitional provisions of IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*; and
  - (vii) Paragraph D34 and D35 includes the transitional provisions of IFRS 15 *Revenue from contracts with customer*.

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8. IFRS 1 provides for various optional exemptions that an entity can seek while an entity transitions to IFRS from its previous GAAP. Similar provisions have been retained under Ind AS 101. However, there are few changes that have been made, which can be broadly categorized as follows:

(a) *Elimination of effective dates prior to transition date to Ind ASs. IFRS 1 provides for various dates from which a standard could have been implemented. For example,*

Paragraph D2 of IFRS 1 provides that an entity is encouraged, but not required, to apply IFRS 2 *Share-based Payment* to equity instruments that were granted on or before 7 November 2002 or to instruments that were granted after 7 November 2002 and vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, for Ind AS 101 purposes, all these dates have been changed to coincide with the transition date elected by the entity adopting these converged standards ie Ind AS.

(b) *Deletion of borrowing cost exemptions not relevant for India:*

Paragraph D23 of IFRS 1 provides for transitional adjustment requiring companies to apply the provisions of IAS 23 prospectively after the transition date to IFRS. However, this was considered as not relevant in Indian situation as AS 16 always required an entity to capitalize borrowing costs as compared to IAS 23 where it provided an option to expense out such borrowing cost.

(c) *Inclusion/modification of existing exemptions to make it relevant for India. For example,*

1. Paragraph D7AA has been added to provide for transitional relief from the retrospective application of Ind AS 16, *Property, Plant and Equipment*. Paragraph D7AA, provides an entity option to use carrying values of all such assets as on the date of transition to Ind ASs, in accordance with previous GAAP as an acceptable starting point under Ind AS. Paragraph 27AA has been included in Ind AS 101 which requires the disclosure that if an entity adopts for first time exemption the option provided in accordance with

paragraph D7AA, the fact and the accounting policy shall be disclosed by the entity until such time that those items of property, plant and equipment, investment properties or intangible assets, as the case may be, are significantly depreciated, impaired or derecognised from the entity's Balance Sheet.

2. Paragraph D9AA has been added to provide for transitional relief while applying Ind AS 17, *Leases*. D9AA provides an entity to use the transition date facts and circumstances for lease arrangements which includes both land and building elements to assess the classification of each element as finance or an operating lease at the transition date to Ind ASs. Also, if there is any land lease newly classified as finance lease then the first time adopter may recognise assets and liability at fair value on that date; any difference between those fair values is recognised in retained earnings.
3. Paragraph D35AA has been added to provide for transitional relief while applying Ind AS 105 - *Non-current Assets Held for Sale and Discontinued Operations*. Paragraph D35AA provides an entity to use the transitional date circumstances to measure such assets or operations at the lower of carrying value and fair value less cost to sell.
9. Appendix E of IFRS 1 on 'Short-term exemptions from IFRSs', however Ind AS 101 does not provide the above said short-term exemption. In order to maintain consistency with Appendix numbers of IFRS 1, the Appendix E is retained in Ind AS 101.
10. <sup>16</sup>IFRS 9 *Financial Instruments* is effective from annual period beginning on or after January 1, 2018. As the above said standard is not yet effective consequential amendments due to this standard

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<sup>16</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

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have not been incorporated in current version of IFRS 1. However, corresponding Ind AS 109, *Financial Instruments* has been issued with consequential amendments in other Ind ASs including Ind AS 101. Accordingly, its consequential amendments to Ind AS 109 have been incorporated in Ind AS 101.

11. Different terminology is used in Ind AS 101, e.g., the term 'Balance Sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.
12. Following paragraph numbers appear as 'deleted' in IFRS 1. In order to maintain consistency with paragraph numbers of IFRS 1, the paragraph numbers are retained in Ind AS 101:
  - (i) Paragraph 19
  - (ii) Paragraph D1(e)
  - (iii) Paragraph D1(o)
  - (iv) Paragraphs D10-11
  - (v) Paragraph D24
  - (vi) Paragraph D31
13. <sup>17</sup>IAS 40, *Investment Property* permits both cost model and fair value model (except in some situations) for measurement of investment properties after initial recognition. Ind AS 40, *Investment Property* permits only the cost model. As a consequence, paragraph 30 is amended and paragraph D7(a) is deleted.
14. <sup>18</sup>Paragraphs 34 to 39W and 39Y to 39AB have not been included in Ind AS 101 as these paragraphs relate to effective date and are not relevant in Indian context. However, in order to maintain consistency with paragraph numbers of IFRS 1, these paragraph numbers have been retained in Ind AS 101.

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<sup>17</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>18</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Indian Accounting Standard (Ind AS) 102

# Share-based Payment<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Standard is to specify the financial reporting by an entity when it undertakes a *share-based payment transaction*. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which *share options* are granted to employees.

## Scope

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- 2 An entity shall apply this Standard in accounting for all share-based payment transactions, whether or not the entity can identify specifically some or all of the goods or services received, including:
  - (a) *equity-settled share-based payment transactions*,
  - (b) *cash-settled share-based payment transactions*, and
  - (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments,except as noted in paragraphs 3A–6. In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this Standard applies.
- 3 [Refer Appendix 1]

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

*Share-based Payment*

- 3A A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. Paragraph 2 also applies to an entity that
- (a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or
  - (b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services
- unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.
- 4 For the purposes of this Standard, a transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. For example, if an entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class, the granting or exercise of that right is not subject to the requirements of this Standard.
- 5 As noted in paragraph 2, this Standard applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. However, an entity shall not apply this Standard to transactions in which the entity acquires goods as part of the net assets acquired in a business combination as defined by Ind AS 103, *Business Combinations*, in a combination of entities or businesses under common control as described in Appendix C of Ind AS 103, or the contribution of a business on the formation of a joint venture as defined by Ind AS 111, *Joint Arrangements*. Hence, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of this Standard. However, equity instruments granted to employees of the acquiree in their capacity as employees (eg in return for continued service) are within the scope of this Standard. Similarly, the cancellation,

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replacement or other modification of *share-based payment arrangements* because of a business combination or other equity restructuring shall be accounted for in accordance with this Standard. Ind AS 103 provides guidance on determining whether equity instruments issued in a business combination are part of the consideration transferred in exchange for control of the acquiree (and therefore within the scope of Ind AS 103) or are in return for continued service to be recognised in the post-combination period (and therefore within the scope of this Standard).

- 6 This Standard does not apply to share-based payment transactions in which the entity receives or acquires goods or services under a contract within the scope of paragraphs 8–10 of Ind AS 32, *Financial Instruments: Presentation*, or paragraphs 2.4–2.7 of Ind AS 109, *Financial Instruments*.
- 6A This Standard uses the term ‘fair value’ in a way that differs in some respects from the definition of fair value in Ind AS 113, *Fair Value Measurement*. Therefore, when applying Ind AS 102 an entity measures fair value in accordance with this Standard, not Ind AS 113.

## Recognition

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- 7 **An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.**
- 8 **When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.**
- 9 Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately, in which case an expense is recognised as the counterparty renders service. Goods might be consumed over a period of time or, in the case of inventories, sold at a later date, in which case an expense is

recognised when the goods are consumed or sold. However, sometimes it is necessary to recognise an expense before the goods or services are consumed or sold, because they do not qualify for recognition as assets. For example, an entity might acquire goods as part of the research phase of a project to develop a new product. Although those goods have not been consumed, they might not qualify for recognition as assets under the applicable Ind AS.

## **Equity-settled share-based payment transactions**

### **Overview**

- 10** For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to<sup>1</sup> the fair value of the equity instruments granted.
- 11 To apply the requirements of paragraph 10 to transactions with *employees and others providing similar services*,<sup>2</sup> the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received, as explained in paragraph 12. The fair value of those equity instruments shall be measured at *grant date*.
- 12 Typically, shares, share options or other equity instruments are granted to employees as part of their remuneration package, in

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<sup>1</sup> This Standard uses the phrase 'by reference to' rather than 'at', because the transaction is ultimately measured by multiplying the fair value of the equity instruments granted, measured at the date specified in paragraph 11 or 13 (whichever is applicable), by the number of equity instruments that vest, as explained in paragraph 19.

<sup>2</sup> In the remainder of this Standard, all references to employees also include others providing similar services.

addition to a cash salary and other employment benefits. Usually, it is not possible to measure directly the services received for particular components of the employee's remuneration package. It might also not be possible to measure the fair value of the total remuneration package independently, without measuring directly the fair value of the equity instruments granted. Furthermore, shares or share options are sometimes granted as part of a bonus arrangement, rather than as a part of basic remuneration, eg as an incentive to the employees to remain in the entity's employment or to reward them for their efforts in improving the entity's performance. By granting shares or share options, in addition to other remuneration, the entity is paying additional remuneration to obtain additional benefits. Estimating the fair value of those additional benefits is likely to be difficult. Because of the difficulty of measuring directly the fair value of the services received, the entity shall measure the fair value of the employee services received by reference to the fair value of the equity instruments granted.

To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service.

- 13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this Standard. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However,

for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

### Transactions in which services are received

- 14 If the equity instruments granted vest immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity.
- 15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:
- (a) if an employee is granted share options conditional upon completing three years' service, then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period.
  - (b) if an employee is granted share options conditional upon the achievement of a *performance condition* and remaining in the entity's employment until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. The entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a *market condition*, the estimate of the length of the expected

vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

## **Transactions measured by reference to the fair value of the equity instruments granted**

### **Determining the fair value of equity instruments granted**

- 16 For transactions measured by reference to the fair value of the equity instruments granted, an entity shall measure the fair value of equity instruments granted at the *measurement date*, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted (subject to the requirements of paragraphs 19–22).
- 17 If market prices are not available, the entity shall estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing financial instruments, and shall incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 19–22).
- 18 Appendix B contains further guidance on the measurement of the fair value of shares and share options, focusing on the specific terms and conditions that are common features of a grant of shares or share options to employees.

### **Treatment of vesting conditions**

- 19 <sup>3</sup>A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share

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<sup>3</sup> Substituted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

### Share-based Payment

options to an employee is typically conditional on the employee remaining in the entity's employment for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions, other than market conditions, shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a *vesting condition*, other than a market condition, for example, the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.

- 20 To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21.
- 21 Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.

**Treatment of non-vesting conditions**

- 21A Similarly, an entity shall take into account all non-vesting conditions when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with non-vesting conditions, the entity shall recognise the goods or services received from a counterparty that satisfies all vesting conditions that are not market conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether those non-vesting conditions are satisfied.

**Treatment of a reload feature**

- 22 For options with a *reload feature*, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a *reload option* shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

**After vesting date**

- 23 Having recognised the goods or services received in accordance with paragraphs 10–22, and a corresponding increase in equity, the entity shall make no subsequent adjustment to total equity after vesting date. For example, the entity shall not subsequently reverse the amount recognised for services received from an employee if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised. However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

**If the fair value of the equity instruments cannot be estimated reliably<sup>4</sup>**

- 24 The requirements in paragraphs 16–23 apply when the entity is required to measure a share-based payment transaction by reference to the fair value of the equity instruments granted. In rare cases, the entity may be unable to estimate reliably the fair value of

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<sup>4</sup> For example, in case of share options granted to employees, the credit given to an appropriate equity account, say, 'share options outstanding account' (upon receiving the services) may be transferred to another appropriate equity account, say, 'General Reserves' when the options are not exercised.

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the equity instruments granted at the measurement date, in accordance with the requirements in paragraphs 16–22. In these rare cases only, the entity shall instead:

- (a) measure the equity instruments at their *intrinsic value*, initially at the date the entity obtains the goods or the counterparty renders service and subsequently at the end of each reporting period and at the date of final settlement, with any change in intrinsic value recognised in profit or loss. For a grant of share options, the share-based payment arrangement is finally settled when the options are exercised, are forfeited (eg upon cessation of employment) or lapse (eg at the end of the option's life).
- (b) recognise the goods or services received based on the number of equity instruments that ultimately vest or (where applicable) are ultimately exercised. To apply this requirement to share options, for example, the entity shall recognise the goods or services received during the vesting period, if any, in accordance with paragraphs 14 and 15, except that the requirements in paragraph 15(b) concerning a market condition do not apply. The amount recognised for goods or services received during the vesting period shall be based on the number of share options expected to vest. The entity shall revise that estimate, if necessary, if subsequent information indicates that the number of share options expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. After vesting date, the entity shall reverse the amount recognised for goods or services received if the share options are later forfeited, or lapse at the end of the share option's life.

25 If an entity applies paragraph 24, it is not necessary to apply paragraphs 26–29, because any modifications to the terms and conditions on which the equity instruments were granted will be taken into account when applying the intrinsic value method set out in paragraph 24. However, if an entity settles a grant of equity instruments to which paragraph 24 has been applied:

- (a) if the settlement occurs during the vesting period, the entity shall account for the settlement as an acceleration of vesting,

and shall therefore recognise immediately the amount that would otherwise have been recognised for services received over the remainder of the vesting period.

- (b) any payment made on settlement shall be accounted for as the repurchase of equity instruments, ie as a deduction from equity, except to the extent that the payment exceeds the intrinsic value of the equity instruments, measured at the repurchase date. Any such excess shall be recognised as an expense.

### **Modifications to the terms and conditions on which equity instruments were granted, including cancellations and settlements**

- 26 An entity might modify the terms and conditions on which the equity instruments were granted. For example, it might reduce the exercise price of options granted to employees (ie reprice the options), which increases the fair value of those options. The requirements in paragraphs 27–29 to account for the effects of modifications are expressed in the context of share-based payment transactions with employees. However, the requirements shall also be applied to share-based payment transactions with parties other than employees that are measured by reference to the fair value of the equity instruments granted. In the latter case, any references in paragraphs 27–29 to grant date shall instead refer to the date the entity obtains the goods or the counterparty renders service.
- 27 The entity shall recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments. In addition, the entity shall recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. Guidance on applying this requirement is given in Appendix B.

- 28 If a grant of equity instruments is cancelled or settled during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):
- (a) the entity shall account for the cancellation or settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.
  - (b) any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense. However, if the share-based payment arrangement included liability components, the entity shall remeasure the fair value of the liability at the date of cancellation or settlement. Any payment made to settle the liability component shall be accounted for as an extinguishment of the liability.
  - (c) if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 27 and the guidance in Appendix B. The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new equity instruments granted as replacement equity

instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments.

- 28A If an entity or counterparty can choose whether to meet a non-vesting condition, the entity shall treat the entity's or counterparty's failure to meet that non-vesting condition during the vesting period as a cancellation.
- 29 If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

## **Cash-settled share-based payment transactions**

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- 30 **<sup>5</sup>For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability, subject to the requirements of paragraphs 31–33D. Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.**
- 31 <sup>6</sup>For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Alternatively, an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (for example, upon cessation of employment) or at the employee's option. These arrangements are examples of cash-settled share-based payment

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<sup>5</sup> Substituted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

<sup>6</sup> Substituted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

transactions. Share appreciation rights are used to illustrate some of the requirements in paragraphs 32–33D; however, the requirements in those paragraphs apply to all cash-settled share-based payment transactions.

- 32 The entity shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights vest immediately, and the employees are therefore not required to complete a specified period of service to become entitled to the cash payment. In the absence of evidence to the contrary, the entity shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the entity shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity shall recognise the services received, and a liability to pay for them, as the employees render service during that period.
- 33 <sup>7</sup>The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date subject to the requirements of paragraphs 33A–33D. An entity might modify the terms and conditions on which a cash-settled share-based payment is granted. Guidance for a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled is given in paragraphs B44A–B44C in Appendix B.

### **<sup>8</sup>Treatment of vesting and non-vesting conditions**

- 33A A cash-settled share-based payment transaction might be conditional upon satisfying specified vesting conditions. There might be performance conditions that must be satisfied, such as the entity

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<sup>7</sup> Substituted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

<sup>8</sup> Headings and paragraphs 33A–33H inserted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date. Instead, vesting conditions, other than market conditions, shall be taken into account by adjusting the number of awards included in the measurement of the liability arising from the transaction.

- 33B To apply the requirements in paragraph 33A, the entity shall recognise an amount for the goods or services received during the vesting period. That amount shall be based on the best available estimate of the number of awards that are expected to vest. The entity shall revise that estimate, if necessary, if subsequent information indicates that the number of awards that are expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of awards that ultimately vested.
- 33C Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, as well as non-vesting conditions, shall be taken into account when estimating the fair value of the cash-settled share-based payment granted and when remeasuring the fair value at the end of each reporting period and at the date of settlement.
- 33D As a result of applying paragraphs 30–33C, the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share-based payment is equal to the cash that is paid.

### **Share-based payment transactions with a net settlement feature for withholding tax obligations**

- 33E Tax laws or regulations may oblige an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf. To fulfil this obligation, the terms of the share-based payment arrangement may permit or require the entity to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued

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to the employee upon exercise (or vesting) of the share-based payment (ie the share-based payment arrangement has a 'net settlement feature').

- 33F As an exception to the requirements in paragraph 34, the transaction described in paragraph 33E shall be classified in its entirety as an equity-settled share-based payment transaction if it would have been so classified in the absence of the net settlement feature.
- 33G The entity applies paragraph 29 of this Standard to account for the withholding of shares to fund the payment to the tax authority in respect of the employee's tax obligation associated with the share-based payment. Therefore, the payment made shall be accounted for as a deduction from equity for the shares withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.
- 33H The exception in paragraph 33F does not apply to:
- (a) a share-based payment arrangement with a net settlement feature for which there is no obligation on the entity under tax laws or regulations to withhold an amount for an employee's tax obligation associated with that share-based payment; or
  - (b) any equity instruments that the entity withholds in excess of the employee's tax obligation associated with the share-based payment (ie the entity withheld an amount of shares that exceeds the monetary value of the employee's tax obligation). Such excess shares withheld shall be accounted for as a cash-settled share-based payment when this amount is paid in cash (or other assets) to the employee.

## **Share-based payment transactions with cash alternatives**

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- 34 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to**

**settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.**

**Share-based payment transactions in which the terms of the arrangement provide the counterparty with a choice of settlement**

- 35 If an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash<sup>9</sup> or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (ie the counterparty's right to demand payment in cash) and an equity component (ie the counterparty's right to demand settlement in equity instruments rather than in cash). For transactions with parties other than employees, in which the fair value of the goods or services received is measured directly, the entity shall measure the equity component of the compound financial instrument as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.
- 36 For other transactions, including transactions with employees, the entity shall measure the fair value of the compound financial instrument at the measurement date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted.
- 37 To apply paragraph 36, the entity shall first measure the fair value of the debt component, and then measure the fair value of the equity component—taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument. The fair value of the compound financial instrument is the sum of the fair values of the two components. However, share-based payment transactions in which the counterparty has the choice of settlement are often structured so that the fair value of one settlement alternative is the same as the other. For example, the counterparty might have the choice of receiving share options or cash-settled

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<sup>9</sup> In paragraphs 35–43, all references to cash also include other assets of the entity.

## *Share-based Payment*

share appreciation rights. In such cases, the fair value of the equity component is zero, and hence the fair value of the compound financial instrument is the same as the fair value of the debt component. Conversely, if the fair values of the settlement alternatives differ, the fair value of the equity component usually will be greater than zero, in which case the fair value of the compound financial instrument will be greater than the fair value of the debt component.

- 38 The entity shall account separately for the goods or services received or acquired in respect of each component of the compound financial instrument. For the debt component, the entity shall recognise the goods or services acquired, and a liability to pay for those goods or services, as the counterparty supplies goods or renders service, in accordance with the requirements applying to cash-settled share-based payment transactions (paragraphs 30–33). For the equity component (if any), the entity shall recognise the goods or services received, and an increase in equity, as the counterparty supplies goods or renders service, in accordance with the requirements applying to equity-settled share-based payment transactions (paragraphs 10–29).
- 39 At the date of settlement, the entity shall remeasure the liability to its fair value. If the entity issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued.
- 40 If the entity pays in cash on settlement rather than issuing equity instruments, that payment shall be applied to settle the liability in full. Any equity component previously recognised shall remain within equity. By electing to receive cash on settlement, the counterparty forfeited the right to receive equity instruments. However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

### **Share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement**

- 41 For a share-based payment transaction in which the terms of the arrangement provide an entity with the choice of whether to settle in

cash or by issuing equity instruments, the entity shall determine whether it has a present obligation to settle in cash and account for the share-based payment transaction accordingly. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (eg because the entity is legally prohibited from issuing shares), or the entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

- 42 If the entity has a present obligation to settle in cash, it shall account for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions, in paragraphs 30–33.
- 43 If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 10–29. Upon settlement:
- (a) if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except as noted in (c) below.
  - (b) if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below.
  - (c) if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, ie the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable.

## **Share-based payment transactions among group entities**

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- 43A For share-based payment transactions among group entities, in its separate or individual financial statements, the entity receiving the

### *Share-based Payment*

goods or services shall measure the goods or services received as either an equity-settled or a cash-settled share-based payment transaction by assessing:

- (a) the nature of the awards granted, and
- (b) its own rights and obligations.

The amount recognised by the entity receiving the goods or services may differ from the amount recognised by the consolidated group or by another group entity settling the share-based payment transaction.

43B The entity receiving the goods or services shall measure the goods or services received as an equity-settled share-based payment transaction when:

- (a) the awards granted are its own equity instruments, or
- (b) the entity has no obligation to settle the share-based payment transaction.

The entity shall subsequently remeasure such an equity-settled share-based payment transaction only for changes in non-market vesting conditions in accordance with paragraphs 19–21. In all other circumstances, the entity receiving the goods or services shall measure the goods or services received as a cash-settled share-based payment transaction.

43C The entity settling a share-based payment transaction when another entity in the group receives the goods or services shall recognise the transaction as an equity-settled share-based payment transaction only if it is settled in the entity's own equity instruments. Otherwise, the transaction shall be recognised as a cash-settled share-based payment transaction.

43D Some group transactions involve repayment arrangements that require one group entity to pay another group entity for the provision of the share-based payments to the suppliers of goods or services. In such cases, the entity that receives the goods or services shall account for the share-based payment transaction in accordance with paragraph 43B regardless of intragroup repayment arrangements.

## Disclosures

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- 44** An entity shall disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period.
- 45 To give effect to the principle in paragraph 44, the entity shall disclose at least the following:
- (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (eg whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information, unless separate disclosure of each arrangement is necessary to satisfy the principle in paragraph 44.
  - (b) the number and weighted average exercise prices of share options for each of the following groups of options:
    - (i) outstanding at the beginning of the period;
    - (ii) granted during the period;
    - (iii) forfeited during the period;
    - (iv) exercised during the period;
    - (v) expired during the period;
    - (vi) outstanding at the end of the period; and
    - (vii) exercisable at the end of the period.
  - (c) for share options exercised during the period, the weighted average share price at the date of exercise. If options were exercised on a regular basis throughout the period, the entity may instead disclose the weighted average share price during the period.
  - (d) for share options outstanding at the end of the period, the range of exercise prices and weighted average remaining

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contractual life. If the range of exercise prices is wide, the outstanding options shall be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

**46 An entity shall disclose information that enables users of the financial statements to understand how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined.**

47 If the entity has measured the fair value of goods or services received as consideration for equity instruments of the entity indirectly, by reference to the fair value of the equity instruments granted, to give effect to the principle in paragraph 46, the entity shall disclose at least the following:

- (a) for share options granted during the period, the weighted average fair value of those options at the measurement date and information on how that fair value was measured, including:
  - (i) the option pricing model used and the inputs to that model, including the weighted average share price, exercise price, expected volatility, option life, expected dividends, the risk-free interest rate and any other inputs to the model, including the method used and the assumptions made to incorporate the effects of expected early exercise;
  - (ii) how expected volatility was determined, including an explanation of the extent to which expected volatility was based on historical volatility; and
  - (iii) whether and how any other features of the option grant were incorporated into the measurement of fair value, such as a market condition.
- (b) for other equity instruments granted during the period (ie other than share options), the number and weighted average fair value of those equity instruments at the measurement date, and information on how that fair value was measured,

including:

- (i) if fair value was not measured on the basis of an observable market price, how it was determined;
  - (ii) whether and how expected dividends were incorporated into the measurement of fair value; and
  - (iii) whether and how any other features of the equity instruments granted were incorporated into the measurement of fair value.
- (c) for share-based payment arrangements that were modified during the period:
- (i) an explanation of those modifications;
  - (ii) the incremental fair value granted (as a result of those modifications); and
  - (iii) information on how the incremental fair value granted was measured, consistently with the requirements set out in (a) and (b) above, where applicable.

48 If the entity has measured directly the fair value of goods or services received during the period, the entity shall disclose how that fair value was determined, eg whether fair value was measured at a market price for those goods or services.

49 If the entity has rebutted the presumption in paragraph 13, it shall disclose that fact, and give an explanation of why the presumption was rebutted.

50 **An entity shall disclose information that enables users of the financial statements to understand the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.**

51 To give effect to the principle in paragraph 50, the entity shall disclose at least the following:

- (a) the total expense recognised for the period arising from share-based payment transactions in which the goods or services received did not qualify for recognition as assets and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that

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arises from transactions accounted for as equity-settled share-based payment transactions;

- (b) for liabilities arising from share-based payment transactions:
  - (i) the total carrying amount at the end of the period; and
  - (ii) the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (eg vested share appreciation rights).

52 <sup>10</sup>If the information required to be disclosed by this Standard does not satisfy the principles in paragraphs 44, 46 and 50, the entity shall disclose such additional information as is necessary to satisfy them. For example, if an entity has classified any share-based payment transactions as equity-settled in accordance with paragraph 33F, the entity shall disclose an estimate of the amount that it expects to transfer to the tax authority to settle the employee's tax obligation when it is necessary to inform users about the future cash flow effects associated with the share-based payment arrangement.

## **<sup>11</sup>Transitional provisions**

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53-59 [Refer Appendix 1]

59A An entity shall apply the amendments in paragraphs 30–31, 33–33H and B44A–B44C as set out below. Prior periods shall not be restated.

- (a) The amendments in paragraphs B44A–B44C apply only to modifications that occur on or after the date that an entity first applies the amendments.
- (b) The amendments in paragraphs 30–31 and 33–33D apply to share-based payment transactions that are unvested at the date that an entity first applies the amendments and to share-based payment transactions with a grant date on or after the

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<sup>10</sup> Substituted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

<sup>11</sup> Headings and paragraphs 53-63D inserted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

date that an entity first applies the amendments. For unvested share-based payment transactions granted prior to the date that an entity first applies the amendments, an entity shall remeasure the liability at that date and recognise the effect of the remeasurement in opening retained earnings (or other component of equity, as appropriate) of the reporting period in which the amendments are first applied.

- (c) The amendments in paragraphs 33E–33H and the amendment to paragraph 52 apply to share-based payment transactions that are unvested (or vested but unexercised), at the date that an entity first applies the amendments and to share-based payment transactions with a grant date on or after the date that an entity first applies the amendments. For unvested (or vested but unexercised) share-based payment transactions (or components thereof) that were previously classified as cash-settled share-based payments but now are classified as equity-settled in accordance with the amendments, an entity shall reclassify the carrying value of the share-based payment liability to equity at the date that it first applies the amendments.

- 59B Notwithstanding the requirements in paragraph 59A, an entity may apply the amendments in paragraph 63D retrospectively, in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, if and only if it is possible without hindsight. If an entity elects retrospective application, it must do so for all of the amendments made by *Amendments to Classification and Measurement of Share-based Payment Transactions* under Ind AS 102.

## Effective date

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60-63C [Refer Appendix 1]

- 63D *Amendments to Classification and Measurement of Share-based Payment Transactions* under Ind AS 102 amended paragraphs 19, 30–31, 33 and 52 and added paragraphs 33A–33H, 59A–59B, 63D and B44A–B44C and their related headings. An entity shall apply those amendments for annual periods beginning on or after 1 April, 2017

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>cash-settled share-based payment transaction</b>	<b>share-payment</b>	A <b>share-based payment transaction</b> in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of <b>equity instruments</b> (including shares or <b>share options</b> ) of the entity or another group entity.
<b>employees and others providing services</b>	<b>similar</b>	Individuals who render personal services to the entity and either (a) the individuals are regarded as employees for legal or tax purposes, (b) the individuals work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes, or (c) the services rendered are similar to those rendered by employees. For example, the term encompasses all management personnel, ie those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.
<b>equity instrument</b>		A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. <sup>12</sup>
<b>equity instrument granted</b>		The right (conditional or unconditional) to an <b>equity instrument</b> of the entity conferred by the entity on another party, under a <b>share-based payment arrangement</b> .

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<sup>12</sup> *The Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India, defines a liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (ie an outflow of cash or other assets of the entity).

<b>equity-settled share-based payment transaction</b>	<p>A <b>share-based payment transaction</b> in which the entity</p> <ul style="list-style-type: none"><li>(a) receives goods or services as consideration for its own <b>equity instruments</b> (including shares or <b>share options</b>), or</li><li>(b) receives goods or services but has no obligation to settle the transaction with the supplier.</li></ul>
<b>fair value</b>	<p>The amount for which an asset could be exchanged, a liability settled, or an <b>equity instrument granted</b> could be exchanged, between knowledgeable, willing parties in an arm's length transaction.</p>
<b>grant date</b>	<p>The date at which the entity and another party (including an employee) agree to a <b>share-based payment arrangement</b>, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or <b>equity instruments</b> of the entity, provided the specified <b>vesting conditions</b>, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.</p>
<b>intrinsic value</b>	<p>The difference between the <b>fair value</b> of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a <b>share option</b> with an exercise price of Rs. 15, on a share with a fair value of Rs. 20, has an intrinsic value of Rs. 5.</p>
<b>market condition</b>	<p>A <b>performance condition</b> upon which the exercise price, vesting or exercisability of an <b>equity instrument</b> depends that is related to the market price (or value) of the entity's <b>equity</b></p>

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**instruments** (or the equity instruments of another entity in the same group), such as:

- (a) attaining a specified share price or a specified amount of **intrinsic value** of a **share option**; or
- (b) achieving a specified target that is based on the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group) relative to an index of market prices of **equity instruments** of other entities.

A market condition requires the counterparty to complete a specified period of service (ie a **service condition**); the service requirement can be explicit or implicit.

**measurement date**

The date at which the **fair value** of the **equity instruments granted** is measured for the purposes of this Ind AS. For transactions with **employees and others providing similar services**, the measurement date is **grant date**. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

**performance condition**

A **vesting condition** that requires:

- (a) the counterparty to complete a specified period of service (ie a **service condition**); the service requirement can be explicit or implicit; and
- (b) specified performance target(s) to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s):

- (a) shall not extend beyond the end of the service period; and

- (b) may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period.

A performance target is defined by reference to:

- (a) the entity's own operations (or activities) or the operations or activities of another entity in the same group (ie a non-market condition); or
- (b) the price (or value) of the entity's **equity instruments** or the equity instruments of another entity in the same group (including shares and **share options**) (ie a **market condition**).

A performance target might relate either to the performance of the entity as a whole or to some part of the entity (or part of the group), such as a division or an individual employee.

**reload feature**

A feature that provides for an automatic grant of additional **share options** whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

**reload option**

A new **share option** granted when a share is used to satisfy the exercise price of a previous share option.

**service condition**

A **vesting condition** that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the **vesting period**, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

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<b>share-based payment arrangement</b>	<p>An agreement between the entity (or another group<sup>13</sup> entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive</p> <ul style="list-style-type: none"><li>(a) cash or other assets of the entity for amounts that are based on the price (or value) of <b>equity instruments</b> (including shares or <b>share options</b>) of the entity or another group entity, or</li><li>(b) <b>equity instruments</b> (including shares or <b>share options</b>) of the entity or another group entity,</li></ul> <p>provided the specified <b>vesting conditions</b>, if any, are met.</p>
<b>share-based payment transaction</b>	<p>A transaction in which the entity</p> <ul style="list-style-type: none"><li>(a) receives goods or services from the supplier of those goods or services (including an employee) in a <b>share-based payment arrangement</b>, or</li><li>(b) incurs an obligation to settle the transaction with the supplier in a <b>share-based payment arrangement</b> when another group entity receives those goods or services.</li></ul>
<b>share option</b>	<p>A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.</p>
<b>vest</b>	<p>To become an entitlement. Under a <b>share-based payment arrangement</b>, a counterparty's right to receive cash, other assets or <b>equity instruments</b> of the entity vests when the counterparty's</p>

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<sup>13</sup> A 'group' is defined in Appendix A of Ind AS 110, *Consolidated Financial Statements*, as 'a parent and its subsidiaries' from the perspective of the reporting entity's ultimate parent.

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entitlement is no longer conditional on the satisfaction of any **vesting conditions**.

**vesting condition**

A condition that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or **equity instruments** of the entity, under a **share-based payment arrangement**. A vesting condition is either a **service condition** or a **performance condition**.

**vesting period**

The period during which all the specified **vesting conditions** of a **share-based payment arrangement** are to be satisfied.

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS.*

#### **Estimating the fair value of equity instruments granted**

B1 Paragraphs B2–B41 of this appendix discuss measurement of the fair value of shares and share options granted, focusing on the specific terms and conditions that are common features of a grant of shares or share options to employees. Therefore, it is not exhaustive. Furthermore, because the valuation issues discussed below focus on shares and share options granted to employees, it is assumed that the fair value of the shares or share options is measured at grant date. However, many of the valuation issues discussed below (eg determining expected volatility) also apply in the context of estimating the fair value of shares or share options granted to parties other than employees at the date the entity obtains the goods or the counterparty renders service.

#### **Shares**

B2 For shares granted to employees, the fair value of the shares shall be measured at the market price of the entity's shares (or an estimated market price, if the entity's shares are not publicly traded), adjusted to take into account the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value in accordance with paragraphs 19–21).

B3 For example, if the employee is not entitled to receive dividends during the vesting period, this factor shall be taken into account when estimating the fair value of the shares granted. Similarly, if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price

that a knowledgeable, willing market participant would pay for those shares. Restrictions on transfer or other restrictions that exist during the vesting period shall not be taken into account when estimating the grant date fair value of the shares granted, because those restrictions stem from the existence of vesting conditions, which are accounted for in accordance with paragraphs 19–21.

### **Share options**

- B4 For share options granted to employees, in many cases market prices are not available, because the options granted are subject to terms and conditions that do not apply to traded options. If traded options with similar terms and conditions do not exist, the fair value of the options granted shall be estimated by applying an option pricing model.
- B5 The entity shall consider factors that knowledgeable, willing market participants would consider in selecting the option pricing model to apply. For example, many employee options have long lives, are usually exercisable during the period between vesting date and the end of the options' life, and are often exercised early. These factors should be considered when estimating the grant date fair value of the options. For many entities, this might preclude the use of the Black-Scholes-Merton formula, which does not allow for the possibility of exercise before the end of the option's life and may not adequately reflect the effects of expected early exercise. It also does not allow for the possibility that expected volatility and other model inputs might vary over the option's life. However, for share options with relatively short contractual lives, or that must be exercised within a short period of time after vesting date, the factors identified above may not apply. In these instances, the Black-Scholes-Merton formula may produce a value that is substantially the same as a more flexible option pricing model.
- B6 All option pricing models take into account, as a minimum, the following factors:
- (a) the exercise price of the option;
  - (b) the life of the option;
  - (c) the current price of the underlying shares;
  - (d) the expected volatility of the share price;

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(e) the dividends expected on the shares (if appropriate); and

(f) the risk-free interest rate for the life of the option.

B7 Other factors that knowledgeable, willing market participants would consider in setting the price shall also be taken into account (except for vesting conditions and reload features that are excluded from the measurement of fair value in accordance with paragraphs 19–22).

B8 For example, a share option granted to an employee typically cannot be exercised during specified periods (eg during the vesting period or during periods specified by securities regulators). This factor shall be taken into account if the option pricing model applied would otherwise assume that the option could be exercised at any time during its life. However, if an entity uses an option pricing model that values options that can be exercised only at the end of the options' life, no adjustment is required for the inability to exercise them during the vesting period (or other periods during the options' life), because the model assumes that the options cannot be exercised during those periods.

B9 Similarly, another factor common to employee share options is the possibility of early exercise of the option, for example, because the option is not freely transferable, or because the employee must exercise all vested options upon cessation of employment. The effects of expected early exercise shall be taken into account, as discussed in paragraphs B16–B21.

B10 Factors that a knowledgeable, willing market participant would not consider in setting the price of a share option (or other equity instrument) shall not be taken into account when estimating the fair value of share options (or other equity instruments) granted. For example, for share options granted to employees, factors that affect the value of the option from the individual employee's perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant.

### **Inputs to option pricing models**

B11 In estimating the expected volatility of and dividends on the underlying shares, the objective is to approximate the expectations that would be reflected in a current market or negotiated exchange price for the option. Similarly, when estimating the effects of early

exercise of employee share options, the objective is to approximate the expectations that an outside party with access to detailed information about employees' exercise behaviour would develop based on information available at the grant date.

- B12 Often, there is likely to be a range of reasonable expectations about future volatility, dividends and exercise behaviour. If so, an expected value should be calculated, by weighting each amount within the range by its associated probability of occurrence.
- B13 Expectations about the future are generally based on experience, modified if the future is reasonably expected to differ from the past. In some circumstances, identifiable factors may indicate that unadjusted historical experience is a relatively poor predictor of future experience. For example, if an entity with two distinctly different lines of business disposes of the one that was significantly less risky than the other, historical volatility may not be the best information on which to base reasonable expectations for the future.
- B14 In other circumstances, historical information may not be available. For example, a newly listed entity will have little, if any, historical data on the volatility of its share price. Unlisted and newly listed entities are discussed further below.
- B15 In summary, an entity should not simply base estimates of volatility, exercise behaviour and dividends on historical information without considering the extent to which the past experience is expected to be reasonably predictive of future experience.

**Expected early exercise**

- B16 Employees often exercise share options early, for a variety of reasons. For example, employee share options are typically non-transferable. This often causes employees to exercise their share options early, because that is the only way for the employees to liquidate their position. Also, employees who cease employment are usually required to exercise any vested options within a short period of time, otherwise the share options are forfeited. This factor also causes the early exercise of employee share options. Other factors causing early exercise are risk aversion and lack of wealth diversification.
- B17 The means by which the effects of expected early exercise are taken

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into account depends upon the type of option pricing model applied. For example, expected early exercise could be taken into account by using an estimate of the option's expected life (which, for an employee share option, is the period of time from grant date to the date on which the option is expected to be exercised) as an input into an option pricing model (eg the Black-Scholes-Merton formula). Alternatively, expected early exercise could be modelled in a binomial or similar option pricing model that uses contractual life as an input.

- B18 Factors to consider in estimating early exercise include:
- (a) the length of the vesting period, because the share option typically cannot be exercised until the end of the vesting period. Hence, determining the valuation implications of expected early exercise is based on the assumption that the options will vest. The implications of vesting conditions are discussed in paragraphs 19–21.
  - (b) the average length of time similar options have remained outstanding in the past.
  - (c) the price of the underlying shares. Experience may indicate that the employees tend to exercise options when the share price reaches a specified level above the exercise price.
  - (d) the employee's level within the organisation. For example, experience might indicate that higher-level employees tend to exercise options later than lower-level employees (discussed further in paragraph B21).
  - (e) expected volatility of the underlying shares. On average, employees might tend to exercise options on highly volatile shares earlier than on shares with low volatility.
- B19 As noted in paragraph B17, the effects of early exercise could be taken into account by using an estimate of the option's expected life as an input into an option pricing model. When estimating the expected life of share options granted to a group of employees, the entity could base that estimate on an appropriately weighted average expected life for the entire employee group or on appropriately weighted average lives for subgroups of employees within the group, based on more detailed data about employees'

exercise behaviour (discussed further below).

- B20 Separating an option grant into groups for employees with relatively homogeneous exercise behaviour is likely to be important. Option value is not a linear function of option term; value increases at a decreasing rate as the term lengthens. For example, if all other assumptions are equal, although a two-year option is worth more than a one-year option, it is not worth twice as much. That means that calculating estimated option value on the basis of a single weighted average life that includes widely differing individual lives would overstate the total fair value of the share options granted. Separating options granted into several groups, each of which has a relatively narrow range of lives included in its weighted average life, reduces that overstatement.
- B21 Similar considerations apply when using a binomial or similar model. For example, the experience of an entity that grants options broadly to all levels of employees might indicate that top-level executives tend to hold their options longer than middle-management employees hold theirs and that lower-level employees tend to exercise their options earlier than any other group. In addition, employees who are encouraged or required to hold a minimum amount of their employer's equity instruments, including options, might on average exercise options later than employees not subject to that provision. In those situations, separating options by groups of recipients with relatively homogeneous exercise behaviour will result in a more accurate estimate of the total fair value of the share options granted.

**Expected volatility**

- B22 Expected volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. Volatility is typically expressed in annualised terms that are comparable regardless of the time period used in the calculation, for example, daily, weekly or monthly price observations.
- B23 The rate of return (which may be positive or negative) on a share for a period measures how much a shareholder has benefited from dividends and appreciation (or depreciation) of the share price.

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- B24 The expected annualised volatility of a share is the range within which the continuously compounded annual rate of return is expected to fall approximately two-thirds of the time. For example, to say that a share with an expected continuously compounded rate of return of 12 per cent has a volatility of 30 per cent means that the probability that the rate of return on the share for one year will be between –18 per cent (12% – 30%) and 42 per cent (12% + 30%) is approximately two-thirds. If the share price is Rs.100 at the beginning of the year and no dividends are paid, the year-end share price would be expected to be between Rs.83.53 ( $\text{Rs.}100 \times e^{-0.18}$ ) and Rs.152.20 ( $\text{Rs.}100 \times e^{0.42}$ ) approximately two-thirds of the time.
- B25 Factors to consider in estimating expected volatility include:
- (a) implied volatility from traded share options on the entity's shares, or other traded instruments of the entity that include option features (such as convertible debt), if any.
  - (b) the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option (taking into account the remaining contractual life of the option and the effects of expected early exercise).
  - (c) the length of time an entity's shares have been publicly traded. A newly listed entity might have a high historical volatility, compared with similar entities that have been listed longer. Further guidance for newly listed entities is given below.
  - (d) the tendency of volatility to revert to its mean, ie its long-term average level, and other factors indicating that expected future volatility might differ from past volatility. For example, if an entity's share price was extraordinarily volatile for some identifiable period of time because of a failed takeover bid or a major restructuring, that period could be disregarded in computing historical average annual volatility.
  - (e) appropriate and regular intervals for price observations. The price observations should be consistent from period to period. For example, an entity might use the closing price for each week or the highest price for the week, but it should not use the closing price for some weeks and the highest price for other weeks. Also, the price observations should be

expressed in the same currency as the exercise price.

*Newly listed entities*

- B26 As noted in paragraph B25, an entity should consider historical volatility of the share price over the most recent period that is generally commensurate with the expected option term. If a newly listed entity does not have sufficient information on historical volatility, it should nevertheless compute historical volatility for the longest period for which trading activity is available. It could also consider the historical volatility of similar entities following a comparable period in their lives. For example, an entity that has been listed for only one year and grants options with an average expected life of five years might consider the pattern and level of historical volatility of entities in the same industry for the first six years in which the shares of those entities were publicly traded.

*Unlisted entities*

- B27 An unlisted entity will not have historical information to consider when estimating expected volatility. Some factors to consider instead are set out below.
- B28 In some cases, an unlisted entity that regularly issues options or shares to employees (or other parties) might have set up an internal market for its shares. The volatility of those share prices could be considered when estimating expected volatility.
- B29 Alternatively, the entity could consider the historical or implied volatility of similar listed entities, for which share price or option price information is available, to use when estimating expected volatility. This would be appropriate if the entity has based the value of its shares on the share prices of similar listed entities.
- B30 If the entity has not based its estimate of the value of its shares on the share prices of similar listed entities, and has instead used another valuation methodology to value its shares, the entity could derive an estimate of expected volatility consistent with that valuation methodology. For example, the entity might value its shares on a net asset or earnings basis. It could consider the expected volatility of those net asset values or earnings.

**Expected dividends**

- B31 Whether expected dividends should be taken into account when

### *Share-based Payment*

measuring the fair value of shares or options granted depends on whether the counterparty is entitled to dividends or dividend equivalents.

- B32 For example, if employees were granted options and are entitled to dividends on the underlying shares or dividend equivalents (which might be paid in cash or applied to reduce the exercise price) between grant date and exercise date, the options granted should be valued as if no dividends will be paid on the underlying shares, ie the input for expected dividends should be zero.
- B33 Similarly, when the grant date fair value of shares granted to employees is estimated, no adjustment is required for expected dividends if the employee is entitled to receive dividends paid during the vesting period.
- B34 Conversely, if the employees are not entitled to dividends or dividend equivalents during the vesting period (or before exercise, in the case of an option), the grant date valuation of the rights to shares or options should take expected dividends into account. That is to say, when the fair value of an option grant is estimated, expected dividends should be included in the application of an option pricing model. When the fair value of a share grant is estimated, that valuation should be reduced by the present value of dividends expected to be paid during the vesting period.
- B35 Option pricing models generally call for expected dividend yield. However, the models may be modified to use an expected dividend amount rather than a yield. An entity may use either its expected yield or its expected payments. If the entity uses the latter, it should consider its historical pattern of increases in dividends. For example, if an entity's policy has generally been to increase dividends by approximately 3 per cent per year, its estimated option value should not assume a fixed dividend amount throughout the option's life unless there is evidence that supports that assumption.
- B36 Generally, the assumption about expected dividends should be based on publicly available information. An entity that does not pay dividends and has no plans to do so should assume an expected dividend yield of zero. However, an emerging entity with no history of paying dividends might expect to begin paying dividends during

the expected lives of its employee share options. Those entities could use an average of their past dividend yield (zero) and the mean dividend yield of an appropriately comparable peer group.

**Risk-free interest rate**

- B37 Typically, the risk-free interest rate is the implied yield currently available on zero-coupon government issues of the country in whose currency the exercise price is expressed, with a remaining term equal to the expected term of the option being valued (based on the option's remaining contractual life and taking into account the effects of expected early exercise). It may be necessary to use an appropriate substitute, if no such government issues exist or circumstances indicate that the implied yield on zero-coupon government issues is not representative of the risk-free interest rate (for example, in high inflation economies). Also, an appropriate substitute should be used if market participants would typically determine the risk-free interest rate by using that substitute, rather than the implied yield of zero-coupon government issues, when estimating the fair value of an option with a life equal to the expected term of the option being valued.

**Capital structure effects**

- B38 Typically, third parties, not the entity, write traded share options. When these share options are exercised, the writer delivers shares to the option holder. Those shares are acquired from existing shareholders. Hence the exercise of traded share options has no dilutive effect.
- B39 In contrast, if share options are written by the entity, new shares are issued when those share options are exercised (either actually issued or issued in substance, if shares previously repurchased and held in treasury are used). Given that the shares will be issued at the exercise price rather than the current market price at the date of exercise, this actual or potential dilution might reduce the share price, so that the option holder does not make as large a gain on exercise as on exercising an otherwise similar traded option that does not dilute the share price.
- B40 Whether this has a significant effect on the value of the share options granted depends on various factors, such as the number of new shares that will be issued on exercise of the options compared

with the number of shares already issued. Also, if the market already expects that the option grant will take place, the market may have already factored the potential dilution into the share price at the date of grant.

- B41 However, the entity should consider whether the possible dilutive effect of the future exercise of the share options granted might have an impact on their estimated fair value at grant date. Option pricing models can be adapted to take into account this potential dilutive effect.

### **Modifications to equity-settled share-based payment arrangements**

- B42 Paragraph 27 requires that, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, the entity should recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. In addition, the entity should recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

- B43 To apply the requirements of paragraph 27:
- (a) if the modification increases the fair value of the equity instruments granted (eg by reducing the exercise price), measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount

based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period. If the modification occurs after vesting date, the incremental fair value granted is recognised immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

- (b) similarly, if the modification increases the number of equity instruments granted, the entity shall include the fair value of the additional equity instruments granted, measured at the date of the modification, in the measurement of the amount recognised for services received as consideration for the equity instruments granted, consistently with the requirements in (a) above. For example, if the modification occurs during the vesting period, the fair value of the additional equity instruments granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the additional equity instruments vest, in addition to the amount based on the grant date fair value of the equity instruments originally granted, which is recognised over the remainder of the original vesting period.
- (c) if the entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the vesting period or by modifying or eliminating a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

B44 Furthermore, if the entity modifies the terms or conditions of the equity instruments granted in a manner that reduces the total fair value of the share-based payment arrangement, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred (other than a cancellation of some or all the equity instruments granted, which shall be accounted for in accordance with paragraph 28). For

example:

- (a) if the modification reduces the fair value of the equity instruments granted, measured immediately before and after the modification, the entity shall not take into account that decrease in fair value and shall continue to measure the amount recognised for services received as consideration for the equity instruments based on the grant date fair value of the equity instruments granted.
- (b) if the modification reduces the number of equity instruments granted to an employee, that reduction shall be accounted for as a cancellation of that portion of the grant, in accordance with the requirements of paragraph 28.
- (c) if the entity modifies the vesting conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or by modifying or adding a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall not take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

**<sup>14</sup>Accounting for a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled**

B44A If the terms and conditions of a cash-settled share-based payment transaction are modified with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as such from the date of the modification. Specifically:

- (a) The equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted at the modification date. The equity-settled share-based payment transaction is recognised in equity on the modification date to the extent to which goods or services have been received.

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<sup>14</sup> Heading and paragraphs B44A-B44C inserted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

- (b) The liability for the cash-settled share-based payment transaction as at the modification date is derecognised on that date.
  - (c) Any difference between the carrying amount of the liability derecognised and the amount of equity recognised on the modification date is recognised immediately in profit or loss.
- B44B If, as a result of the modification, the vesting period is extended or shortened, the application of the requirements in paragraph B44A reflect the modified vesting period. The requirements in paragraph B44A apply even if the modification occurs after the vesting period.
- B44C A cash-settled share-based payment transaction may be cancelled or settled (other than a transaction cancelled by forfeiture when the vesting conditions are not satisfied). If equity instruments are granted and, on that grant date, the entity identifies them as a replacement for the cancelled cash-settled share-based payment, the entity shall apply paragraphs B44A and B44B.

### **Share-based payment transactions among group entities**

- B45 Paragraphs 43A–43C address the accounting for share-based payment transactions among group entities in each entity’s separate or individual financial statements. Paragraphs B46–B61 discuss how to apply the requirements in paragraphs 43A–43C. As noted in paragraph 43D, share-based payment transactions among group entities may take place for a variety of reasons depending on facts and circumstances. Therefore, this discussion is not exhaustive and assumes that when the entity receiving the goods or services has no obligation to settle the transaction, the transaction is a parent’s equity contribution to the subsidiary, regardless of any intragroup repayment arrangements.
- B46 Although the discussion below focuses on transactions with employees, it also applies to similar share-based payment transactions with suppliers of goods or services other than employees. An arrangement between a parent and its subsidiary may require the subsidiary to pay the parent for the provision of the equity instruments to the employees. The discussion below does not

address how to account for such an intragroup payment arrangement.

- B47 Four issues are commonly encountered in share-based payment transactions among group entities. For convenience, the examples below discuss the issues in terms of a parent and its subsidiary.

**Share-based payment arrangements involving an entity's own equity instruments**

- B48 The first issue is whether the following transactions involving an entity's own equity instruments should be accounted for as equity-settled or as cash-settled in accordance with the requirements of this Standard:

- (a) an entity grants to its employees rights to equity instruments of the entity (eg share options), and either chooses or is required to buy equity instruments (ie treasury shares) from another party, to satisfy its obligations to its employees; and
- (b) an entity's employees are granted rights to equity instruments of the entity (eg share options), either by the entity itself or by its shareholders, and the shareholders of the entity provide the equity instruments needed.

- B49 The entity shall account for share-based payment transactions in which it receives services as consideration for its own equity instruments as equity-settled. This applies regardless of whether the entity chooses or is required to buy those equity instruments from another party to satisfy its obligations to its employees under the share-based payment arrangement. It also applies regardless of whether:

- (a) the employee's rights to the entity's equity instruments were granted by the entity itself or by its shareholder(s); or
- (b) the share-based payment arrangement was settled by the entity itself or by its shareholder(s).

- B50 If the shareholder has an obligation to settle the transaction with its investee's employees, it provides equity instruments of its investee rather than its own. Therefore, if its investee is in the same group as the shareholder, in accordance with paragraph 43C, the shareholder

shall measure its obligation in accordance with the requirements applicable to cash-settled share-based payment transactions in the shareholder's separate financial statements and those applicable to equity-settled share-based payment transactions in the shareholder's consolidated financial statements.

**Share-based payment arrangements involving equity instruments of the parent**

- B51 The second issue concerns share-based payment transactions between two or more entities within the same group involving an equity instrument of another group entity. For example, employees of a subsidiary are granted rights to equity instruments of its parent as consideration for the services provided to the subsidiary.
- B52 Therefore, the second issue concerns the following share-based payment arrangements:
- (a) a parent grants rights to its equity instruments directly to the employees of its subsidiary: the parent (not the subsidiary) has the obligation to provide the employees of the subsidiary with the equity instruments; and
  - (b) a subsidiary grants rights to equity instruments of its parent to its employees: the subsidiary has the obligation to provide its employees with the equity instruments.

*A parent grants rights to its equity instruments to the employees of its subsidiary (paragraph B52(a))*

- B53 The subsidiary does not have an obligation to provide its parent's equity instruments to the subsidiary's employees. Therefore, in accordance with paragraph 43B, the subsidiary shall measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions, and recognise a corresponding increase in equity as a contribution from the parent.
- B54 The parent has an obligation to settle the transaction with the subsidiary's employees by providing the parent's own equity instruments. Therefore, in accordance with paragraph 43C, the parent shall measure its obligation in accordance with the requirements applicable to equity-settled share-based payment transactions.

## Share-based Payment

*A subsidiary grants rights to equity instruments of its parent to its employees (paragraph B52(b))*

- B55 Because the subsidiary does not meet either of the conditions in paragraph 43B, it shall account for the transaction with its employees as cash-settled. This requirement applies irrespective of how the subsidiary obtains the equity instruments to satisfy its obligations to its employees.

### **Share-based payment arrangements involving cash-settled payments to employees**

- B56 The third issue is how an entity that receives goods or services from its suppliers (including employees) should account for share-based arrangements that are cash-settled when the entity itself does not have any obligation to make the required payments to its suppliers. For example, consider the following arrangements in which the parent (not the entity itself) has an obligation to make the required cash payments to the employees of the entity:

- (a) the employees of the entity will receive cash payments that are linked to the price of its equity instruments.
- (b) the employees of the entity will receive cash payments that are linked to the price of its parent's equity instruments.

- B57 The subsidiary does not have an obligation to settle the transaction with its employees. Therefore, the subsidiary shall account for the transaction with its employees as equity-settled, and recognise a corresponding increase in equity as a contribution from its parent. The subsidiary shall remeasure the cost of the transaction subsequently for any changes resulting from non-market vesting conditions not being met in accordance with paragraphs 19–21. This differs from the measurement of the transaction as cash-settled in the consolidated financial statements of the group.

- B58 Because the parent has an obligation to settle the transaction with the employees, and the consideration is cash, the parent (and the consolidated group) shall measure its obligation in accordance with the requirements applicable to cash-settled share-based payment transactions in paragraph 43C.

### **Transfer of employees between group entities**

- B59 The fourth issue relates to group share-based payment

arrangements that involve employees of more than one group entity. For example, a parent might grant rights to its equity instruments to the employees of its subsidiaries, conditional upon the completion of continuing service with the group for a specified period. An employee of one subsidiary might transfer employment to another subsidiary during the specified vesting period without the employee's rights to equity instruments of the parent under the original share-based payment arrangement being affected. If the subsidiaries have no obligation to settle the share-based payment transaction with their employees, they account for it as an equity-settled transaction. Each subsidiary shall measure the services received from the employee by reference to the fair value of the equity instruments at the date the rights to those equity instruments were originally granted by the parent as defined in Appendix A, and the proportion of the vesting period the employee served with each subsidiary.

- B60 If the subsidiary has an obligation to settle the transaction with its employees in its parent's equity instruments, it accounts for the transaction as cash-settled. Each subsidiary shall measure the services received on the basis of grant date fair value of the equity instruments for the proportion of the vesting period the employee served with each subsidiary. In addition, each subsidiary shall recognise any change in the fair value of the equity instruments during the employee's service period with each subsidiary.
- B61 Such an employee, after transferring between group entities, may fail to satisfy a vesting condition other than a market condition as defined in Appendix A, eg the employee leaves the group before completing the service period. In this case, because the vesting condition is service to the group, each subsidiary shall adjust the amount previously recognised in respect of the services received from the employee in accordance with the principles in paragraph 19. Hence, if the rights to the equity instruments granted by the parent do not vest because of an employee's failure to meet a vesting condition other than a market condition, no amount is recognised on a cumulative basis for the services received from that employee in the financial statements of any group entity.

## Appendix 1

Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this *Appendix* is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 102 and the corresponding International Financial Reporting Standard (IFRS) 2, Share-based Payment, issued by the International Accounting Standards Board.

### Comparison with IFRS 2, *Share-based Payment*

1. The transitional provisions given in IFRS 2 and portions related thereto have not been given in Ind AS 102, since all transitional provisions related to Ind ASs, wherever considered appropriate, have been included in Ind AS 101, First-time Adoption of Indian Accounting Standards corresponding to IFRS 1, First-time Adoption of International Financial Reporting Standards.
2. Cross-reference to paragraphs B1-B4 of IFRS 3 contained in paragraph 5 of IFRS 2 has been modified as cross-reference to Appendix C of Ind AS 103 in paragraph 5 of Ind AS 102. This is consequential to the insertion of Appendix C in Ind AS 103 to deal with business combination of entities under common control.
3. Different terminology is used in the Standard, eg, the term 'balance sheet' is used instead of 'Statement of financial position'.
4. Paragraph number 3 appears as 'Deleted' in IFRS 2. In order to maintain consistency with paragraph numbers of IFRS 2, the paragraph number is retained in Ind AS 102.
5. <sup>15</sup>Paragraphs 53-59 and 60-63C in IFRS 2 have not been included in Ind AS 102 as these paragraphs relate to Transitional Provisions and Effective date, respectively. However, in order to maintain consistency with paragraph numbers of IFRS 2, the paragraph numbers are retained in Ind AS 102.

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<sup>15</sup> Inserted vide Notification No. G.S.R. 258(E) dated 17<sup>th</sup> March, 2017.

## Indian Accounting Standard (Ind AS) 103

# Business Combinations<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set out in **bold** type and plain type which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a *business combination* and its effects. To accomplish that, this Ind AS establishes principles and requirements for how the *acquirer*:
  - (a) recognises and measures in its financial statements the *identifiable* assets acquired, the liabilities assumed and any *non-controlling interest* in the *acquiree*;
  - (b) recognises and measures the *goodwill* acquired in the business combination or a gain from a bargain purchase<sup>1</sup>; and
  - (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

## Scope

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- 2 This Ind AS applies to a transaction or other event that meets the definition of a business combination. This Ind AS does not apply to:

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>1</sup> In this standard as well as in all other Indian Accounting Standards, reference to bargain purchase gain arising on a business combination includes amounts recognised in paragraphs 34 and 36A of this Ind AS, as the case may be, unless otherwise specified.

- (a) the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.
  - (b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in Ind AS 38, *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.
  - (c) [Refer Appendix 1]
- 2A 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.
- 2B Appendix C deals with accounting for combination of entities or businesses under common control.

## Identifying a business combination

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- 3 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 assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the definition of a business.**

## The acquisition method

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- 4 An entity shall account for each business combination by applying the acquisition method.**
- 5 Applying the acquisition method requires:
- (a) identifying the acquirer;
  - (b) determining the *acquisition date*;

Ind AS 103

- (c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
- (d) recognising and measuring goodwill or a gain from a bargain purchase.

### **Identifying the acquirer**

- 6 For each business combination, one of the combining entities shall be identified as the acquirer.**
- 7 The guidance in Ind AS 110 shall be used to identify the acquirer—the entity that obtains *control* of another entity, ie the acquiree. If a business combination has occurred but applying the guidance in Ind AS 110 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

### **Determining the acquisition date**

- 8 The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.**
- 9 The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

## **Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree**

### **Recognition principle**

- 10 **As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

### *Recognition conditions*

- 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other Ind AS.
- 12 In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former *owners*) exchanged in the business combination transaction rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 51–53 to determine which assets acquired or liabilities assumed are part of the exchange for the acquiree and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable Ind AS.
- 13 The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the

acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

- 14 Paragraphs B28–B40 provide guidance on recognising operating leases and intangible assets. Paragraphs 22–28 specify the types of identifiable assets and liabilities that include items for which this Ind AS provides limited exceptions to the recognition principle and conditions.

*Classifying or designating identifiable assets acquired and liabilities assumed in a business combination*

- 15 **At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other Ind ASs subsequently. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.**

- 16 In some situations, Ind ASs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

- (a) classification of particular financial assets and liabilities as measured at fair value through profit or loss or at amortised cost, or as a financial asset measured at fair value through other comprehensive income in accordance with Ind AS 109, *Financial Instruments*;
- (b) designation of a derivative instrument as a hedging instrument in accordance with Ind AS 109; and
- (c) assessment of whether an embedded derivative should be separated from a host contract in accordance with Ind AS 109 (which is a matter of ‘classification’ as this Ind AS uses that term).

- 17 This Ind AS provides two exceptions to the principle in paragraph 15:
- (a) classification of a lease contract as either an operating lease or a finance lease in accordance with Ind AS 17, *Leases*; and
  - (b) classification of a contract as an insurance contract in accordance with Ind AS 104, *Insurance Contracts*.

The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

**Measurement principle**

- 18 **The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

- 19 For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

- (a) fair value; or
- (b) The present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by Ind AS.

- 20 Paragraphs 24–31 specify the types of identifiable assets and liabilities that include items for which this Ind AS provides limited exceptions to the measurement principle.

**Exceptions to the recognition or measurement principles**

- 21 This Ind AS provides limited exceptions to its recognition and measurement principles. Paragraphs 22–31 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 22–31, which will result in

some items being:

- (a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other Ind ASs, with results that differ from applying the recognition principle and conditions.
- (b) measured at an amount other than their acquisition-date fair values.

*Exception to the recognition principle*

### **Contingent liabilities**

22 Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, defines a contingent liability as:

- (a) a possible obligation 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; or
- (b) a present obligation that arises from past events but is not recognised because:
  - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  - (ii) the amount of the obligation cannot be measured with sufficient reliability.

23 The requirements in Ind AS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

*Exceptions to both the recognition and measurement principles*

**Income taxes**

- 24 The acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, *Income Taxes*.
- 25 The acquirer shall account for the potential tax effects of temporary differences and carryforwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.

**Employee benefits**

- 26 The acquirer shall recognise and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with Ind AS 19, *Employee Benefits*.

**Indemnification assets**

- 27 The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph B41 provides related application guidance).
- 28 In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement

principles. For example, an indemnification may relate to a contingent liability that is not recognised at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an employee benefit, that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset shall be recognised and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 57 provides guidance on the subsequent accounting for an indemnification asset.

*Exceptions to the measurement principle*

**Reacquired rights**

- 29 The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract regardless of whether market participants would consider potential contractual renewals when measuring its fair value. Paragraphs B35 and B36 provide related application guidance.

**Share-based payment transactions**

- 30 The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in Ind AS 102, *Share-based Payment*, at the acquisition date. (This Ind AS refers to the result of that method as the 'market-based measure' of the share-based payment transaction.)

**Assets held for sale**

- 31 The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*, at fair value less costs to sell in accordance with paragraphs 15–18 of that Ind AS.

## **Recognising and measuring goodwill or a gain from a bargain purchase**

32 The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:

(a) the aggregate of:

- (i) the consideration transferred measured in accordance with this Ind AS, which generally requires acquisition-date fair value (see paragraph 37);
- (ii) the amount of any non-controlling interest in the acquiree measured in accordance with this Ind AS; and
- (iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

33 In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the equity interests transferred. To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquiree in place of the acquisition-date fair value of the consideration transferred (paragraph 32(a)(i)). Paragraphs B46–B49 provide related application guidance.

### **Bargain purchases**

34 In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the amount in

paragraph 32(b) exceeds the aggregate of the amounts specified in paragraph 32(a). If that excess remains after applying the requirements in paragraph 36, the acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve. The gain shall be attributed to the acquirer.

35 A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion. However, the recognition or measurement exceptions for particular items discussed in paragraphs 22–31 may also result in recognising a gain (or change the amount of a recognised gain) on a bargain purchase.

36 Before recognising a gain on a bargain purchase, the acquirer shall determine whether there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase. If such evidence exists, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this Ind AS requires to be recognised at the acquisition date for all of the following:

- (a) the identifiable assets acquired and liabilities assumed;
- (b) the non-controlling interest in the acquiree, if any;
- (c) for a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree; and
- (d) the consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

36A If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the acquirer shall apply the requirements of reassessment and review described in paragraph 36. The excess, if any, as determined in accordance with paragraph 32 after applying the said requirements of paragraph 36, shall be recognised directly in equity as capital reserve.

**Consideration transferred**

37 The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with paragraph 30 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, *contingent consideration*, ordinary or preference equity instruments, options, warrants and member interests of *mutual entities*.

38 The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss. However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

*Contingent consideration*

39 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 37). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

40 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 on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, *Financial Instruments: Presentation*. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 provides guidance on the subsequent accounting for contingent consideration.

### **Additional guidance for applying the acquisition method to particular types of business combinations**

#### **A business combination achieved in stages**

41 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. This Ind AS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.

42 In a business combination achieved in stages, the 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 profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

#### **A business combination achieved without the transfer of consideration**

43 An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

(a) The acquiree repurchases a sufficient number of its own

shares for an existing investor (the acquirer) to obtain control.

- (b) Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.
- (c) The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

- 44 In a business combination achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this Ind AS. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

### **Measurement period**

- 45 **If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of**

**the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.**

- 46 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:
- (a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;
  - (b) the consideration transferred for the acquiree (or the other amount used in measuring goodwill);
  - (c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer; and
  - (d) the resulting goodwill or gain on a bargain purchase.
- 47 The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value measured at that date is likely to indicate an error in the provisional amount.
- 48 The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquiree's

facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognised for the claim receivable from the insurer. If the adjustment results in reduction of goodwill and if the amount of adjustment exceeds the amount previously recognized as goodwill that excess shall be accounted for in accordance with paragraph 34 or paragraph 36A as applicable.

- 49 During the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.
- 50 After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

### **Determining what is part of the business combination transaction**

- 51 **The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, ie amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant Ind AS.**
- 52 A transaction entered into by or on behalf of the acquirer or primarily

for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

- (a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- (b) a transaction that remunerates employees or former owners of the acquiree for future services; and
- (c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

Paragraphs B50-B62 provide related application guidance.

#### **Acquisition-related costs**

- 53 Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

## **Subsequent measurement and accounting**

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- 54 **In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind ASs for those items, depending on their nature. However, this Ind AS provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:**
- (a) reacquired rights;
  - (b) contingent liabilities recognised as of the acquisition date;

(c) indemnification assets; and

(d) contingent consideration.

Paragraph B63 provides related application guidance.

### Reacquired rights

- 55 A reacquired right recognised as an intangible asset shall be amortised over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

### Contingent liabilities

- 56 <sup>2</sup>After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

- (a) the amount that would be recognised in accordance with Ind AS 37; and
- (b) the amount initially recognised less, if appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115, *Revenue from Contracts with Customers*.

This requirement does not apply to contracts accounted for in accordance with Ind AS 109.

### Indemnification assets

- 57 At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

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<sup>2</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Contingent consideration

- 58 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45–49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:
- (a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.
  - (b) Other contingent consideration that:
    - (i) is within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss in accordance with Ind AS 109.
    - (ii) is not within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss.

## Disclosures

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- 59 **The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:**
- (a) **during the current reporting period; or**
  - (b) **after the end of the reporting period but before the financial statements are approved for issue.**
- 60 To meet the objective in paragraph 59, the acquirer shall disclose the information specified in paragraphs B64—B66.
- 61 **The acquirer shall disclose information that enables users of its**

**financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.**

- 62 To meet the objective in paragraph 61, the acquirer shall disclose the information specified in paragraph B67.
- 63 If the specific disclosures required by this and other Ind ASs do not meet the objectives set out in paragraphs 59 and 61, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

**<sup>3</sup>Effective Date**

- 64 \*
- 64A \*
- 64B \*
- 64C \*
- 64D \*
- 64E \*
- 64F \*
- 64G \*
- 64H \*
- 64I \*
- 64J \*
- 64K As a consequence of issuance of Ind AS 115, paragraph 56 has been amended. An entity shall follow the amendment when it applies Ind AS 115.

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<sup>3</sup> Heading and paragraphs 64-64K inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

\* Refer Appendix 1

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>acquiree</b>	The business or businesses that the <b>acquirer</b> obtains control of in a <b>business combination</b> .
<b>acquirer</b>	The entity that obtains control of the <b>acquiree</b> .
<b>acquisition date</b>	The date on which the <b>acquirer</b> obtains control of the <b>acquiree</b> .
<b>business</b>	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.
<b>business combination</b>	A transaction or other event in which an <b>acquirer</b> obtains control of one or more <b>businesses</b> . Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also <b>business combinations</b> as that term is used in this Ind AS.
<b>contingent consideration</b>	Usually, an obligation of the <b>acquirer</b> to transfer additional assets or <b>equity interests</b> to the former owners of an <b>acquiree</b> as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, <i>contingent consideration</i> also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.
<b>equity interests</b>	For the purposes of this Ind AS, <i>equity interests</i> is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of <b>mutual entities</b> .
<b>fair value</b>	<i>Fair value</i> is the price that would be received to sell an asset or paid to transfer a liability in an orderly

	transaction between market participants at the measurement date. (See Ind AS 113.)
<b>goodwill</b>	An asset representing the future economic benefits arising from other assets acquired in a <b>business combination</b> that are not individually identified and separately recognised.
<b>identifiable</b>	An asset is <i>identifiable</i> if it either: <ul style="list-style-type: none"><li>(a) is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or</li><li>(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.</li></ul>
<b>intangible asset</b>	An <b>identifiable</b> non-monetary asset without physical substance.
<b>mutual entity</b>	An entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its <b>owners</b> , members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.
<b>non-controlling interest</b>	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
<b>owners</b>	For the purposes of this Ind AS, <i>owners</i> is used broadly to include holders of <b>equity interests</b> of investor-owned entities and owners or members of, or participants in, <b>mutual entities</b> .

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS.*

B1-B4 [Refer Appendix 1]

### Identifying a business combination (application of paragraph 3)

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- B5 This Ind AS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:
- (a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
  - (b) by incurring liabilities;
  - (c) by issuing equity interests;
  - (d) by providing more than one type of consideration; or
  - (e) without transferring consideration, including by contract alone (see paragraph 43).
- B6 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:
- (a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
  - (b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
  - (c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or

- (d) a group of former owners of one of the combining entities obtains control of the combined entity.

### **Definition of a business (application of paragraph 3)**

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- B7 A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:
- (a) **Input:** Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.
  - (b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
  - (c) **Output:** The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.
- B8 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce

*Ind AS 103*

outputs, for example, by integrating the business with their own inputs and processes.

- B9 The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many different types of inputs, processes and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities.
- B10 An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:
- (a) has begun planned principal activities;
  - (b) has employees, intellectual property and other inputs and processes that could be applied to those inputs;
  - (c) is pursuing a plan to produce outputs; and
  - (d) will be able to obtain access to customers that will purchase the outputs.

Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.

- B11 Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.
- B12 In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. However, a business need not have goodwill.

## Identifying the acquirer (application of paragraphs 6 and 7)

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- B13 The guidance in Ind AS 110, *Consolidated Financial Statements*, shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in Ind AS 110 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.
- B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called ‘reverse acquisitions’, the issuing entity is the acquiree. Paragraphs B19–B27 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:
- (a) *the relative voting rights in the combined entity after the business combination*—The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
  - (b) *the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest*—The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.
  - (c) *the composition of the governing body of the combined entity*—The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a

majority of the members of the governing body of the combined entity.

- (d) *the composition of the senior management of the combined entity*—The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.
- (e) *the terms of the exchange of equity interests*—The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

B16 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–B17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

## Reverse acquisitions

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B19 A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–B18. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the

public entity. In this example, the public entity is the **legal acquirer** because it issued its equity interests, and the private entity is the **legal acquiree** because its equity interests were acquired. However, application of the guidance in paragraphs B13–B18 results in identifying:

- (a) the public entity as the **acquiree** for accounting purposes (the accounting acquiree); and
- (b) the private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this Ind AS, including the requirement to recognise goodwill, apply.

### **Measuring the consideration transferred**

- B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

### **Preparation and presentation of consolidated financial statements**

- B21 Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the

capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

B22 Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

- (a) the assets and liabilities of the legal subsidiary (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.
- (b) the assets and liabilities of the legal parent (the accounting acquiree) recognised and measured in accordance with this Ind AS.
- (c) the retained earnings and other equity balances of the legal subsidiary (accounting acquirer) **before** the business combination.
- (d) the amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree). However, the equity structure (ie the number and type of equity interests issued) reflects the equity structure of the legal parent (the accounting acquiree), including the equity interests the legal parent issued to effect the combination. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition.
- (e) the non-controlling interest's proportionate share of the legal subsidiary's (accounting acquirer's) pre-combination carrying amounts of retained earnings and other equity interests as discussed in paragraphs B23 and B24.

## **Non-controlling interest**

- B23 In a reverse acquisition, some of the owners of the legal acquiree (the accounting acquirer) might not exchange their equity interests for equity interests of the legal parent (the accounting acquiree). Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquiree that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquiree—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquiree for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.
- B24 The assets and liabilities of the legal acquiree are measured and recognised in the consolidated financial statements at their pre-combination carrying amounts (see paragraph B22(a)). Therefore, in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-combination carrying amounts of the legal acquiree's net assets even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.

## **Earnings per share**

- B25 As noted in paragraph B22(d), the equity structure in the consolidated financial statements following a reverse acquisition reflects the equity structure of the legal acquirer (the accounting acquiree), including the equity interests issued by the legal acquirer to effect the business combination.
- B26 In calculating the weighted average number of ordinary shares<sup>4</sup> outstanding (the denominator of the earnings per share calculation) during the period in which the reverse acquisition occurs:
- (a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be computed on the basis of the weighted average number of ordinary shares of the legal acquiree (accounting acquirer) outstanding during

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<sup>4</sup> In Indian context, the term 'ordinary shares' is equivalent to 'equity shares'.

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the period multiplied by the exchange ratio established in the merger agreement; and

- (b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal acquirer (the accounting acquiree) outstanding during that period.

B27 The basic earnings per share for each comparative period before the acquisition date presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing:

- (a) the profit or loss of the legal acquiree attributable to ordinary shareholders in each of those periods by
- (b) the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement.

## **Recognising particular assets acquired and liabilities assumed (application of paragraphs 10–13)**

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### **Operating leases**

B28 The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs B29 and B30.

B29 The acquirer shall determine whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph B42 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquiree is the lessor.

B30 An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, for example, as

a customer relationship. In that situation, the acquirer shall recognise the associated identifiable intangible asset(s) in accordance with paragraph B31.

### **Intangible assets**

- B31 The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.
- B32 An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:
- (a) an acquiree leases a manufacturing facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease contract.
  - (b) an acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
  - (c) an acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement

separately from one another would not be practical.

- B33 The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.
- B34 An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability. For example:
- (a) market participants exchange deposit liabilities and related depositor relationship intangible assets in observable exchange transactions. Therefore, the acquirer should recognise the depositor relationship intangible asset separately from goodwill.
  - (b) an acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service

indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

### **Reacquired rights**

- B35 As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill. Paragraph 29 provides guidance on measuring a reacquired right and paragraph 55 provides guidance on the subsequent accounting for a reacquired right.
- B36 If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss. Paragraph B52 provides guidance for measuring that settlement gain or loss.

### **Assembled workforce and other items that are not identifiable**

- B37 The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill, any value attributed to it is subsumed into goodwill.
- B38 The acquirer also subsumes into goodwill any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential contracts the

acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not themselves assets at the acquisition date, the acquirer does not recognise them separately from goodwill. The acquirer should not subsequently reclassify the value of those contracts from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognisable intangible asset existed at the acquisition date.

- B39 After initial recognition, an acquirer accounts for intangible assets acquired in a business combination in accordance with the provisions of Ind AS 38, *Intangible Assets*. However, as described in paragraph 3 of Ind AS 38, the accounting for some acquired intangible assets after initial recognition is prescribed by other Ind ASs.
- B40 The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in measuring the fair value of an intangible asset. For example, the acquirer would take into account the assumptions that market participants would use when pricing the intangible asset, such as expectations of future contract renewals, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria. (However, see paragraph 29, which establishes an exception to the fair value measurement principle for reacquired rights recognised in a business combination.) Paragraphs 36 and 37 of Ind AS 38 provide guidance for determining whether intangible assets should be combined into a single unit of account with other intangible or tangible assets.

## **Measuring the fair value of particular identifiable assets and a non-controlling interest in an acquiree (application of paragraphs 18 and 19)**

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### **Assets with uncertain cash flows (valuation allowances)**

- B41 The acquirer shall not recognise a separate valuation allowance as

of the acquisition date for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Ind AS requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for a business combination, the acquirer does not recognise a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date or a loss allowance for expected credit losses.

**Assets subject to operating leases in which the acquiree is the lessor**

- B42 In measuring the acquisition-date fair value of an asset such as a building or a patent that is subject to an operating lease in which the acquiree is the lessor, the acquirer shall take into account the terms of the lease. In other words, the acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms as paragraph B29 requires for leases in which the acquiree is the lessee.

**Assets that the acquirer intends not to use or to use in a way that is different from the way other market participants would use them**

- B43 To protect its competitive position, or for other reasons, the acquirer may intend not to use an acquired non-financial asset actively, or it may not intend to use the asset according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer shall measure the fair value of the non-financial asset assuming its highest and best use by market participants in accordance with the appropriate valuation premise, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

### **Non-controlling interest in an acquiree**

- B44 This Ind AS allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.
- B45 The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

### **Measuring goodwill or a gain from a bargain purchase**

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#### **Measuring the acquisition-date fair value of the acquirer's interest in the acquiree using valuation techniques (application of paragraph 33)**

- B46 In a business combination achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure goodwill or a gain on a bargain purchase (see paragraphs 32–34 and 36A).

#### **Special considerations in applying the acquisition method to combinations of mutual entities (application of paragraph 33)**

- B47 When two mutual entities combine, the fair value of the equity or

member interests in the acquiree (or the fair value of the acquiree) may be more reliably measurable than the fair value of the member interests transferred by the acquirer. In that situation, paragraph 33 requires the acquirer to determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the acquirer's equity interests transferred as consideration. In addition, the acquirer in a combination of mutual entities shall recognise the acquiree's net assets as a direct addition to capital or equity in its balance sheet, not as an addition to retained earnings, which is consistent with the way in which other types of entities apply the acquisition method.

- B48 Although they are similar in many ways to other businesses, mutual entities have distinct characteristics that arise primarily because their members are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year.
- B49 A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, a present value technique may be used to measure the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services.

### **Determining what is part of the business combination transaction (application of paragraphs 51 and 52)**

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- B50 The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquiree or whether the transaction is separate from the business combination:
- (a) **the reasons for the transaction**—Understanding the

reasons why the parties to the combination (the acquirer and the acquiree and their owners, directors and managers—and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.

- (b) **who initiated the transaction**—Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquiree or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.
- (d) **the timing of the transaction**—The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

**Effective settlement of a pre-existing relationship between the acquirer and acquiree in a business combination (application of paragraph 52(a))**

B51 The acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or non-contractual (for example, plaintiff and defendant).

B52 If the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

- (a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value.
- (b) for a pre-existing contractual relationship, the lesser of (i) and (ii):
  - (i) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.)
  - (ii) the amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

If (ii) is less than (i), the difference is included as part of the business combination accounting.

The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements.

B53 A pre-existing relationship may be a contract that the acquirer

recognises as a reacquired right. If the contract includes terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer recognises, separately from the business combination, a gain or loss for the effective settlement of the contract, measured in accordance with paragraph B52.

### **Arrangements for contingent payments to employees or selling shareholders (application of paragraph 52(b))**

- B54 Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.
- B55 If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:
- (a) *Continuing employment*—The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.
  - (b) *Duration of continuing employment*—If the period of required employment coincides with or is longer than the contingent

payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

- (c) *Level of remuneration*—Situations in which employee remuneration other than the contingent payments is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.
- (d) *Incremental payments to employees*—If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.
- (e) *Number of shares owned*—The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide remuneration for post-combination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.
- (f) *Linkage to the valuation*—If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquiree and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula

is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

- (g) *Formula for determining consideration*—The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.
- (h) *Other agreements and issues*—The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

**Acquirer share-based payment awards exchanged for awards held by the acquiree's employees (application of paragraph 52(b))**

B56 An acquirer may exchange its share-based payment awards<sup>5</sup> (replacement awards) for awards held by employees of the acquiree. Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with Ind AS 102, *Share-based Payment*. If the acquirer replaces the acquiree awards, either all or a portion of the market-based measure of the acquirer's replacement awards shall be included in measuring the consideration transferred in the business combination. Paragraphs B57-B62 provide guidance on how to allocate the market-based measure.

However, in situations in which acquiree awards would expire as a consequence of a business combination and if the acquirer replaces those awards when it is not obliged to do so, all of the market-based measure of the replacement awards shall be recognised as remuneration cost in the post-combination financial statements in accordance with Ind AS 102. That is to say, none of the market-based measure of those awards shall be included in measuring the consideration transferred in the business combination. The acquirer is obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement. For example, for the purposes of applying this guidance, the acquirer is obliged to replace the acquiree's awards if replacement is required by:

- (a) the terms of the acquisition agreement;
- (b) the terms of the acquiree's awards; or
- (c) applicable laws or regulations.

B57 To determine the portion of a replacement award that is part of the consideration transferred for the acquiree and the portion that is remuneration for post-combination service, the acquirer shall measure both the replacement awards granted by the acquirer and

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<sup>5</sup> In paragraphs B56-B62 the term 'share-based payment awards' refers to vested or unvested share-based payment transactions.

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the acquiree awards as of the acquisition date in accordance with Ind AS 102. The portion of the market-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to pre-combination service.

- B58 The portion of the replacement award attributable to pre-combination service is the market-based measure of the acquiree award multiplied by the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the acquiree award. The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in Ind AS 102.
- B59 The portion of a non-vested replacement award attributable to post-combination service, and therefore recognised as remuneration cost in the post-combination financial statements, equals the total market-based measure of the replacement award less the amount attributed to pre-combination service. Therefore, the acquirer attributes any excess of the market-based measure of the replacement award over the market-based measure of the acquiree award to post-combination service and recognises that excess as remuneration cost in the post-combination financial statements. The acquirer shall attribute a portion of a replacement award to post-combination service if it requires post-combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquisition date.
- B60 The portion of a non-vested replacement award attributable to pre-combination service, as well as the portion attributable to post-combination service, shall reflect the best available estimate of the number of replacement awards expected to vest. For example, if the market-based measure of the portion of a replacement award attributed to pre-combination service is Rs 100 and the acquirer expects that only 95 per cent of the award will vest, the amount included in consideration transferred in the business combination is Rs 95. Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the

consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Ind AS 102 in determining remuneration cost for the period in which an event occurs.

- B61 The same requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with the provisions of Ind AS 102. All changes in the market-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognised in the acquirer's post-combination financial statements in the period(s) in which the changes occur.
- B62 The income tax effects of replacement awards of share-based payments shall be recognised in accordance with the provisions of Ind AS 12, *Income Taxes*.

### **Equity-settled share-based payment transactions of the acquiree**

- B62A The acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquiree share-based payment transactions are part of the non-controlling interest in the acquiree and are measured at their market-based measure. If unvested, they are measured at their market-based measure as if the acquisition date were the grant date in accordance with paragraphs 19 and 30.
- B62B The market-based measure of unvested share-based payment transactions is allocated to the non-controlling interest on the basis of the ratio of the portion of the vesting period completed to the greater of the total vesting period and the original vesting period of the share-based payment transaction. The balance is allocated to post-combination service.

## **Other Ind ASs that provide guidance on subsequent measurement and accounting (application of paragraph 54)**

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- B63 Examples of other Ind ASs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a business combination include:
- (a) Ind AS 38 prescribes the accounting for identifiable intangible assets acquired in a business combination. The acquirer measures goodwill at the amount recognised at the acquisition date less any accumulated impairment losses. Ind AS 36, *Impairment of Assets*, prescribes the accounting for impairment losses.
  - (b) Ind AS 104, *Insurance Contracts*, provides guidance on the subsequent accounting for an insurance contract acquired in a business combination.
  - (c) Ind AS 12 prescribes the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities acquired in a business combination.
  - (d) Ind AS 102 provides guidance on subsequent measurement and accounting for the portion of replacement share-based payment awards issued by an acquirer that is attributable to employees' future services.
  - (e) Ind AS 110 provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained.

## **Disclosures (application of paragraphs 59 and 61)**

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- B64 To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:
- (a) the name and a description of the acquiree.
  - (b) the acquisition date.
  - (c) the percentage of voting equity interests acquired.

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- (d) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- (e) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
- (f) the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
  - (i) cash;
  - (ii) other tangible or intangible assets, including a business or subsidiary of the acquirer;
  - (iii) liabilities incurred, for example, a liability for contingent consideration; and
  - (iv) equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
- (g) for contingent consideration arrangements and indemnification assets:
  - (i) the amount recognised as of the acquisition date;
  - (ii) a description of the arrangement and the basis for determining the amount of the payment; and
  - (iii) an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- (h) for acquired receivables:
  - (i) the fair value of the receivables;
  - (ii) the gross contractual amounts receivable; and

- (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

- (i) the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.
- (j) for each contingent liability recognised in accordance with paragraph 23, the information required in paragraph 85 of Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:
  - (i) the information required by paragraph 86 of Ind AS 37; and
  - (ii) the reasons why the liability cannot be measured reliably.
- (k) the total amount of goodwill that is expected to be deductible for tax purposes.
- (l) for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination in accordance with paragraph 51:
  - (i) a description of each transaction;
  - (ii) how the acquirer accounted for each transaction;
  - (iii) the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
  - (iv) if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.
- (m) the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of profit

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and loss in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.

- (n) in a bargain purchase (see paragraphs 34–36A):
  - (i) the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;
  - (ii) the amount of any gain directly recognised in equity in accordance with paragraph 36A; and
  - (iii) a description of the reasons why the transaction resulted in a gain in case of (i) above.
- (o) for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:
  - (i) the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
  - (ii) for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.
- (p) in a business combination achieved in stages:
  - (i) the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
  - (ii) the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.
- (q) the following information:
  - (i) the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of profit and loss for the

reporting period; and

- (ii) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Ind AS uses the term 'impracticable' with the same meaning as in Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

- B65 For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraph B64(e)–(q).
- B66 If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are approved for issue, the acquirer shall disclose the information required by paragraph B64 unless the initial accounting for the business combination is incomplete at the time the financial statements are approved for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.
- B67 To meet the objective in paragraph 61, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:
- (a) if the initial accounting for a business combination is incomplete (see paragraph 45) for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally:
    - (i) the reasons why the initial accounting for the business combination is incomplete;

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- (ii) the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
  - (iii) the nature and amount of any measurement period adjustments recognised during the reporting period in accordance with paragraph 49.
- (b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
  - (i) any changes in the recognised amounts, including any differences arising upon settlement;
  - (ii) any changes in the range of outcomes (undiscounted) and the reasons for those changes; and
  - (iii) the valuation techniques and key model inputs used to measure contingent consideration.
- (c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of Ind AS 37 for each class of provision.
- (d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:
  - (i) the gross amount and accumulated impairment losses at the beginning of the reporting period.
  - (ii) additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.
  - (iii) adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with paragraph 67.
  - (iv) goodwill included in a disposal group classified as held

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for sale in accordance with Ind AS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale.

- (v) impairment losses recognised during the reporting period in accordance with Ind AS 36. (Ind AS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)
  - (vi) net exchange rate differences arising during the reporting period in accordance with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*.
  - (vii) any other changes in the carrying amount during the reporting period.
  - (viii) the gross amount and accumulated impairment losses at the end of the reporting period.
- (e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:
- (i) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and
  - (ii) is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

## Appendix C

### Business combinations of entities under common control

*This appendix is an integral part of the Ind AS.*

#### Scope

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- 1 This appendix deals with accounting for business combinations of entities or businesses under common control.

#### Definitions

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- 2 The following terms are used in this Appendix with the meaning specified:

*Transferor* means an entity or business which is combined into another entity as a result of a business combination.

*Transferee* means an entity in which the transferor entity is combined.

*Reserve* means the portion of earnings, receipts or other surplus of an entity (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation.

*Common control business combination* means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

#### Common control business combinations

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- 3 Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.
- 4 The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to

determining whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.

- 5 The fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements of the group in accordance with Ind AS 27 is not relevant to determining whether a combination involves entities under common control.
- 6 An entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind ASs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control.
- 7 A group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

## **Method of accounting for common control business combinations**

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- 8 Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method.
- 9 The pooling of interest method is considered to involve the following:
  - (i) The assets and liabilities of the combining entities are reflected at their carrying amounts.
  - (ii) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.
  - (iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual

## *Business Combinations*

date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

- 10 The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.
- 11 The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.
- 12 The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination. The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

## **Disclosure**

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- 13 The following disclosures shall be made in the first financial statements following the business combination:
  - (a) names and general nature of business of the combining entities;
  - (b) the date on which the transferor obtains control of the transferee;

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- (c) description and number of shares issued, together with the percentage of each entity's equity shares exchanged to effect the business combination; and
- (d) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

## **Business combination after the balance sheet date**

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- 14 When a business combination is effected after the balance sheet but before the approval of the financial statements for issue by either party to the business combination, disclosure is made in accordance with Ind AS 10 *Events after the Reporting Period*, but the business combination is not incorporated in the financial statements. In certain circumstances, the business combination may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

## **Appendix D**

### **References to matters contained in other Indian Accounting Standards**

*This Appendix is an integral part of the Ind AS.*

This appendix lists the appendices which are part of other Indian Accounting Standards and makes reference to Ind AS 103, *Business Combinations*.

1. Appendix A, *Distributions of Non-cash Assets to Owners*, contained in Ind AS 10, *Events After the Reporting Period*

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 103 and the corresponding International Financial Reporting Standard (IFRS) 3, Business Combinations, issued by the International Accounting Standards Board.*

### Comparison with IFRS 3, *Business Combinations*

- 1 IFRS 3 excludes from its scope business combinations of entities under common control. Ind AS 103 (Appendix C) gives the guidance in this regard. Consequently, paragraph 2 has been modified and paragraph 2B has been added in Ind AS 103. Further, paragraphs B1-B4 of IFRS 3 have been deleted in Ind AS 103. In order to maintain consistency with paragraph numbers of IFRS 3, the paragraph numbers are retained in Ind AS 103.
- 2 The transitional provisions given in IFRS 3 have not been given in Ind AS 103, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*, will deal with the same.
- 3 IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss. Ind AS 103 requires the same to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. This has some consequential changes such as change in wording of paragraphs 34, 36 and 48, additional disclosure in paragraph B64(n) and addition of new paragraph 36A. Cross-reference to the new paragraph 36A has been added in paragraphs B46, B64(n).
- 4 Different terminology is used, as used in existing laws eg, the term 'balance sheet' is used instead of 'Statement of financial position', 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'. The words 'approved the financial

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statements for issue' have been used instead of 'authorised the financial statements for issue' in the context of financial statements considered for the purpose of events after the reporting period.

- 5 <sup>6</sup>Paragraphs 64 to 64J related to effective date have not been included in Ind AS 103 as these are not relevant in Indian context. However, in order to maintain consistency with paragraph numbers of IFRS 3, these paragraph numbers are retained in Ind AS 103.

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<sup>6</sup> Inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Indian Accounting Standard (Ind AS) 104

# Insurance Contracts<sup>#1</sup>

(This Indian Accounting Standard includes paragraphs set in **bold type** and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to specify the financial reporting for *insurance contracts* by any entity that issues such contracts (described in this Ind AS as an *insurer*). In particular, this Ind AS requires:
- (a) limited improvements to accounting by insurers for insurance contracts.
  - (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

## Scope

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- 2 An entity shall apply this Ind AS to:
- (a) insurance contracts (including *reinsurance contracts*) that it issues and reinsurance contracts that it holds.
  - (b) financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). Ind AS 107, *Financial Instruments: Disclosures*, requires disclosure about financial instruments, including financial instruments that contain such features.
- 3 This Ind AS does not address other aspects of accounting by

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>1</sup> This Indian Accounting Standard shall come into effect for insurance companies from the date to be separately announced.

insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see Ind AS 32, *Financial Instruments: Presentation*, Ind AS 107 and Ind AS 109, *Financial Instruments*).

- 4 An entity shall not apply this Ind AS to:
- (a) <sup>2</sup>product warranties issued directly by a manufacturer, dealer or retailer (see Ind AS 115, *Revenue from Contracts with Customers* and Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*).
  - (b) employers' assets and liabilities under employee benefit plans (see Ind AS 19, *Employee Benefits*, and Ind AS 102, *Share-based Payment*) and retirement benefit obligations reported by defined benefit retirement plans.
  - (c) <sup>3</sup>contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see Ind AS 17, *Leases*, Ind AS 115, *Revenue from Contracts with Customers* and Ind AS 38, *Intangible Assets*).
  - (d) financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either Ind AS 32, Ind AS 107 and Ind AS 109 or this Ind AS to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.
  - (e) contingent consideration payable or receivable in a business combination (see Ind AS 103, *Business Combinations*).
  - (f) *direct insurance contracts* that the entity holds (ie direct insurance contracts in which the entity is the *policyholder*).

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<sup>2</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>3</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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However, a *cedant* shall apply this Standard to reinsurance contracts that it holds.

- 5 For ease of reference, this Ind AS describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.
- 6 A reinsurance contract is a type of insurance contract. Accordingly, all references in this Ind AS to insurance contracts also apply to reinsurance contracts.

### **Embedded derivatives**

- 7 Ind AS 109 requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in profit or loss. Ind AS 109 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.
- 8 As an exception to the requirements in Ind AS 109, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirements in Ind AS 109 do apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, those requirements also apply if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).
- 9 Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

### **Unbundling of deposit components**

- 10 Some insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is required or permitted to *unbundle* those components:
  - (a) unbundling is required if both the following conditions are met:

- (i) the insurer can measure the deposit component (including any embedded surrender options) separately (ie without considering the insurance component).
  - (ii) the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
- (b) unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
- (c) unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i).
- 11 The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a *reinsurer*, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as income without recognising the resulting obligation, unbundling is required.
- 12 To unbundle a contract, an insurer shall:
- (a) apply this Ind AS to the insurance component.
  - (b) apply Ind AS 109 to the deposit component.

## Recognition and measurement

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### Temporary exemption from some other Ind ASs

- 13 Paragraphs 10–12 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, specify criteria for an entity to use in developing an accounting policy if no Ind AS applies specifically to an item. However, this Ind AS exempts an insurer from applying those criteria to its accounting policies for:
- (a) insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described

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in paragraphs 31 and 32); and

(b) reinsurance contracts that it holds.

14 Nevertheless, this Ind AS does not exempt an insurer from some implications of the criteria in paragraphs 10–12 of Ind AS 8. Specifically, an insurer:

(a) shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions).

(b) shall carry out the *liability adequacy test* described in paragraphs 15–19.

(c) shall remove an insurance liability (or a part of an insurance liability) from its balance sheet when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

(d) shall not offset:

(i) *reinsurance assets* against the related insurance liabilities; or

(ii) income or expense from reinsurance contracts against the expense or income from the related insurance contracts.

(e) shall consider whether its reinsurance assets are impaired (see paragraph 20).

**Liability adequacy test**

15 **An insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.**

16 If an insurer applies a liability adequacy test that meets specified

minimum requirements, this Ind AS imposes no further requirements. The minimum requirements are the following:

- (a) The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.
- (b) If the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss.

17 If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:

- (a) determine the carrying amount of the relevant insurance liabilities<sup>4</sup> less the carrying amount of:
  - (i) any related deferred acquisition costs; and
  - (ii) any related intangible assets, such as those acquired in a business combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).
- (b) determine whether the amount described in (a) is less than the carrying amount that would be required if the relevant insurance liabilities were within the scope of Ind AS 37. If it is less, the insurer shall recognise the entire difference in profit or loss and decrease the carrying amount of the related deferred acquisition costs or related intangible assets or increase the carrying amount of the relevant insurance liabilities.

18 If an insurer's liability adequacy test meets the minimum requirements of paragraph 16, the test is applied at the level of aggregation specified in that test. If its liability adequacy test does not meet those minimum requirements, the comparison described in paragraph 17 shall be made at the level of a portfolio of contracts

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<sup>4</sup> The relevant insurance liabilities are those insurance liabilities (and related deferred acquisition costs and related intangible assets) for which the insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16.

that are subject to broadly similar risks and managed together as a single portfolio.

- 19 The amount described in paragraph 17(b) (ie the result of applying Ind AS 37) shall reflect future investment margins (see paragraphs 27–29) if, and only if, the amount described in paragraph 17(a) also reflects those margins.

#### **Impairment of reinsurance assets**

- 20 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss. A reinsurance asset is impaired if, and only if:
- (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract; and
  - (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

#### **Changes in accounting policies**

- 21 Paragraphs 22-30 apply both to changes made by an insurer that already applies Ind ASs and to changes made by an insurer adopting Ind ASs for the first time.
- 22 **An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in Ind AS 8.**
- 23 To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in Ind AS 8, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:
- (a) current interest rates (paragraph 24);
  - (b) continuation of existing practices (paragraph 25);
  - (c) prudence (paragraph 26);

- (d) future investment margins (paragraphs 27–29); and
- (e) shadow accounting (paragraph 30).

**Current market interest rates**

- 24 An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities<sup>5</sup> to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that time, it may also introduce accounting policies that require other current estimates and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as Ind AS 8 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all these liabilities until they are extinguished.

**Continuation of existing practices**

- 25 An insurer may continue the following practices, but the introduction of any of them does not satisfy paragraph 22:
- (a) measuring insurance liabilities on an undiscounted basis.
  - (b) measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services. It is likely that the fair value at inception of those contractual rights equals the origination costs paid, unless future investment management fees and related costs are out of line with market comparables.
  - (c) using non-uniform accounting policies for the insurance contracts (and related deferred acquisition costs and related intangible assets, if any) of subsidiaries, except as permitted by paragraph 24. If those accounting policies are not uniform, an insurer may change them if the change does not make the

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<sup>5</sup> In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.

accounting policies more diverse and also satisfies the other requirements in this Ind AS.

**Prudence**

- 26 An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence.

**Future investment margins**

- 27 An insurer need not change its accounting policies for insurance contracts to eliminate future investment margins. However, there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts, unless those margins affect the contractual payments. Two examples of accounting policies that reflect those margins are:

- (a) using a discount rate that reflects the estimated return on the insurer's assets; or
- (b) projecting the returns on those assets at an estimated rate of return, discounting those projected returns at a different rate and including the result in the measurement of the liability.

- 28 An insurer may overcome the rebuttable presumption described in paragraph 27 if, and only if, the other components of a change in accounting policies increase the relevance and reliability of its financial statements sufficiently to outweigh the decrease in relevance and reliability caused by the inclusion of future investment margins. For example, suppose that an insurer's existing accounting policies for insurance contracts involve excessively prudent assumptions set at inception and a discount rate prescribed by a regulator without direct reference to market conditions, and ignore some embedded options and guarantees. The insurer might make its financial statements more relevant and no less reliable by switching to a comprehensive investor-oriented basis of accounting that is widely used and involves:

- (a) current estimates and assumptions;
- (b) a reasonable (but not excessively prudent) adjustment to

reflect risk and uncertainty;

- (c) measurements that reflect both the intrinsic value and time value of embedded options and guarantees; and
- (d) a current market discount rate, even if that discount rate reflects the estimated return on the insurer's assets.

29 In some measurement approaches, the discount rate is used to determine the present value of a future profit margin. That profit margin is then attributed to different periods using a formula. In those approaches, the discount rate affects the measurement of the liability only indirectly. In particular, the use of a less appropriate discount rate has a limited or no effect on the measurement of the liability at inception. However, in other approaches, the discount rate determines the measurement of the liability directly. In the latter case, because the introduction of an asset-based discount rate has a more significant effect, it is highly unlikely that an insurer could overcome the rebuttable presumption described in paragraph 27.

#### **Shadow accounting**

30 In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets, such as those described in paragraphs 31 and 32. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in other comprehensive income if, and only if, the unrealised gains or losses are recognised in other comprehensive income. This practice is sometimes described as 'shadow accounting'.

#### **Insurance contracts acquired in a business combination or portfolio transfer**

31 To comply with Ind AS 103, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and *insurance assets* acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded

presentation that splits the fair value of acquired insurance contracts into two components:

- (a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and
- (b) an intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.

32 An insurer acquiring a portfolio of insurance contracts may use the expanded presentation described in paragraph 31.

33 The intangible assets described in paragraphs 31 and 32 are excluded from the scope of Ind AS 38 and Ind AS 36, *Impairment of Assets*. However, Ind AS 38 and Ind AS 36 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

## **Discretionary participation features**

### **Discretionary participation features in insurance contracts**

34 Some insurance contracts contain a discretionary participation feature as well as a *guaranteed element*. The issuer of such a contract:

- (a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability.
- (b) shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. This Ind AS does not specify how the issuer determines whether that feature is a liability or equity. The issuer may split that

feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity.

- (c) may recognise all premiums received as revenue without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part or all of the discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to non-controlling interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see Ind AS 1, *Presentation of Financial Statements*).
- (d) shall, if the contract contains an embedded derivative within the scope of Ind AS 109, apply Ind AS 109 to that embedded derivative.
- (e) shall, in all respects not described in paragraphs 14–20 and 34(a)–(d), continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21–30.

#### **Discretionary participation features in financial instruments**

35 The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:

- (a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15–19 to the whole contract (ie both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying Ind AS 109 to the guaranteed element.
- (b) if the issuer classifies part or all of that feature as a separate

component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying Ind AS 109 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying Ind AS 109 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.

- (c) although these contracts are financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability.
- (d) although these contracts are financial instruments, an issuer applying paragraph 20(b) of Ind AS 107 to contracts with a discretionary participation feature shall disclose the total interest expense recognised in profit or loss, but need not calculate such interest expense using the effective interest method.

## Disclosure

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### Explanation of recognised amounts

- 36 **An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.**
- 37 To comply with paragraph 36, an insurer shall disclose:
- (a) its accounting policies for insurance contracts and related assets, liabilities, income and expense.
  - (b) the recognised assets, liabilities, income and expense (and, if it presents its statement of cash flows using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:
    - (i) gains and losses recognised in profit or loss on

- buying reinsurance; and
- (ii) if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.
- (c) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions.
  - (d) the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements.
  - (e) reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

### **Nature and extent of risks arising from insurance contracts**

38 **An insurer shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts.**

39 To comply with paragraph 38, an insurer shall disclose:

- (a) its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.
- (b) [Refer Appendix 1]
- (c) information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:
  - (i) sensitivity to insurance risk (see paragraph 39A).
  - (ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area, or currency).

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- (iii) actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.
  - (d) information about credit risk, liquidity risk and market risk that paragraphs 31–42 of Ind AS 107 would require if the insurance contracts were within the scope of Ind AS 107. However:
    - (i) an insurer need not provide the maturity analysis required by paragraph 39(a) and (b) of Ind AS 107 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the balance sheet.
    - (ii) if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of Ind AS 107. Such an insurer shall also provide the disclosures required by paragraph 41 of Ind AS 107.
  - (e) information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.
- 39A To comply with paragraph 39(c)(i), an insurer shall disclose either (a) or (b) as follows:
- (a) a sensitivity analysis that shows how profit or loss and equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes

from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of Ind AS 107.

- (b) qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

### **6Effective Date**

40	*
41	*
41A	*
41B	*
41C	*
41D	*
41E	*
41F	*
41G	As a consequence of issuance of Ind AS 115, <i>Revenue from Contracts with Customers</i> , paragraphs 4(a) and (c), B7(b), B18(h) and B21 are amended. An entity shall apply those amendments when it applies Ind AS 115.

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<sup>6</sup> Heading and paragraphs 40-41G, inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

\* Refer Appendix 1

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>Cedant</b>	The <b>policyholder</b> under a <b>reinsurance</b> contract.
<b>deposit component</b>	A contractual component that is not accounted for as a derivative under Ind AS 109 and would be within the scope of Ind AS 109 if it were a separate instrument.
<b>direct insurance contract</b>	An <b>insurance contract</b> that is not a <b>reinsurance contract</b> .
<b>discretionary participation feature</b>	A contractual right to receive, as a supplement to <b>guaranteed benefits</b> , additional benefits: (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: (i) the performance of a specified pool of contracts or a specified type of contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the company, fund or other entity that issues the contract.
<b>fair value</b>	<i>Fair value</i> is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113.)
<b>financial guarantee contract</b>	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

<b>financial risk</b>	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
<b>guaranteed benefits</b>	Payments or other benefits to which a particular <b>policyholder</b> or investor has an unconditional right that is not subject to the contractual discretion of the issuer.
<b>guaranteed element</b>	An obligation to pay <b>guaranteed benefits</b> , included in a contract that contains a <b>discretionary participation feature</b> .
<b>insurance asset</b>	An <b>insurer's</b> net contractual rights under an <b>insurance contract</b> .
<b>insurance contract</b>	A contract under which one party (the <b>insurer</b> ) accepts significant <b>insurance risk</b> from another party (the <b>policyholder</b> ) by agreeing to compensate the policyholder if a specified uncertain future event (the <b>insured event</b> ) adversely affects the policyholder. (See Appendix B for guidance on this definition.)
<b>insurance liability</b>	An <b>insurer's</b> net contractual obligations under an <b>insurance contract</b> .
<b>insurance risk</b>	Risk, other than <b>financial risk</b> , transferred from the holder of a contract to the issuer.
<b>insured event</b>	An uncertain future event that is covered by an <b>insurance contract</b> and creates <b>insurance risk</b> .
<b>insurer</b>	The party that has an obligation under an <b>insurance contract</b> to compensate a <b>policyholder</b> if an <b>insured event</b> occurs.
<b>liability adequacy test</b>	An assessment of whether the carrying amount of an <b>insurance liability</b> needs to be increased (or the carrying amount of related deferred acquisition costs or related intangible assets decreased), based on a review of future cash flows.
<b>policyholder</b>	A party that has a right to compensation under an

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	<b>insurance contract</b> if an <b>insured event</b> occurs.
<b>reinsurance assets</b>	A <b>cedant's</b> net contractual rights under a <b>reinsurance contract</b> .
<b>reinsurance contract</b>	An <b>insurance contract</b> issued by one insurer (the <b>reinsurer</b> ) to compensate another insurer (the <b>cedant</b> ) for losses on one or more contracts issued by the cedant.
<b>reinsurer</b>	The party that has an obligation under a <b>reinsurance contract</b> to compensate a <b>cedant</b> if an <b>insured event</b> occurs.
<b>unbundle</b>	Account for the components of a contract as if they were separate contracts.

## Appendix B

### Definition of an insurance contract

*This appendix is an integral part of the Ind AS.*

- B1 This appendix gives guidance on the definition of an insurance contract in Appendix A. It addresses the following issues:
- (a) the term 'uncertain future event' (paragraphs B2–B4);
  - (b) payments in kind (paragraphs B5–B7);
  - (c) insurance risk and other risks (paragraphs B8–B17);
  - (d) examples of insurance contracts (paragraphs B18–B21);
  - (e) significant insurance risk (paragraphs B22–B28); and
  - (f) changes in the level of insurance risk (paragraphs B29 and B30).

### Uncertain future event

- B2 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:
- (a) whether an *insured event* will occur;
  - (b) when it will occur; or
  - (c) how much the insurer will need to pay if it occurs.
- B3 In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.
- B4 Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such

contracts, the insured event is the discovery of the ultimate cost of those claims.

### **Payments in kind**

- B5 Some insurance contracts require or permit payments to be made in kind. An example is when the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Another example is when an insurer uses its own hospitals and medical staff to provide medical services covered by the contracts.
- B6 Some fixed-fee service contracts in which the level of service depends on an uncertain event meet the definition of an insurance contract in this Ind AS but are not regulated as insurance contracts in some countries. One example is a maintenance contract in which the service provider agrees to repair specified equipment after a malfunction. The fixed service fee is based on the expected number of malfunctions, but it is uncertain whether a particular machine will break down. The malfunction of the equipment adversely affects its owner and the contract compensates the owner (in kind, rather than cash). Another example is a contract for car breakdown services in which the provider agrees, for a fixed annual fee, to provide roadside assistance or tow the car to a nearby garage. The latter contract could meet the definition of an insurance contract even if the provider does not agree to carry out repairs or replace parts.
- B7 Applying this Standard to the contracts described in paragraph B6 is likely to be no more burdensome than applying the Ind ASs that would be applicable if such contracts were outside the scope of this Ind AS:
- (a) There are unlikely to be material liabilities for malfunctions and breakdowns that have already occurred.
  - (b) <sup>7</sup>If Ind AS 115 applied, the service provider would recognise revenue when (or as) it transfers services to the customer (subject to other specified criteria). That approach is also acceptable under this Ind AS, which permits the service provider (i) to continue its existing accounting policies for these contracts unless they involve practices prohibited by

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<sup>7</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

paragraph 14 and (ii) to improve its accounting policies if so permitted by paragraphs 22–30.

- (c) The service provider considers whether the cost of meeting its contractual obligation to provide services exceeds the revenue received in advance. To do this, it applies the liability adequacy test described in paragraphs 15–19 of this Ind AS. If this Accounting Standard did not apply to these contracts, the service provider would apply Ind AS 37 to determine whether the contracts are onerous.
- (d) For these contracts, the disclosure requirements in this Ind AS are unlikely to add significantly to disclosures required by other Ind ASs.

### **Distinction between insurance risk and other risks**

- B8 The definition of an insurance contract refers to insurance risk, which this Ind AS defines as risk, other than *financial risk*, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.
- B9 The definition of financial risk in Appendix A includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not a financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, that risk is insurance risk, not financial risk.
- B10 Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders

(creating financial risk) and promise death benefits that at some times significantly exceed the policyholder's account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.

- B11 Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event—the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 7 of this Ind AS).
- B12 The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.
- B13 The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not exclude 'new-for-old' coverage that pays the policyholder sufficient to permit replacement of a damaged old asset by a new asset. Similarly, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased's dependants, nor does it preclude the payment of predetermined amounts to quantify the loss caused by death or an accident.
- B14 Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying non-financial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash

flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.

- B15 Lapse or persistency risk (ie the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (ie the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.
- B16 Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.
- B17 An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

### **Examples of insurance contracts**

- B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:
- (a) insurance against theft or damage to property.
  - (b) insurance against product liability, professional liability, civil liability or legal expenses.

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- (c) life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).
- (d) life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).
- (e) disability and medical cover.
- (f) surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).
- (g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in Ind AS 109 and are within the scope of Ind AS 107 and Ind AS 109, not this Ind AS (see paragraph 4(d)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either Ind AS 107 and Ind AS 109 or this Ind AS to such financial guarantee contracts.
- (h) <sup>8</sup>product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are

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<sup>8</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

within the scope of this Ind AS. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of Ind AS 115 and Ind AS 37.

- (i) title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.
- (j) travel assistance (ie compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.
- (k) catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).
- (l) insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.
- (m) reinsurance contracts.

B19 The following are examples of items that are not insurance contracts:

- (a) investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).
- (b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

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- (c) self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).
- (d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).
- (e) derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see Ind AS 109).
- (f) a credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see Ind AS 109).
- (g) contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).
- (h) catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.

B20 If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of Ind AS 109. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

- (a) one party recognises the consideration received as a financial liability, rather than as revenue.
- (b) the other party recognises the consideration paid as a financial asset, rather than as an expense.

B21 <sup>9</sup>If the contracts described in paragraph B19 do not create financial assets or financial liabilities, Ind AS 115 applies. Under Ind AS 115, revenue is recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service to a customer in an amount that reflects the consideration to which the entity expects to be entitled.

### **Significant insurance risk**

B22 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8–B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

B23 Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

B24 The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:

- (a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer

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<sup>9</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract.

- (b) waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract.
- (c) a payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million rupees if an asset suffers physical damage causing an insignificant economic loss of one rupee to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one rupee. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999,999 rupees if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract.
- (d) possible reinsurance recoveries. The insurer accounts for these separately.

B25 An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial statements.<sup>10</sup> Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not

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<sup>10</sup> For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.

- B26 It follows from paragraphs B23–B25 that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph B24(b), the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate life-contingent payments are insignificant.
- B27 Paragraph B23 refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.
- B28 If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

### **Changes in the level of insurance risk**

- B29 Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on

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a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.

- B30 A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences between Indian Accounting Standard (Ind AS) 104 and the corresponding International Financial Reporting Standard (IFRS) 4, Insurance Contracts, issued by the International Accounting Standards Board.*

### Comparison with IFRS 4, *Insurance Contracts*

- 1 Different terminology is used, to make it consistent with existing laws eg, term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.
- 2 The transitional provisions given in IFRS 4 have not been given in Ind AS 104, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards* corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.
- 3 Paragraph 39(b) has been deleted in IFRS 4 by IASB. However, paragraph number has been retained in Ind AS 104 to maintain consistency with IFRS 4.
4. <sup>11</sup>Paragraphs 40 to 41F related to effective date have not been included in Ind AS 104 as these are not relevant in Indian context. However, in order to maintain consistency with paragraph numbers of IFRS 4, these paragraph numbers are retained in Ind AS 104.

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<sup>11</sup> Inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Indian Accounting Standard (Ind AS) 105

# Non-current Assets Held for Sale and Discontinued Operations<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to specify the accounting for assets held for sale, and the presentation and disclosure of *discontinued operations*. In particular, this Ind AS requires:
  - (a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and *fair value less costs to sell*, and depreciation on such assets to cease; and
  - (b) assets that meet the criteria to be classified as held for sale to be presented separately in the balance sheet and the results of discontinued operations to be presented separately in the statement of profit and loss.

## Scope

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- 2 The classification and presentation requirements of this Ind AS apply to all recognised *non-current assets*<sup>1</sup> and to all *disposal groups* of an entity. The measurement requirements of this Ind AS apply to all recognised non-current assets and disposal groups (as set out in paragraph 4), except for those assets listed in paragraph 5 which shall continue to be measured in accordance with the Standard noted.

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>1</sup> For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period. Paragraph 3 applies to the classification of such assets.

*Non-current Assets Held for Sale and Discontinued Operations*

- 3 Assets classified as non-current in accordance with Ind AS 1, *Presentation of Financial Statements*, shall not be reclassified as *current assets* until they meet the criteria to be classified as held for sale in accordance with this Ind AS. Assets of a class that an entity would normally regard as non-current that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with this Ind AS.
- 4 Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a disposal group may be a group of *cash-generating units*, a single cash-generating unit, or part of a cash-generating unit.<sup>2</sup> The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded by paragraph 5 from the measurement requirements of this Ind AS. If a non-current asset within the scope of the measurement requirements of this Ind AS is part of a disposal group, the measurement requirements of this Ind AS apply to the group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell. The requirements for measuring the individual assets and liabilities within the disposal group are set out in paragraphs 18, 19 and 23.
- 5 The measurement provisions of this Ind AS<sup>3</sup> do not apply to the following assets, which are covered by the Ind ASs listed, either as individual assets or as part of a disposal group:
- (a) deferred tax assets (Ind AS 12, *Income Taxes*).
  - (b) assets arising from employee benefits (Ind AS 19, *Employee Benefits*).
  - (c) financial assets within the scope of Ind AS 109, *Financial Instruments*.

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<sup>2</sup> However, once the cash flows from an asset or group of assets are expected to arise principally from sale rather than continuing use, they become less dependent on cash flows arising from other assets, and a disposal group that was part of a cash-generating unit becomes a separate cash-generating unit.

<sup>3</sup> Other than paragraphs 18 and 19, which require the assets in question to be measured in accordance with other applicable Accounting Standards.

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- (d) [Refer Appendix 1]
  - (e) non-current assets that are measured at fair value less costs to sell in accordance with Ind AS 41, *Agriculture*.
  - (f) contractual rights under insurance contracts as defined in Ind AS 104, *Insurance Contracts*.
- 5A The classification, presentation and measurement requirements in this Ind AS applicable to a non-current asset (or disposal group) that is classified as held for sale apply also to a non-current asset (or disposal group) that is classified as held for distribution to owners acting in their capacity as owners (held for distribution to owners).
- 5B This Ind AS specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other Ind ASs do not apply to such assets (or disposal groups) unless those Ind ASs require:
- (a) specific disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations; or
  - (b) disclosures about measurement of assets and liabilities within a disposal group that are not within the scope of the measurement requirement of Ind AS 105 and such disclosures are not already provided in the other notes to the financial statements.

Additional disclosures about non-current assets (or disposal groups) classified as held for sale or discontinued operations may be necessary to comply with the general requirements of Ind AS 1, in particular paragraphs 15 and 125 of that Standard.

## **Classification of non-current assets (or disposal groups) as held for sale or as held for distribution to owners**

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

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- 7 For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future.
- 8 For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.
- 8A An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6–8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.
- 9 Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). This will be the case when the criteria in Appendix B are met.
- 10 Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance in accordance with Ind AS 16, *Property, Plant and Equipment*.

- 11 When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, it shall classify the non-current asset (or disposal group) as held for sale at the acquisition date only if the one-year requirement in paragraph 8 is met (except as permitted by paragraph 9) and it is highly probable that any other criteria in paragraphs 7 and 8 that are not met at that date will be met within a short period following the acquisition (usually within three months).
- 12 If the criteria in paragraphs 7 and 8 are met after the reporting period, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the reporting period but before the approval of the financial statements for issue, the entity shall disclose the information specified in paragraph 41(a), (b) and (d) in the notes.
- 12A A non-current asset (or disposal group) is classified as held for distribution to owners when the entity is committed to distribute the asset (or disposal group) to the owners. For this to be the case, the assets must be available for immediate distribution in their present condition and the distribution must be highly probable. For the distribution to be highly probable, actions to complete the distribution must have been initiated and should be expected to be completed within one year from the date of classification. Actions required to complete the distribution should indicate that it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

### **Non-current assets that are to be abandoned**

- 13 An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use. However, if the disposal group to be abandoned meets the criteria in paragraph 32(a)–(c), the entity shall present the results and cash flows of the disposal group as discontinued operations in accordance with paragraphs 33 and 34 at the date on which it ceases to be used. Non-current assets (or disposal groups) to be

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abandoned include non-current assets (or disposal groups) that are to be used to the end of their economic life and non-current assets (or disposal groups) that are to be closed rather than sold.

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

## **Measurement of non-current assets (or disposal groups) classified as held for sale**

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### **Measurement of a non-current asset (or disposal group)**

- 15 An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.
- 15A An entity shall measure a non-current asset (or disposal group) classified as held for distribution to owners at the lower of its carrying amount and fair value less costs to distribute.<sup>4</sup>
- 16 If a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.
- 17 When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.
- 18 Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind ASs.

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<sup>4</sup> Costs to distribute are the incremental costs directly attributable to the distribution, excluding finance costs and income tax expense.

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- 19 On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this Ind AS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with applicable Ind ASs before the fair value less costs to sell of the disposal group is remeasured.

**Recognition of impairment losses and reversals**

- 20 An entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell, to the extent that it has not been recognised in accordance with paragraph 19.
- 21 An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognised either in accordance with this Ind AS or previously in accordance with Ind AS 36, *Impairment of Assets*.
- 22 An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of a disposal group:
- (a) to the extent that it has not been recognised in accordance with paragraph 19; but
  - (b) not in excess of the cumulative impairment loss that has been recognised, either in accordance with this Ind AS or previously in accordance with Ind AS 36, on the non-current assets that are within the scope of the measurement requirements of this Ind AS.
- 23 The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this Ind AS, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of Ind AS 36.
- 24 A gain or loss not previously recognised by the date of the sale of a non-current asset (or disposal group) shall be recognised at the date of derecognition. Requirements relating to derecognition are set out in:

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- (a) paragraphs 67–72 of Ind AS 16 for property, plant and equipment, and
- (b) paragraphs 112–117 of Ind AS 38, *Intangible Assets*, for intangible assets.

25 An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.

**Changes to a plan of sale or to a plan of distribution to owners**

26 <sup>5</sup>If an entity has classified an asset (or disposal group) as held for sale or as held for distribution to owners, but the criteria in paragraphs 7–9 (for held for sale) or in paragraph 12A (for held for distribution to owners) are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale or held for distribution to owners (respectively). In such cases an entity shall follow the guidance in paragraphs 27-29 to account for this change except when paragraph 26A applies.

26A <sup>6</sup>If an entity reclassifies an asset (or disposal group) directly from being held for sale to being held for distribution to owners, or directly from being held for distribution to owners to being held for sale, then the change in classification is considered a continuation of the original plan of disposal. The entity:

- (a) shall not follow the guidance in paragraphs 27–29 to account for this change. The entity shall apply the classification, presentation and measurement requirements in this Ind AS that are applicable to the new method of disposal.
- (b) shall measure the non-current asset (or disposal group) by following the requirements in paragraph 15 (if reclassified as held for sale) or 15A (if reclassified as held for distribution to owners) and recognise any reduction or increase in the fair

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<sup>5</sup> Heading and opening paragraph substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>6</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

value less costs to sell/costs to distribute of the non-current asset (or disposal group) by following the requirements in paragraphs 20–25.

- (c) shall not change the date of classification in accordance with paragraphs 8 and 12A. This does not preclude an extension of the period required to complete a sale or a distribution to owners if the conditions in paragraph 9 are met.

27 <sup>7</sup>The entity shall measure a non-current asset (or disposal group) that ceases to be classified as held for sale or as held for distribution to owners (or ceases to be included in a disposal group classified as held for sale or as held for distribution to owners) at the lower of:

- (a) its carrying amount before the asset (or disposal group) was classified as held for sale or as held for distribution to owners, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale or as held for distribution to owners, and
- (b) its *recoverable amount* at the date of the subsequent decision not to sell or distribute.<sup>8</sup>

28 <sup>9</sup>The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale or as held for distribution to owners in profit or loss<sup>10</sup> from continuing operations in the period in which the criteria in paragraphs 7–9 or 12A, respectively, are no longer met. Financial statements for the periods since classification as held for sale or as held for distribution to owners shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as

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<sup>7</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>8</sup> If the non-current asset is part of a cash-generating unit, its recoverable amount is the carrying amount that would have been recognised after the allocation of any impairment loss arising on that cash-generating unit in accordance with Ind AS 36.

<sup>9</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>10</sup> Unless the asset is property, plant and equipment or an intangible asset that had been revalued in accordance with Ind AS 16 or Ind AS 38 before classification as held for sale, in which case the adjustment shall be treated as a revaluation increase or decrease.

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held for sale or as held for distribution to owners is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate. The entity shall present that adjustment in the same caption in the statement of profit and loss used to present a gain or loss, if any, recognised in accordance with paragraph 37.

- 29 <sup>11</sup>If an entity removes an individual asset or liability from a disposal group classified as held for sale, the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group only if the group meets the criteria in paragraphs 7–9. If an entity removes an individual asset or liability from a disposal group classified as held for distribution to owners, the remaining assets and liabilities of the disposal group to be distributed shall continue to be measured as a group only if the group meets the criteria in paragraph 12A. Otherwise, the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale (or as held for distribution to owners) shall be measured individually at the lower of their carrying amounts and fair values less costs to sell (or costs to distribute) at that date. Any non-current assets that do not meet the criteria for held for sale shall cease to be classified as held for sale in accordance with paragraph 26. Any non-current assets that do not meet the criteria for held for distribution to owners shall cease to be classified as held for distribution to owners in accordance with paragraph 26.

## **Presentation and disclosure**

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- 30 **An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).**

### **Presenting discontinued operations**

- 31 *A component of an entity* comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-

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<sup>11</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

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generating units while being held for use.

32 A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and

- (a) represents a separate major line of business or geographical area of operations,
- (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or
- (c) is a subsidiary acquired exclusively with a view to resale.

33 An entity shall disclose:

- (a) a single amount in the statement of profit and loss comprising the total of:
  - (i) the post-tax profit or loss of discontinued operations and
  - (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- (b) an analysis of the single amount in (a) into:
  - (i) the revenue, expenses and pre-tax profit or loss of discontinued operations;
  - (ii) the related income tax expense as required by paragraph 81(h) of Ind AS 12.
  - (iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
  - (iv) the related income tax expense as required by paragraph 81(h) of Ind AS 12.

The analysis may be presented in the notes or in the statement of profit and loss. If it is presented in the statement of profit and loss it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. The analysis is not required for

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disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

- (c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).
- (d) the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of profit and loss.

33A [Refer Appendix 1]

34 An entity shall re-present the disclosures in paragraph 33 for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the reporting period for the latest period presented.

35 Adjustments in the current period to amounts previously presented in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period shall be classified separately in discontinued operations. The nature and amount of such adjustments shall be disclosed. Examples of circumstances in which these adjustments may arise include the following:

- (a) the resolution of uncertainties that arise from the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser.
- (b) the resolution of uncertainties that arise from and are directly related to the operations of the component before its disposal, such as environmental and product warranty obligations retained by the seller.
- (c) the settlement of employee benefit plan obligations, provided that the settlement is directly related to the disposal transaction.

- 36 If an entity ceases to classify a component of an entity as held for sale, the results of operations of the component previously presented in discontinued operations in accordance with paragraphs 33–35 shall be reclassified and included in income from continuing operations for all periods presented. The amounts for prior periods shall be described as having been re-presented.
- 36A An entity that is committed to a sale plan involving loss of control of a subsidiary shall disclose the information required in paragraphs 33–36 when the subsidiary is a disposal group that meets the definition of a discontinued operation in accordance with paragraph 32.

### **Gains or losses relating to continuing operations**

- 37 Any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale that does not meet the definition of a discontinued operation shall be included in profit or loss from continuing operations.

### **Presentation of a non-current asset or disposal group classified as held for sale**

- 38 An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the balance sheet or in the notes, except as permitted by paragraph 39. An entity shall present separately any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.
- 39 If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition (see paragraph 11), disclosure of the major classes of assets and liabilities is not required.
- 40 An entity shall not reclassify or re-present amounts presented for

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non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the balance sheets for prior periods to reflect the classification in the balance sheet for the latest period presented.

**Additional disclosures**

- 41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:
- (a) a description of the non-current asset (or disposal group);
  - (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
  - (c) the gain or loss recognised in accordance with paragraphs 20–22 and, if not separately presented in the statement of profit and loss, the caption in the statement of profit and loss that includes that gain or loss;
  - (d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with Ind AS 108, *Operating Segments*.
- 42 If either paragraph 26 or paragraph 29 applies, an entity shall disclose, in the period of the decision to change the plan to sell the non-current asset (or disposal group), a description of the facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>cash-generating unit</b>	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
<b>component of an entity</b>	Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
<b>costs to sell</b>	The incremental costs directly attributable to the disposal of an asset (or <b>disposal group</b> ), excluding finance costs and income tax expense.
<b>current asset</b>	An entity shall classify an asset as current when: <ul style="list-style-type: none"><li>(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;</li><li>(b) it holds the asset primarily for the purpose of trading;</li><li>(c) it expects to realise the asset within twelve months after the reporting period; or</li><li>(d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.</li></ul>
<b>discontinued operation</b>	A <b>component of an entity</b> that either has been disposed of or is classified as held for sale and: <ul style="list-style-type: none"><li>(a) represents a separate major line of business or geographical area of operations,</li><li>(b) is part of a single co-ordinated plan to dispose of a separate major line of business</li></ul>

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or geographical area of operations or

- (c) is a subsidiary acquired exclusively with a view to resale.

<b>disposal group</b>	A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a <b>cash-generating unit</b> to which goodwill has been allocated in accordance with the requirements of paragraphs 80–87 of Ind AS 36, <i>Impairment of Assets</i> , or if it is an operation within such a cash-generating unit.
<b>fair value</b>	<i>Fair value</i> is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113.)
<b>firm purchase commitment</b>	An agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance <b>highly probable</b> .
<b>highly probable</b>	Significantly more likely than <b>probable</b> .
<b>non-current asset</b>	An asset that does not meet the definition of a <b>current asset</b> .
<b>probable</b>	More likely than not.
<b>recoverable amount</b>	The higher of an asset's <b>fair value</b> less <b>costs to sell</b> and its <b>value in use</b> .
<b>value in use</b>	The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

## Appendix B

### Application supplement

*This appendix is an integral part of the Ind AS.*

### Extension of the period required to complete a sale

- B1 As noted in paragraph 9, an extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). An exception to the one-year requirement in paragraph 8 shall therefore apply in the following situations in which such events or circumstances arise:
- (a) at the date an entity commits itself to a plan to sell a non-current asset (or disposal group) it reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:
    - (i) actions necessary to respond to those conditions cannot be initiated until after a *firm purchase commitment* is obtained, and
    - (ii) a firm purchase commitment is highly probable within one year.
  - (b) an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:
    - (i) timely actions necessary to respond to the conditions have been taken, and
    - (ii) a favourable resolution of the delaying factors is expected.

*Non-current Assets Held for Sale and Discontinued Operations*

- (c) during the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:
  - (i) during the initial one-year period the entity took action necessary to respond to the change in circumstances,
  - (ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and
  - (iii) the criteria in paragraphs 7 and 8 are met.

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## **Appendix C**

### **References to matters contained in other Indian Accounting Standards**

*This Appendix is an integral part of the Ind AS.*

Appendix A, *Distributions of Non-cash Assets to Owners*, contained in Ind AS 10, *Events after the Reporting Period*.

## **Appendix 1**

*Note: This appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 105 and the corresponding International Financial Reporting Standard (IFRS) 5, Non-current Assets Held for Sale and Discontinued Operations, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations**

- 1 The transitional provisions given in IFRS 5 have not been given in Ind AS 105, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.
- 2 Different terminology is used in this standard, eg, the term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'. Words 'approval of the financial statements for issue' have been used instead of 'authorisation of the financial statements for issue' in the context of financial statements considered for the purpose of events after the reporting period.
- 3 Requirements regarding presentation of discontinued operations in the separate income statement, where separate income statement is presented under paragraph 33A of IFRS 5 have been deleted. This change is consequential to the removal of option regarding two statement approach in Ind AS 1. Ind AS 1 requires that the components of profit or loss and components of other comprehensive income shall be presented as a part of the statement of profit and loss. However, paragraph number 33A has been retained in Ind AS 105 to maintain consistency with paragraph numbers of IFRS 5.
- 4 Paragraph 5(d) of IFRS 5 deals with non-current assets that are accounted for in accordance with the fair value model in IAS 40, Investment Property. Since Ind AS 40 prohibits the use of fair value

*Ind AS 105*

model, this paragraph is deleted in Ind AS 105.

- 5 Paragraph 7 prescribes the conditions for classification of a non-current asset (or disposal group) as held for sale. A clarification has been added in Paragraph 7 that the non-current asset (or disposal group) cannot be classified as held for sale, if the entity intends to sell it in a distant future.

## Indian Accounting Standard (Ind AS) 106

# Exploration for and Evaluation of Mineral Resources<sup>#</sup>

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to specify the financial reporting for the *exploration for and evaluation of mineral resources*.
- 2 In particular, the Ind AS requires:
  - (a) limited improvements to existing accounting practices for *exploration and evaluation expenditures*.
  - (b) entities that recognise *exploration and evaluation assets* to assess such assets for impairment in accordance with this Ind AS and measure any impairment in accordance with Ind AS 36, *Impairment of Assets*.
  - (c) disclosures that identify and explain the amounts in the entity's financial statements arising from the exploration for and evaluation of mineral resources and help users of those financial statements understand the amount, timing and certainty of future cash flows from any exploration and evaluation assets recognised.

## Scope

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- 3 An entity shall apply this Ind AS to exploration and evaluation expenditures that it incurs.
- 4 This Ind AS does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral resources.
- 5 An entity shall not apply this Ind AS to expenditures incurred:

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015.

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- (a) before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- (b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

## **Recognition of Exploration and Evaluation Assets**

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### **Temporary exemption from Ind AS 8 paragraphs 11 and 12**

- 6 When developing its accounting policies, an entity recognising exploration and evaluation assets shall apply paragraph 10 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 7 Paragraphs 11 and 12 of Ind AS 8 specify sources of authoritative requirements and guidance that management is required to consider in developing an accounting policy for an item if no Accounting Standard applies specifically to that item. Subject to paragraphs 9 and 10 below, this Accounting Standard exempts an entity from applying those paragraphs to its accounting policies for the recognition and measurement of exploration and evaluation assets.

## **Measurement of Exploration and Evaluation Assets**

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### **Measurement at recognition**

- 8 **Exploration and evaluation assets shall be measured at cost.**

### **Elements of cost of exploration and evaluation assets**

- 9 An entity shall determine an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are

## *Exploration for and Evaluation of Mineral Resources*

examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

- (a) acquisition of rights to explore;
- (b) topographical, geological, geochemical and geophysical studies;
- (c) exploratory drilling;
- (d) trenching;
- (e) sampling; and
- (f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

10 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The *Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India and Ind AS 38, *Intangible Assets*, provide guidance on the recognition of assets arising from development.

11 In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.

### **Measurement after recognition**

12 After recognition, an entity shall apply either the cost model or the revaluation model to the exploration and evaluation assets. If the revaluation model is applied (either the model in Ind AS 16, *Property, Plant and Equipment*, or the model in Ind AS 38) it shall be consistent with the classification of the assets (see paragraph 15).

### **Changes in accounting policies**

13 **An entity may change its accounting policies for exploration and evaluation expenditures if the change makes the financial statements more relevant to the economic decision-making**

**needs of users and no less reliable, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in Ind AS 8.**

- 14 To justify changing its accounting policies for exploration and evaluation expenditures, an entity shall demonstrate that the change brings its financial statements closer to meeting the criteria in Ind AS 8, but the change need not achieve full compliance with those criteria.

## **Presentation**

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### **Classification of exploration and evaluation assets**

- 15 An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.
- 16 Some exploration and evaluation assets are treated as intangible (eg drilling rights), whereas others are tangible (eg vehicles and drilling rigs). To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.

### **Reclassification of exploration and evaluation assets**

- 17 An exploration and evaluation asset shall no longer be classified as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. Exploration and evaluation assets shall be assessed for impairment, and any impairment loss recognised, before reclassification.

## **Impairment**

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### **Recognition and measurement**

- 18 **Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may**

**exceed its recoverable amount. When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, an entity shall measure, present and disclose any resulting impairment loss in accordance with Ind AS 36, except as provided by paragraph 21 below.**

19 For the purposes of exploration and evaluation assets only, paragraph 20 of this Accounting Standard shall be applied rather than paragraphs 8-17 of Ind AS 36 when identifying an exploration and evaluation asset that may be impaired. Paragraph 20 uses the term 'assets' but applies equally to separate exploration and evaluation assets or a cash-generating unit.

20 One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):

- (a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.
- (b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.
- (c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area.
- (d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

In any such case, or similar cases, the entity shall perform an impairment test in accordance with Ind AS 36. Any impairment loss is recognised as an expense in accordance with Ind AS 36.

### **Specifying the level at which exploration and evaluation assets are assessed for impairment**

21 **An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or**

**groups of cash-generating units for the purpose of assessing such assets for impairment. Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than an operating segment determined in accordance with Ind AS 108, *Operating Segments*.**

- 22 The level identified by the entity for the purposes of testing exploration and evaluation assets for impairment may comprise one or more cash-generating units.

## **Disclosure**

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- 23 **An entity shall disclose information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources.**
- 24 To comply with paragraph 23, an entity shall disclose:
- (a) its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets.
  - (b) the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.
- 25 An entity shall treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either Ind AS 16 or Ind AS 38 consistent with how the assets are classified.

## Appendix A

### Defined Terms

*This Appendix is an integral part of the Ind AS.*

<b>exploration and evaluation assets</b>	<b>Exploration and evaluation expenditures</b> recognised as assets in accordance with the entity's accounting policy.
<b>exploration and evaluation expenditures</b>	Expenditures incurred by an entity in connection with the <b>exploration for and evaluation of mineral resources</b> before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.
<b>exploration for and evaluation of mineral resources</b>	The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.

## **Appendix 1**

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 106 and the corresponding International Financial Reporting Standard (IFRS) 6, Exploration for and Evaluation of Mineral Resources, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 6, *Exploration for and Evaluation of Mineral Resources***

1. The transitional provisions given in IFRS 6 have not been given in Ind AS 106, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.

## Indian Accounting Standard (Ind AS) 107

# Financial Instruments: Disclosures<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to require entities to provide disclosures in their financial statements that enable users to evaluate:
  - (a) the significance of financial instruments for the entity's financial position and performance; and
  - (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.
- 2 The principles in this Ind AS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Ind AS 32, *Financial Instruments: Presentation*, and Ind AS 109, *Financial Instruments*.

## Scope

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- 3 This Ind AS shall be applied by all entities to all types of financial instruments, except:
  - (a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with Ind AS 110, *Consolidated Financial Statements*, Ind AS 27, *Separate Financial Statements* or Ind AS 28, *Investments in Associates and Joint Ventures*. However, in some cases, Ind AS 110, Ind AS 27 or Ind AS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture using Ind

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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AS 109; in those cases, entities shall apply the requirements of this Ind AS and, for those measured at fair value, the requirements of Ind AS 113, *Fair Value Measurement*. Entities shall also apply this Ind AS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in Ind AS 32.

- (b) employers' rights and obligations arising from employee benefit plans, to which Ind AS 19, *Employee Benefits*, applies.
  - (c) [Refer Appendix 1]
  - (d) insurance contracts as defined in Ind AS 104, *Insurance Contracts*. However, this Ind AS applies to derivatives that are embedded in insurance contracts if Ind AS 109 requires the entity to account for them separately. Moreover, an issuer shall apply this Ind AS to *financial guarantee contracts* if the issuer applies Ind AS 109 in recognising and measuring the contracts, but shall apply Ind AS 104 if the issuer elects, in accordance with paragraph 4(d) of Ind AS 104, to apply Ind AS 104 in recognising and measuring them.
  - (e) financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102, *Share-based Payment*, applies, except that this Ind AS applies to contracts within the scope of Ind AS 109.
  - (f) instruments that are required to be classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of Ind AS 32.
- 4 This Ind AS applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of Ind AS 109. Unrecognised financial instruments include some financial instruments that, although outside the scope of Ind AS 109, are within the scope of this Ind AS.
- 5 This Ind AS applies to contracts to buy or sell a non-financial item that are within the scope of Ind AS 109.

- 5A <sup>1</sup>The credit risk disclosure requirements in paragraphs 35A to 35N apply to those rights that Ind AS 115, *Revenue from Contracts with Customers* specifies are accounted for in accordance with Ind AS 109 for the purposes of recognising impairment gains or losses. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

## **Classes of financial instruments and level of disclosure**

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- 6 When this Ind AS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the balance sheet.

## **Significance of financial instruments for financial position and performance**

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- 7 **An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.**

### **Balance sheet**

#### **Categories of financial assets and financial liabilities**

- 8 The carrying amounts of each of the following categories, as specified in Ind AS 109, shall be disclosed either in the balance sheet or in the notes:
- (a) financial assets measured at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 6.7.1 of Ind AS 109 and (ii) those mandatorily measured at fair value through profit or loss in accordance with Ind AS 109.

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<sup>1</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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(b)- (d) [Refer Appendix 1]

- (e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 6.7.1 of Ind AS 109 and (ii) those that meet the definition of held for trading in Ind AS 109 .
- (f) financial assets measured at amortised cost.
- (g) financial liabilities measured at amortised cost.
- (h) financial assets measured at fair value through other comprehensive income, showing separately (i) financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109; and (ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 5.7.5 of Ind AS 109.

**Financial assets or financial liabilities at fair value through profit or loss**

9 If the entity has designated as measured at fair value through profit or loss a financial asset (or group of financial assets) that would otherwise be measured at fair value through other comprehensive income or amortised cost, it shall disclose:

- (a) the maximum exposure to *credit risk* (see paragraph 36(a)) of the financial asset (or group of financial assets) at the end of the reporting period.
- (b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk (see paragraph 36(b)).
- (c) the amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) that is attributable to changes in the credit risk of the financial asset determined either:
  - (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to *market risk*; or

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- (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

- (d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the financial asset was designated.

10 If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 4.2.2 of Ind AS 109 and is required to present the effects of changes in that liability's credit risk in other comprehensive income (see paragraph 5.7.7 of Ind AS 109), it shall disclose:

- (a) the amount of change, cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs B5.7.13-B5.7.20 of Ind AS 109 for guidance on determining the effects of changes in a liability's credit risk).
- (b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.
- (c) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.
- (d) if a liability is derecognised during the period, the amount (if any) presented in other comprehensive income that was realised at derecognition.

10A If an entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 4.2.2 of Ind AS 109 and is required to present all changes in the fair value of that liability (including the effects of changes in the credit risk of the liability) in profit or loss (see paragraphs 5.7.7 and 5.7.8 of Ind AS 109), it shall disclose:

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- (a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs B5.7.13–B5.7.20 of Ind AS 109 for guidance on determining the effects of changes in a liability’s credit risk); and
- (b) the difference between the financial liability’s carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

11 The entity shall also disclose:

- (a) a detailed description of the methods used to comply with the requirements in paragraphs 9(c), 10(a) and 10A(a) and paragraph 5.7.7(a) of Ind AS 109, including an explanation of why the method is appropriate.
- (b) if the entity believes that the disclosure it has given, either in the balance sheet or in the notes, to comply with the requirements in paragraph 9(c), 10(a) or 10A(a) or paragraph 5.7.7(a) of Ind AS 109 does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.
- (c) a detailed description of the methodology or methodologies used to determine whether presenting the effects of changes in a liability’s credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss (see paragraphs 5.7.7 and 5.7.8 of Ind AS 109). If an entity is required to present the effects of changes in a liability’s credit risk in profit or loss (see paragraph 5.7.8 of Ind AS 109), the disclosure must include a detailed description of the economic relationship described in paragraph B5.7.6 of Ind AS 109.

**Investments in equity instruments designated at fair value through other comprehensive income**

11A If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of Ind AS 109, it shall disclose:

- (a) which investments in equity instruments have been

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designated to be measured at fair value through other comprehensive income.

- (b) the reasons for using this presentation alternative.
- (c) the fair value of each such investment at the end of the reporting period.
- (d) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.
- (e) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

11B If an entity derecognised investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

- (a) the reasons for disposing of the investments.
- (b) the fair value of the investments at the date of derecognition.
- (c) the cumulative gain or loss on disposal.

**Reclassification**

12-12A [Refer Appendix 1]

12B An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 4.4.1 of Ind AS 109. For each such event, an entity shall disclose:

- (a) the date of reclassification.
- (b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.
- (c) the amount reclassified into and out of each category.

12C For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of the fair value through profit or loss category so that they are measured at amortised cost or fair value through other comprehensive income in accordance with paragraph 4.4.1 of Ind

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AS 109:

- (a) the effective interest rate determined on the date of reclassification; and
- (b) the interest revenue recognised.

12D If, since its last annual reporting date, an entity has reclassified financial assets out of the fair value through other comprehensive income category so that they are measured at amortised cost or out of the fair value through profit or loss category so that they are measured at amortised cost or fair value through other comprehensive income it shall disclose:

- (a) the fair value of the financial assets at the end of the reporting period; and
- (b) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets had not been reclassified.

13 [Refer Appendix 1]

**Offsetting financial assets and financial liabilities**

13A The disclosures in paragraphs 13B–13E supplement the other disclosure requirements of this Ind AS and are required for all recognised financial instruments that are set off in accordance with paragraph 42 of Ind AS 32. These disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 42 of Ind AS 32.

13B An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A.

13C To meet the objective in paragraph 13B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A:

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- (a) the gross amounts of those recognised financial assets and recognised financial liabilities;
- (b) the amounts that are set-off in accordance with the criteria in paragraph 42 of Ind AS 32 when determining the net amounts presented in the statement of financial position;
- (c) the net amounts presented in the balance sheet;
- (d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b), including:
  - (i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of Ind AS 32; and
  - (ii) amounts related to financial collateral (including cash collateral); and
- (e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

- 13D The total amount disclosed in accordance with paragraph 13C(d) for an instrument shall be limited to the amount in paragraph 13C(c) for that instrument.
- 13E An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 13C(d), including the nature of those rights.
- 13F If the information required by paragraphs 13B–13E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

**Collateral**

- 14 An entity shall disclose:
  - (a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including

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amounts that have been reclassified in accordance with paragraph 3.2.23(a) of Ind AS 109; and

(b) the terms and conditions relating to its pledge.

15 When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

(a) the fair value of the collateral held;

(b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and

(c) the terms and conditions associated with its use of the collateral.

**Allowance account for credit losses**

16 [Refer Appendix 1]

16A The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109 is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the balance sheet as a reduction of the carrying amount of the financial asset. However, an entity shall disclose the loss allowance in the notes to the financial statements.

**Compound financial instruments with multiple embedded derivatives**

17 If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 28 of Ind AS 32) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

**Defaults and breaches**

18 For *loans payable* recognised at the end of the reporting period, an entity shall disclose:

(a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) the carrying amount of the loans payable in default at the end of the reporting period; and

- (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for issue.

19 If, during the period, there were breaches of loan agreement terms other than those described in paragraph 18, an entity shall disclose the same information as required by paragraph 18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

## **Statement of profit and loss**

### **Items of income, expense, gains or losses**

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of profit and loss or in the notes:

- (a) net gains or net losses on:
  - (i) financial assets or financial liabilities measured at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition or subsequently in accordance with paragraph 6.7.1 of Ind AS 109, and those on financial assets or financial liabilities that are mandatorily measured at fair value through profit or loss in accordance with Ind AS 109 (eg financial liabilities that meet the definition of held for trading in Ind AS 109). For financial liabilities designated as at fair value through profit or loss, an entity shall show separately the amount of gain or loss recognised in other comprehensive income and the amount recognised in profit or loss.
  - (ii)- (iv) [Refer Appendix 1]
  - (v) financial liabilities measured at amortised cost.
  - (vi) financial assets measured at amortised cost.
  - (vii) investments in equity instruments designated at fair value through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109.

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- (viii) financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified upon derecognition from accumulated other comprehensive income to profit or loss for the period.
  - (b) total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109 (showing these amounts separately); or financial liabilities that are not measured at fair value through profit or loss.
  - (c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:
    - (i) financial assets and financial liabilities that are not at fair value through profit or loss; and
    - (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.
  - (d)-(e) [Refer Appendix 1]
- 20A An entity shall disclose an analysis of the gain or loss recognised in the statement of profit and loss arising from the derecognition of financial assets measured at amortised cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognising those financial assets.

## Other disclosures

### Accounting policies

- 21 <sup>2</sup>In accordance with paragraph 117 of Ind AS 1, *Presentation of Financial Statements*, an entity discloses its significant accounting policies, comprising the measurement basis (or bases) used in preparing the financial statements and the other accounting policies

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<sup>2</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

used that are relevant to an understanding of the financial statements.

**Hedge accounting**

- 21A An entity shall apply the disclosure requirements in paragraphs 21B–24F for those risk exposures that an entity hedges and for which it elects to apply hedge accounting. Hedge accounting disclosures shall provide information about:
- (a) an entity's risk management strategy and how it is applied to manage risk;
  - (b) how the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
  - (c) the effect that hedge accounting has had on the entity's balance sheet, statement of profit and loss and statement of changes in equity.
- 21B An entity shall present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.
- 21C When paragraphs 22A–24F require the entity to separate by risk category the information disclosed, the entity shall determine each risk category on the basis of the risk exposures an entity decides to hedge and for which hedge accounting is applied. An entity shall determine risk categories consistently for all hedge accounting disclosures.
- 21D To meet the objectives in paragraph 21A, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed. However, an entity shall use the same level of aggregation or

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disaggregation it uses for disclosure requirements of related information in this Ind AS and Ind AS 113, *Fair Value Measurement*.

*The risk management strategy*

22 [Refer Appendix 1]

22A An entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example):

- (a) how each risk arises.
- (b) how the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why.
- (c) the extent of risk exposures that the entity manages.

22B To meet the requirements in paragraph 22A, the information should include (but is not limited to) a description of:

- (a) the hedging instruments that are used (and how they are used) to hedge risk exposures;
- (b) how the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness; and
- (c) how the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are.

22C When an entity designates a specific risk component as a hedged item (see paragraph 6.3.7 of Ind AS 109) it shall provide, in addition to the disclosures required by paragraphs 22A and 22B, qualitative or quantitative information about:

- (a) how the entity determined the risk component that is designated as the hedged item (including a description of the nature of the relationship between the risk component and the item as a whole); and
- (b) how the risk component relates to the item in its entirety (for example, the designated risk component historically covered on average 80 per cent of the changes in fair value of the item as a whole).

*The amount, timing and uncertainty of future cash flows*

- 23 [Refer Appendix 1]
- 23A Unless exempted by paragraph 23C, an entity shall disclose by risk category quantitative information to allow users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity.
- 23B To meet the requirement in paragraph 23A, an entity shall provide a breakdown that discloses:
- (a) a profile of the timing of the nominal amount of the hedging instrument; and
  - (b) if applicable, the average price or rate (for example strike or forward prices etc) of the hedging instrument.
- 23C In situations in which an entity frequently resets (ie discontinues and restarts) hedging relationships because both the hedging instrument and the hedged item frequently change (ie the entity uses a dynamic process in which both the exposure and the hedging instruments used to manage that exposure do not remain the same for long—such as in the example in paragraph B6.5.24(b) of Ind AS 109) the entity:
- (a) is exempt from providing the disclosures required by paragraphs 23A and 23B.
  - (b) shall disclose:
    - (i) information about what the ultimate risk management strategy is in relation to those hedging relationships;
    - (ii) a description of how it reflects its risk management strategy by using hedge accounting and designating those particular hedging relationships; and
    - (iii) an indication of how frequently the hedging relationships are discontinued and restarted as part of the entity's process in relation to those hedging relationships.
- 23D An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.

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23E If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness.

23F For cash flow hedges, an entity shall disclose a description of any forecast transaction for which hedge accounting had been used in the previous period, but which is no longer expected to occur.

*The effects of hedge accounting on financial position and performance*

24 [Refer Appendix 1]

24A An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

- (a) the carrying amount of the hedging instruments (financial assets separately from financial liabilities);
- (b) the line item in the balance sheet that includes the hedging instrument;
- (c) the change in fair value of the hedging instrument used as the basis for recognising hedge ineffectiveness for the period; and
- (d) the nominal amounts (including quantities such as tonnes or cubic metres) of the hedging instruments.

24B An entity shall disclose, in a tabular format, the following amounts related to hedged items separately by risk category for the types of hedges as follows:

- (a) for fair value hedges:
  - (i) the carrying amount of the hedged item recognised in the balance sheet (presenting assets separately from liabilities);
  - (ii) the accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognised in the balance sheet (presenting assets separately from liabilities);
  - (iii) the line item in the balance sheet that includes the hedged item;

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- (iv) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period; and
  - (v) the accumulated amount of fair value hedge adjustments remaining in the balance sheet for any hedged items that have ceased to be adjusted for hedging gains and losses in accordance with paragraph 6.5.10 of Ind AS 109.
- (b) for cash flow hedges and hedges of a net investment in a foreign operation:
- (i) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period (ie for cash flow hedges the change in value used to determine the recognised hedge ineffectiveness in accordance with paragraph 6.5.11(c) of Ind AS 109);
  - (ii) the balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges that are accounted for in accordance with paragraphs 6.5.11 and 6.5.13(a) of Ind AS 109; and
  - (iii) the balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

24C An entity shall disclose, in a tabular format, the following amounts separately by risk category for the types of hedges as follows:

- (a) for fair value hedges:
  - (i) hedge ineffectiveness—ie the difference between the hedging gains or losses of the hedging instrument and the hedged item—recognised in profit or loss (or other comprehensive income for hedges of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109); and
  - (ii) the line item in the statement of profit and loss that includes the recognised hedge ineffectiveness.

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- (b) for cash flow hedges and hedges of a net investment in a foreign operation:
  - (i) hedging gains or losses of the reporting period that were recognised in other comprehensive income;
  - (ii) hedge ineffectiveness recognised in profit or loss;
  - (iii) the line item in the statement of profit and loss that includes the recognised hedge ineffectiveness;
  - (iv) the amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into profit or loss as a reclassification adjustment (see Ind AS 1) (differentiating between amounts for which hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected profit or loss);
  - (v) the line item in the statement of profit and loss that includes the reclassification adjustment (see Ind AS 1); and
  - (vi) for hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of profit and loss (see paragraph 6.6.4 of Ind AS 109).

24D When the volume of hedging relationships to which the exemption in paragraph 23C applies is unrepresentative of normal volumes during the period (ie the volume at the reporting date does not reflect the volumes during the period) an entity shall disclose that fact and the reason it believes the volumes are unrepresentative.

24E An entity shall provide a reconciliation of each component of equity and an analysis of other comprehensive income in accordance with Ind AS 1 that, taken together:

- (a) differentiates, at a minimum, between the amounts that relate to the disclosures in paragraph 24C(b)(i) and (b)(iv) as well as the amounts accounted for in accordance with paragraph 6.5.11(d)(i) and (d)(iii) of Ind AS 109;
- (b) differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options

that hedge time-period related hedged items when an entity accounts for the time value of an option in accordance with paragraph 6.5.15 of Ind AS 109; and

- (c) differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction related hedged items, and the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time-period related hedged items when an entity accounts for those amounts in accordance with paragraph 6.5.16 of Ind AS 109.

24F An entity shall disclose the information required in paragraph 24E separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements.

*Option to designate a credit exposure as measured at fair value through profit or loss*

24G If an entity designated a financial instrument, or a proportion of it, as measured at fair value through profit or loss because it uses a credit derivative to manage the credit risk of that financial instrument it shall disclose:

- (a) for credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair value through profit or loss in accordance with paragraph 6.7.1 of Ind AS 109, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period;
- (b) the gain or loss recognised in profit or loss on designation of a financial instrument, or a proportion of it, as measured at fair value through profit or loss in accordance with paragraph 6.7.1 of Ind AS 109; and
- (c) on discontinuation of measuring a financial instrument, or a proportion of it, at fair value through profit or loss, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 6.7.4(b) of Ind AS 109 and the related nominal or principal amount (except for providing comparative information in accordance with Ind

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AS 1, an entity does not need to continue this disclosure in subsequent periods).

**Fair value**

- 25 Except as set out in paragraph 29, for each class of financial assets and financial liabilities (see paragraph 6), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
- 26 In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the balance sheet.
- 27-27B [Refer Appendix 1]
- 28 In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of Ind AS 109). In such cases, the entity shall disclose by class of financial asset or financial liability:
- (a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of Ind AS 109).
  - (b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
  - (c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.
- 29 Disclosures of fair value are not required:
- (a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
  - (b) [Refer Appendix 1]

- (c) for a contract containing a discretionary participation feature (as described in Ind AS 104) if the fair value of that feature cannot be measured reliably.
- 30 In the case described in paragraph 29(c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those contracts and their fair value, including:
- (a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
  - (b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
  - (c) information about the market for the instruments;
  - (d) information about whether and how the entity intends to dispose of the financial instruments; and
  - (e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

## **Nature and extent of risks arising from financial instruments**

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- 31 **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.**
- 32 The disclosures required by paragraphs 33–42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, *liquidity risk* and market risk.
- 32A Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and

quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

### **Qualitative disclosures**

- 33 For each type of risk arising from financial instruments, an entity shall disclose:
- (a) the exposures to risk and how they arise;
  - (b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
  - (c) any changes in (a) or (b) from the previous period.

### **Quantitative disclosures**

- 34 For each type of risk arising from financial instruments, an entity shall disclose:
- (a) summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in Ind AS 24, *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.
  - (b) the disclosures required by paragraphs 36–42, to the extent not provided in accordance with (a).
  - (c) concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

- 35 If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

### **Credit risk**

#### *Scope and objectives*

- 35A An entity shall apply the disclosure requirements in paragraphs 35F–35N to financial instruments to which the impairment requirements in Ind AS 109 are applied. However:
- (a) for trade receivables, contract assets and lease receivables,

- paragraph 35J applies to those trade receivables, contract
- (b) assets or lease receivables on which lifetime expected credit losses are recognised in accordance with paragraph 5.5.15 of Ind AS 109, if those financial assets are modified while more than 30 days past due; and
  - (c) paragraph 35K(b) does not apply to lease receivables.
- 35B The credit risk disclosures made in accordance with paragraphs 35F–35N shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures shall provide:
- (a) information about an entity’s credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;
  - (b) quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and
  - (c) information about an entity’s credit risk exposure (ie the credit risk inherent in an entity’s financial assets and commitments to extend credit) including significant credit risk concentrations.
- 35C An entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to other statements, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.
- 35D To meet the objectives in paragraph 35B, an entity shall (except as otherwise specified) consider how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need

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additional explanations to evaluate the quantitative information disclosed.

- 35E If the disclosures provided in accordance with paragraphs 35F–35N are insufficient to meet the objectives in paragraph 35B, an entity shall disclose additional information that is necessary to meet those objectives.

*The credit risk management practices*

- 35F An entity shall explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate:

- (a) how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:
  - (i) financial instruments are considered to have low credit risk in accordance with paragraph 5.5.10 of Ind AS 109, including the classes of financial instruments to which it applies; and
  - (ii) the presumption in paragraph 5.5.11 of Ind AS 109, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted;
- (b) an entity's definitions of default, including the reasons for selecting those definitions;
- (c) how the instruments were grouped if expected credit losses were measured on a collective basis;
- (d) how an entity determined that financial assets are credit-impaired financial assets;
- (e) an entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and
- (f) how the requirements in paragraph 5.5.12 of Ind AS 109 for the modification of contractual cash flows of financial assets

have been applied, including how an entity:

- (i) determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has improved to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with paragraph 5.5.5 of Ind AS 109; and
- (ii) monitors the extent to which the loss allowance on financial assets meeting the criteria in (i) is subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with paragraph 5.5.3 of Ind AS 109.

35G An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of Ind AS 109. For this purpose an entity shall disclose:

- (a) the basis of inputs and assumptions and the estimation techniques used to:
  - (i) measure the 12-month and lifetime expected credit losses;
  - (ii) determine whether the credit risk of financial instruments have increased significantly since initial recognition; and
  - (iii) determine whether a financial asset is a credit-impaired financial asset.
- (b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and
- (c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

*Quantitative and qualitative information about amounts arising from expected credit losses*

35H To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial

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instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

- (a) the loss allowance measured at an amount equal to 12-month expected credit losses;
- (b) the loss allowance measured at an amount equal to lifetime expected credit losses for:
  - (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
  - (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
  - (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind AS 109.
- (c) financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

35I To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 35H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph 35H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

- (a) changes because of financial instruments originated or acquired during the reporting period;
- (b) the modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with Ind AS 109;

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- (c) changes because of financial instruments that were derecognised (including those that were written-off) during the reporting period; and
  - (d) changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.
- 35J To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, an entity shall disclose:
- (a) the amortised cost before the modification and the net modification gain or loss recognised for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and
  - (b) the gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance has changed during the reporting period to an amount equal to 12-month expected credit losses.
- 35K To enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses, an entity shall disclose by class of financial instrument:
- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with Ind AS 32).
  - (b) a narrative description of collateral held as security and other credit enhancements, including:
    - (i) a description of the nature and quality of the collateral held;

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- (ii) an explanation of any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and
  - (iii) information about financial instruments for which an entity has not recognised a loss allowance because of the collateral.
- (c) quantitative information about the collateral held as security and other credit enhancements (for example, quantification of the extent to which collateral and other credit enhancements mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

35L An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity.

*Credit risk exposure*

35M To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by *credit risk rating grades*, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments:

- (a) for which the loss allowance is measured at an amount equal to 12-month expected credit losses;
- (b) for which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:
  - (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
  - (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
  - (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind AS 109.

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- (c) that are purchased or originated credit-impaired financial assets.

35N For trade receivables, contract assets and lease receivables to which an entity applies paragraph 5.5.15 of Ind AS 109, the information provided in accordance with paragraph 35M may be based on a provision matrix (see paragraph B5.5.35 of Ind AS 109).

36 For all financial instruments within the scope of this Ind AS, but to which the impairment requirements in Ind AS 109 are not applied, an entity shall disclose by class of financial instrument:

- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with Ind AS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

- (b) a description of collateral held as security and other credit enhancements, and their financial effect (eg quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

(c) [Refer Appendix 1]

(d) [Refer Appendix 1]

*Financial assets that are either past due or impaired*

37 [Refer Appendix 1].

*Collateral and other credit enhancements obtained*

38 When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such assets meet the recognition criteria in other Ind AS, an entity shall disclose for such assets held at the reporting date:

- (a) the nature and carrying amount of the assets; and
- (b) when the assets are not readily convertible into cash, its

policies for disposing of such assets or for using them in its operations.

### **Liquidity risk**

39 An entity shall disclose:

- (a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
- (b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B).
- (c) a description of how it manages the liquidity risk inherent in (a) and (b).

### **Market risk**

#### *Sensitivity analysis*

40 Unless an entity complies with paragraph 41, it shall disclose:

- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) the methods and assumptions used in preparing the sensitivity analysis; and
- (c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

41 If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 40. The entity shall also disclose:

- (a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

- (b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

*Other market risk disclosures*

- 42 When the sensitivity analyses disclosed in accordance with paragraph 40 or 41 are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

## **Transfers of financial assets**

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- 42A The disclosure requirements in paragraphs 42B–42H relating to transfers of financial assets supplement the other disclosure requirements of this Ind AS. An entity shall present the disclosures required by paragraphs 42B–42H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:
  - (a) transfers the contractual rights to receive the cash flows of that financial asset; or
  - (b) retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.
- 42B An entity shall disclose information that enables users of its financial statements:
  - (a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
  - (b) to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.

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- 42C For the purposes of applying the disclosure requirements in paragraphs 42E–42H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 42E–42H, the following do not constitute continuing involvement:
- (a) normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;
  - (b) forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or
  - (c) an arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 3.2.5(a)–(c) of Ind AS 109 are met.

**Transferred financial assets that are not derecognised in their entirety**

- 42D An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 42B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognised in their entirety:
- (a) the nature of the transferred assets.
  - (b) the nature of the risks and rewards of ownership to which the entity is exposed.
  - (c) a description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.

- (d) when the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).
- (e) when the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.
- (f) when the entity continues to recognise the assets to the extent of its continuing involvement (see paragraphs 3.2.6(c)(ii) and 3.2.16 of Ind AS 109), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

### **Transferred financial assets that are derecognised in their entirety**

42E To meet the objectives set out in paragraph 42B(b), when an entity derecognizes transferred financial assets in their entirety (see paragraph 3.2.6(a) and (c)(i) of Ind AS 109) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

- (a) the carrying amount of the assets and liabilities that are recognised in the entity's balance sheet and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised.
- (b) the fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.
- (c) the amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined.
- (d) the undiscounted cash outflows that would or may be required to repurchase derecognised financial assets (eg the strike

price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.

- (e) a maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.
- (f) qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

42F An entity may aggregate the information required by paragraph 42E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognised financial asset, and report it under one type of continuing involvement.

42G In addition, an entity shall disclose for each type of continuing involvement:

- (a) the gain or loss recognised at the date of transfer of the assets.
- (b) income and expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (eg fair value changes in derivative instruments).
- (c) if the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):
  - (i) when the greatest transfer activity took place within that reporting period (eg the last five days before the end of the reporting period),
  - (ii) the amount (eg related gains or losses) recognised from transfer activity in that part of the reporting period, and
  - (iii) the total amount of proceeds from transfer activity in that part of the reporting period.

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An entity shall provide this information for each period for which a statement of profit and loss is presented.

**Supplementary information**

42H An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 42B.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>credit risk</b>	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
<b>credit risk rating grades</b>	Rating of credit risk based on the risk of a default occurring <b>rating grades</b> on the financial instrument.
<b>currency risk</b>	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
<b>interest rate risk</b>	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
<b>liquidity risk</b>	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.
<b>loans payable</b>	Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.
<b>market risk</b>	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: <b>currency risk, interest rate risk and other price risk.</b>
<b>other price risk</b>	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from <b>interest rate risk</b> or <b>currency risk</b> ), whether those changes are caused by factors specific to the individual financial instrument or its issuer or by factors affecting all similar financial instruments traded in the market.

The following terms are defined in paragraph 11 of Ind AS 32, Appendix A of Ind AS 109 or Appendix A of Ind AS 113 and are used in this Ind AS with the meaning specified in Ind AS 32, Ind AS 109 and Ind AS 113.

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- amortised cost of a financial asset or financial liability
- contract asset
- credit-impaired financial assets
- derecognition
- derivative
- dividends
- effective interest method
- equity instrument
- expected credit losses
- fair value
- financial asset
- financial guarantee contract
- financial instrument
- financial liability
- financial liability at fair value through profit or loss
- forecast transaction
- gross carrying amount
- hedging instrument
- held for trading
- impairment gains or losses
- loss allowance
- purchased or originated credit-impaired financial assets
- reclassification date
- regular way purchase or sale

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS.*

### **Classes of financial instruments and level of disclosure (paragraph 6)**

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- B1 Paragraph 6 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in Ind AS 109 (which determine how financial instruments are measured and where changes in fair value are recognised).
- B2 In determining classes of financial instrument, an entity shall, at a minimum:
- (a) distinguish instruments measured at amortised cost from those measured at fair value.
  - (b) treat as a separate class or classes those financial instruments outside the scope of this Ind AS.
- B3 An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Ind AS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.
- B4 [Refer Appendix 1]

**Other disclosure – accounting policies (paragraph 21)**

- B5 <sup>3</sup>Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:
- (a) for financial liabilities designated as at fair value through profit or loss:
    - (i) the nature of the financial liabilities the entity has designated as at fair value through profit or loss;
    - (ii) the criteria for so designating such financial liabilities on initial recognition; and
    - (iii) how the entity has satisfied the conditions in paragraph 4.2.2 of Ind AS 109 for such designation.
  - (aa) for financial assets designated as measured at fair value through profit or loss:
    - (i) the nature of the financial assets the entity has designated as measured at fair value through profit or loss; and
    - (ii) how the entity has satisfied the criteria in paragraph 4.1.5 of Ind AS 109 for such designation.
  - (b) [Refer Appendix 1]
  - (c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 3.1.2 of Ind AS 109).
  - (d) [Refer Appendix 1]
  - (e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.

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<sup>3</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

(f)-(g) [Refer Appendix 1]

<sup>4</sup>Paragraph 122 of Ind AS 1 also requires entities to disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

## **Nature and extent of risks arising from financial instruments (paragraphs 31–42)**

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B6 The disclosures required by paragraphs 31–42 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

### **Quantitative disclosures (paragraph 34)**

B7 Paragraph 34(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information. Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, discusses relevance and reliability.

B8 Paragraph 34(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

(a) a description of how management determines concentrations;

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<sup>4</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

- (b) a description of the shared characteristic that identifies each concentration (eg counterparty, geographical area, currency or market); and
- (c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

**Credit risk management practices (paragraphs 35F-35G)**

- B8A Paragraph 35F(b) requires the disclosure of information about how an entity has defined default for different financial instruments and the reasons for selecting those definitions. In accordance with paragraph 5.5.9 of Ind AS 109, the determination of whether lifetime expected credit losses should be recognised is based on the increase in the risk of a default occurring since initial recognition. Information about an entity's definitions of default that will assist users of financial statements in understanding how an entity has applied the expected credit loss requirements in Ind AS 109 may include:
- (a) the qualitative and quantitative factors considered in defining default;
  - (b) whether different definitions have been applied to different types of financial instruments; and
  - (c) assumptions about the cure rate (ie the number of financial assets that return to a performing status) after a default occurred on the financial asset.
- B8B To assist users of financial statements in evaluating an entity's restructuring and modification policies, paragraph 35F(f)(i) requires the disclosure of information about how an entity monitors the extent to which the loss allowance on financial assets previously disclosed in accordance with paragraph 35F(f)(i) are subsequently measured at an amount equal to lifetime expected credit losses in accordance with paragraph 5.5.3 of Ind AS 109. Quantitative information that will assist users in understanding the subsequent increase in credit risk of modified financial assets may include information about modified financial assets meeting the criteria in paragraph 35F(f)(i) for which the loss allowance has reverted to being measured at an amount equal to lifetime expected credit losses (ie a deterioration rate).
- B8C Paragraph 35G(a) requires the disclosure of information about the

basis of inputs and assumptions and the estimation techniques used to apply the impairment requirements in Ind AS 109. An entity's assumptions and inputs used to measure expected credit losses or determine the extent of increases in credit risk since initial recognition may include information obtained from internal historical information or rating reports and assumptions about the expected life of financial instruments and the timing of the sale of collateral.

**Changes in the loss allowance (paragraph 35H)**

B8D In accordance with paragraph 35H, an entity is required to explain the reasons for the changes in the loss allowance during the period. In addition to the reconciliation from the opening balance to the closing balance of the loss allowance, it may be necessary to provide a narrative explanation of the changes. This narrative explanation may include an analysis of the reasons for changes in the loss allowance during the period, including:

- (a) the portfolio composition;
- (b) the volume of financial instruments purchased or originated;  
and
- (c) the severity of the expected credit losses.

B8E For loan commitments and financial guarantee contracts the loss allowance is recognised as a provision. An entity should disclose information about the changes in the loss allowance for financial assets separately from those for loan commitments and financial guarantee contracts. However, if a financial instrument includes both a loan (ie financial asset) and an undrawn commitment (ie loan commitment) component and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognised together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision.

**Collateral (paragraph 35K)**

B8F Paragraph 35K requires the disclosure of information that will enable users of financial statements to understand the effect of collateral

and other credit enhancements on the amount of expected credit losses. An entity is neither required to disclose information about the fair value of collateral and other credit enhancements nor is it required to quantify the exact value of the collateral that was included in the calculation of expected credit losses (ie the loss given default).

- B8G A narrative description of collateral and its effect on amounts of expected credit losses might include information about:
- (a) the main types of collateral held as security and other credit enhancements (examples of the latter being guarantees, credit derivatives and netting agreements that do not qualify for offset in accordance with Ind AS 32);
  - (b) the volume of collateral held and other credit enhancements and its significance in terms of the loss allowance;
  - (c) the policies and processes for valuing and managing collateral and other credit enhancements;
  - (d) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
  - (e) information about risk concentrations within the collateral and other credit enhancements.

**Credit risk exposure (paragraphs 35M–35N)**

- B8H Paragraph 35M requires the disclosure of information about an entity's credit risk exposure and significant concentrations of credit risk at the reporting date. A concentration of credit risk exists when a number of counterparties are located in a geographical region or are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. An entity should provide information that enables users of financial statements to understand whether there are groups or portfolios of financial instruments with particular features that could affect a large portion of that group of financial instruments such as concentration to particular risks. This could include, for example, loan-to-value groupings, geographical, industry or issuer-type concentrations.
- B8I The number of credit risk rating grades used to disclose the

information in accordance with paragraph 35M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes. If past due information is the only borrower-specific information available and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 5.5.10 of Ind AS 109, an entity shall provide an analysis by past due status for those financial assets.

- B8J When an entity has measured expected credit losses on a collective basis, the entity may not be able to allocate the gross carrying amount of individual financial assets or the exposure to credit risk on loan commitments and financial guarantee contracts to the credit risk rating grades for which lifetime expected credit losses are recognised. In that case, an entity should apply the requirement in paragraph 35M to those financial instruments that can be directly allocated to a credit risk rating grade and disclose separately the gross carrying amount of financial instruments for which lifetime expected credit losses have been measured on a collective basis.

### **Maximum credit risk exposure (paragraph 36(a))**

- B9 Paragraphs 35K(a) and 36(a) require disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:
- (a) any amounts offset in accordance with Ind AS 32; and
  - (b) any loss allowance recognised in accordance with Ind AS 109.
- B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:
- (a) granting loans to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.
  - (b) entering into derivative contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.
  - (c) granting financial guarantees. In this case, the maximum

exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

- (d) making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognised as a liability.

### **Quantitative liquidity risk disclosures (paragraphs 34(a) and 39(a) and (b))**

B10A In accordance with paragraph 34(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

- (a) occur significantly earlier than indicated in the data, or
- (b) be for significantly different amounts from those indicated in the data (eg for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement),

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 39(a) or (b).

B11 In preparing the maturity analyses required by paragraph 39(a) and (b), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

- (a) not later than one month;
- (b) later than one month and not later than three months;

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- (c) later than three months and not later than one year; and
  - (d) later than one year and not later than five years.
- B11A In complying with paragraph 39(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) financial instrument. For such an instrument, an entity shall apply paragraph 39(a).
- B11B Paragraph 39(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:
- (a) an interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.
  - (b) all loan commitments.
- B11C Paragraph 39(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:
- (a) when a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (eg demand deposits) are included in the earliest time band.
  - (b) when an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.
  - (c) for issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.
- B11D The contractual amounts disclosed in the maturity analyses as required by paragraph 39(a) and (b) are the contractual undiscounted cash flows, for example:
- (a) gross finance lease obligations (before deducting finance charges);

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- (b) prices specified in forward agreements to purchase financial assets for cash;
- (c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) contractual amounts to be exchanged in a derivative financial instrument (eg a currency swap) for which gross cash flows are exchanged; and
- (e) gross loan commitments.

Such undiscounted cash flows differ from the amount included in the balance sheet because the amount in balance sheet is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

- B11E Paragraph 39(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 39(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (eg financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.
- B11F Other factors that an entity might consider in providing the disclosure required in paragraph 39(c) include, but are not limited to, whether the entity:
- (a) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;
  - (b) holds deposits at central banks to meet liquidity needs;
  - (c) has very diverse funding sources;
  - (d) has significant concentrations of liquidity risk in either its assets or its funding sources;

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- (e) has internal control processes and contingency plans for managing liquidity risk;
- (f) has instruments that include accelerated repayment terms (eg on the downgrade of the entity's credit rating);
- (g) has instruments that could require the posting of collateral (eg margin calls for derivatives);
- (h) has instruments that allow the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or
- (i) has instruments that are subject to master netting agreements.

B12-B16 [Refer Appendix 1]

### **Market risk – sensitivity analysis (paragraphs 40 and 41)**

B17 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph B3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

- (a) an entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.
- (b) an entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

B18 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable (eg prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:

- (a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had

been different. Instead, entities disclose the effect on profit or loss and equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on profit or loss (ie interest expense) for the current year if interest rates had varied by reasonably possible amounts.

- (b) entities are not required to disclose the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

B19 In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

- (a) the economic environments in which it operates. A reasonably possible change should not include remote or 'worst case' scenarios or 'stress tests'. Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 per cent and an entity determines that a fluctuation in interest rates of  $\pm 50$  basis points is reasonably possible. It would disclose the effect on profit or loss and equity if interest rates were to change to 4.5 per cent or 5.5 per cent. In the next period, interest rates have increased to 5.5 per cent. The entity continues to believe that interest rates may fluctuate by  $\pm 50$  basis points (ie that the rate of change in interest rates is stable). The entity would disclose the effect on profit or loss and equity if interest rates were to change to 5 per cent or 6 per cent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by  $\pm 50$  basis points, unless there is evidence that interest rates have become significantly more volatile.
- (b) the time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are

considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

- B20 Paragraph 41 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 41(a) by disclosing the type of value-at-risk model used (eg whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (eg the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.
- B21 An entity shall provide sensitivity analyses for the whole of its business, but may provide different types of sensitivity analysis for different classes of financial instruments.

#### **Interest rate risk**

- B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the balance sheet (eg debt instruments acquired or issued) and on some financial instruments not recognised in the balance sheet (eg some loan commitments).

#### **Currency risk**

- B23 *Currency risk* (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency, ie in a currency other than the functional currency in which they are measured. For the purpose of this Ind AS, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.
- B24 A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

**Other price risk**

- B25 *Other price risk* arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 40, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.
- B26 Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.
- B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments measured at fair value through profit or loss) is disclosed separately from the sensitivity of other comprehensive income (that arises, for example, from investments in equity instruments whose changes in fair value are presented in other comprehensive income).
- B28 Financial instruments that an entity classifies as equity instruments are not remeasured. Neither profit or loss nor equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

**Derecognition (paragraphs 42C–42H)**

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**Continuing involvement (paragraph 42C)**

- B29 The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 42E–42H is made at the level of the reporting entity. For example, if a subsidiary transfers to an unrelated third party a financial asset in which the parent of the subsidiary has continuing involvement, the subsidiary does not include the parent's involvement in the assessment of whether it has continuing involvement in the

transferred asset in its separate or individual financial statements (ie when the subsidiary is the reporting entity). However, a parent would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its subsidiary in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (ie when the reporting entity is the group).

B30 <sup>5</sup>An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term 'payment' in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

B30A <sup>6</sup>When an entity transfers a financial asset, the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. The entity assesses the servicing contract in accordance with the guidance in paragraphs 42C and B30 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a servicer has continuing involvement for the purposes of the disclosure requirements if a fixed fee would not be paid in full because of non-performance of the transferred financial asset. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

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<sup>5</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>6</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

- B31 Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

**Transferred financial assets that are not derecognised in their entirety (paragraph 42D)**

- B32 Paragraph 42D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognise the transferred financial assets, regardless of when the transfers occurred.

**Types of continuing involvement (paragraphs 42E–42H)**

- B33 Paragraphs 42E–42H require qualitative and quantitative disclosures for each type of continuing involvement in derecognised financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity's exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (eg guarantees or call options) or by type of transfer (eg factoring of receivables, securitisations and securities lending).

**Maturity analysis for undiscounted cash outflows to repurchase transferred assets (paragraph 42E(e))**

- B34 Paragraph 42E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognised financial assets or other amounts payable to the transferee in respect of the derecognised financial assets, showing the remaining contractual maturities of the entity's continuing involvement. This analysis distinguishes cash flows that are required to be paid (eg forward contracts), cash flows that the entity may be required to pay (eg written put options) and cash flows that the entity might choose to pay (eg purchased call options).
- B35 An entity shall use its judgement to determine an appropriate

number of time bands in preparing the maturity analysis required by paragraph 42E(e). For example, an entity might determine that the following maturity time bands are appropriate:

- (a) not later than one month;
- (b) later than one month and not later than three months;
- (c) later than three months and not later than six months;
- (d) later than six months and not later than one year;
- (e) later than one year and not later than three years;
- (f) later than three years and not later than five years; and
- (g) more than five years.

B36 If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

### **Qualitative information (paragraph 42E(f))**

B37 The qualitative information required by paragraph 42E(f) includes a description of the derecognised financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

- (a) a description of how the entity manages the risk inherent in its continuing involvement in the derecognised financial assets.
- (b) whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (ie its continuing involvement in the asset).
- (c) a description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

### **Gain or loss on derecognition (paragraph 42G(a))**

B38 Paragraph 42G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of

the previously recognised asset (ie the interest in the asset derecognised and the interest retained by the entity) were different from the fair value of the previously recognised asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 27A.

### **Supplementary information (paragraph 42H)**

- B39 The disclosures required in paragraphs 42D–42G may not be sufficient to meet the disclosure objectives in paragraph 42B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

### **Offsetting financial assets and financial liabilities (paragraphs 13A–13F).**

#### *Scope (paragraph 13A)*

- B40 The disclosures in paragraphs 13B–13E are required for all recognised financial instruments that are set off in accordance with paragraph 42 of Ind AS 32. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 13B–13E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set-off in accordance with paragraph 42 of Ind AS 32.
- B41 The similar agreements referred to in paragraphs 13A and B40 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph B40 include derivatives, sale and repurchase agreements, reverse sale and repurchase

agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 13A are loans and customer deposits at the same institution (unless they are set-off in the balance sheet), and financial instruments that are subject only to a collateral agreement.

**Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)**

- B42 Financial instruments disclosed in accordance with paragraph 13C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognised amounts and describe any resulting measurement differences in the related disclosures.

**Disclosure of the gross amounts of recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C(a))**

- B43 The amounts required by paragraph 13C(a) relate to recognised financial instruments that are set-off in accordance with paragraph 42 of Ind AS 32. The amounts required by paragraph 13C(a) also relate to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 13C(a) do not relate to any amounts recognised as a result of collateral agreements that do not meet the offsetting criteria in paragraph 42 of Ind AS 32. Instead, such amounts are required to be disclosed in accordance with paragraph 13C(d).

**Disclosure of the amounts that are set-off in accordance with the criteria in paragraph 42 of Ind AS 32 (paragraph 13C(b))**

- B44 Paragraph 13C(b) requires that entities disclose the amounts set-off in accordance with paragraph 42 of Ind AS 32 when determining the net amounts presented in the balance sheet. The amounts of both the recognised financial assets and the recognised financial liabilities that are subject to set-off under the same arrangement will

be disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognised derivative asset and a recognised derivative liability that meet the offsetting criteria in paragraph 42 of Ind AS 32. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with paragraph 13C(a)) and the entire amount of the derivative liability (in accordance with paragraph 13C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 13C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 13C(b)) that is equal to the amount of the derivative liability.

**Disclosure of the net amounts presented in the balance sheet (paragraph 13C(c))**

- B45 If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 13A), but that do not meet the offsetting criteria in paragraph 42 of Ind AS 32, the amounts required to be disclosed by paragraph 13C(c) would equal the amounts required to be disclosed by paragraph 13C(a).
- B46 The amounts required to be disclosed by paragraph 13C(c) must be reconciled to the individual line item amounts presented in the balance sheet. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 13C(c) back to the individual line item amounts presented in the balance sheet.

**Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))**

- B47 Paragraph 13C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b). Paragraph 13C(d)(i) refers to amounts related to recognised

financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of Ind AS 32 (for example, current rights of set-off that do not meet the criterion in paragraph 42(b) of Ind AS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

- B48 Paragraph 13C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 13C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognised to return or receive back such collateral.

**Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)**

- B49 When disclosing amounts in accordance with paragraph 13C(d), an entity must take into account the effects of over-collateralisation by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 13C(d)(i) from the amount disclosed in accordance with paragraph 13C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 13C(d)(ii) to the remaining amount in paragraph 13C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D.

**Description of the rights of set-off subject to enforceable master netting arrangements and similar agreements (paragraph 13E)**

- B50 An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 13C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 42 of Ind AS 32, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is

restricted).

**Disclosure by type of financial instrument or by counterparty**

- B51 The quantitative disclosures required by paragraph 13C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).
- B52 Alternatively, an entity may group the quantitative disclosures required by paragraph 13C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 13C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 13C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

**Other**

- B53 The specific disclosures required by paragraphs 13C–13E are minimum requirements. To meet the objective in paragraph 13B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity's financial position.

## Appendix C

### References to matters contained in other Indian Accounting Standards

*This Appendix is an integral part of the Ind AS.*

This appendix lists the appendices which are part of other Indian Accounting Standards and makes reference to Ind AS 107, *Financial Instruments: Disclosures*.

1. Appendix A, *Distributions of Non-cash Assets to Owners*, contained in Ind AS 10, *Events After the Reporting Period*
2. <sup>7</sup>Appendix D, *Service Concession Arrangements*, contained in Ind AS 115, *Revenue from Contracts with Customers*.

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<sup>7</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 107 and the corresponding International Financial Reporting Standard (IFRS) 7, Financial Instruments: Disclosures, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 7, Financial Instruments: Disclosures**

- 1 The transitional provisions given in IFRS 7 have not been given in Ind AS 107, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, First-time Adoption of Indian Accounting Standards corresponding to IFRS 1, First-time Adoption of International Financial Reporting Standards.
- 2 Different terminology is used, as used in existing laws eg, the term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'. Words 'approved for issue' have been used instead of 'authorised for issue' in the context of financial statements considered for the purpose of events after the reporting period.
- 3 Requirements regarding disclosure of description of gains and losses presented in the separate income statement, where separate income statement is presented, have been deleted. This change is consequential to the removal of option regarding two statement approach in Ind AS 1 as compared to IAS 1. Ind AS 1 requires that the components of profit or loss and components of other comprehensive income shall be presented as a part of the statement of profit and loss.
- 4 The following paragraph numbers appear as 'Deleted' in IFRS 7. In order to maintain consistency with paragraph numbers of IFRS 7, the paragraph numbers are retained in Ind AS 107 :
  - (i) paragraph 3(c)
  - (ii) paragraph 8(b)-(d)
  - (iii) paragraph 12-12A

*Ind AS 107*

- (iv) paragraph 13
- (v) paragraph 16
- (vi) paragraph 20(a) (ii)-(iv) and 20(d)-(e)
- (vii) paragraph 22
- (viii) paragraph 23
- (ix) paragraph 24
- (x) paragraph 27-27B
- (xi) paragraph 29(b)
- (xii) paragraph 36 (c)-(d)
- (xiii) paragraph 37
- (xiv) paragraph B4 of Appendix B
- (xv) paragraph B5 (b), (d), (f) & (g)
- (xvi) paragraphs B12-B16 of Appendix B

## Indian Accounting Standard (Ind AS) 108

# Operating Segments<sup>#</sup>

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

## Core principle

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- 1 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.**

## Scope

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- 2 This Accounting Standard shall apply to companies to which Indian Accounting Standards (Ind ASs) notified under the Companies Act apply.  
[Refer Appendix 1]
- 3 If an entity that is not required to apply this Ind AS chooses to disclose information about segments that does not comply with this Ind AS, it shall not describe the information as segment information.
- 4 If a financial report contains both the consolidated financial statements of a parent that is within the scope of this Ind AS as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

## Operating segments

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- 5 An operating segment is a component of an entity:
  - (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015.

*Ind AS 108*

- (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- (c) for which discrete financial information is available.

An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

- 6 Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments. For the purposes of this Ind AS, an entity's post-employment benefit plans are not operating segments.
- 7 The term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the chief operating decision maker of an entity is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others.
- 8 For many entities, the three characteristics of operating segments described in paragraph 5 clearly identify its operating segments. However, an entity may produce reports in which its business activities are presented in a variety of ways. If the chief operating decision maker uses more than one set of segment information, other factors may identify a single set of components as constituting an entity's operating segments, including the nature of the business activities of each component, the existence of managers responsible for them, and information presented to the board of directors.
- 9 Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The term 'segment manager' identifies a function, not necessarily a manager with a specific title. The chief operating decision maker also may be the

segment manager for some operating segments. A single manager may be the segment manager for more than one operating segment. If the characteristics in paragraph 5 apply to more than one set of components of an organisation but there is only one set for which segment managers are held responsible, that set of components constitutes the operating segments.

- 10 The characteristics in paragraph 5 may apply to two or more overlapping sets of components for which managers are held responsible. That structure is sometimes referred to as a matrix form of organisation. For example, in some entities, some managers are responsible for different product and service lines worldwide, whereas other managers are responsible for specific geographical areas. The chief operating decision maker regularly reviews the operating results of both sets of components, and financial information is available for both. In that situation, the entity shall determine which set of components constitutes the operating segments by reference to the core principle.

## **Reportable segments**

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- 11 An entity shall report separately information about each operating segment that:
- (a) has been identified in accordance with paragraphs 5–10 or results from aggregating two or more of those segments in accordance with paragraph 12, and
  - (b) exceeds the quantitative thresholds in paragraph 13.

Paragraphs 14–19 specify other situations in which separate information about an operating segment shall be reported.

### **Aggregation criteria**

- 12 Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this Ind AS, the segments have similar economic

characteristics, and the segments are similar in each of the following respects:

- (a) the nature of the products and services;
- (b) the nature of the production processes;
- (c) the type or class of customer for their products and services;
- (d) the methods used to distribute their products or provide their services; and
- (e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

### **Quantitative thresholds**

13 An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

- (a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.
- (b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.
- (c) Its assets are 10 per cent or more of the combined assets of all operating segments.

Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.

14 An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria listed in paragraph 12.

## *Operating Segments*

- 15 If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria in paragraph 13) until at least 75 per cent of the entity's revenue is included in reportable segments.
- 16 Information about other business activities and operating segments that are not reportable shall be combined and disclosed in an 'all other segments' category separately from other reconciling items in the reconciliations required by paragraph 28. The sources of the revenue included in the 'all other segments' category shall be described.
- 17 If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability in paragraph 13.
- 18 If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the criteria for reportability in paragraph 13 in the prior period, unless the necessary information is not available and the cost to develop it would be excessive.
- 19 There may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Although no precise limit has been determined, as the number of segments that are reportable in accordance with paragraphs 13–18 increases above ten, the entity should consider whether a practical limit has been reached.

## **Disclosure**

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- 20 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.**

- 21 To give effect to the principle in paragraph 20, an entity shall disclose the following for each period for which a statement of profit and loss is presented:
- (a) general information as described in paragraph 22;
  - (b) information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement, as described in paragraphs 23–27; and
  - (c) reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts as described in paragraph 28.

Reconciliations of the amounts in the balance sheet for reportable segments to the amounts in the entity's balance sheet are required for each date at which a balance sheet is presented. Information for prior periods shall be restated as described in paragraphs 29 and 30.

### **General information**

- 22 An entity shall disclose the following general information:
- (a) factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated) ;
  - (aa) the judgements made by management in applying the aggregation criteria in paragraph 12. This includes a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics; and

- (b) types of products and services from which each reportable segment derives its revenues.

### **Information about profit or loss, assets and liabilities**

23 An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

- (a) revenues from external customers;
- (b) revenues from transactions with other operating segments of the same entity;
- (c) interest revenue;
- (d) interest expense;
- (e) depreciation and amortisation;
- (f) material items of income and expense disclosed in accordance with paragraph 97 of Ind AS 1, *Presentation of Financial Statements*;
- (g) the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;
- (h) income tax expense or income; and
- (i) material non-cash items other than depreciation and amortisation.

An entity shall report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and make decisions about resources to be allocated to the segment. In that situation, an entity may report

that segment's interest revenue net of its interest expense and disclose that it has done so.

- 24 An entity shall disclose the following about each reportable segment if the specified amounts are included in the measure of segment assets reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in the measure of segment assets:
- (a) the amount of investment in associates and joint ventures accounted for by the equity method, and
  - (b) the amounts of additions to non-current assets<sup>1</sup> other than financial instruments, deferred tax assets, net defined benefit assets (see Ind AS 19, *Employee Benefits*) and rights arising under insurance contracts.

## Measurement

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- 25 The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. Adjustments and eliminations made in preparing an entity's financial statements and allocations of revenues, expenses, and gains or losses shall be included in determining reported segment profit or loss only if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker. Similarly, only those assets and liabilities that are included in the measures of the segment's assets and segment's liabilities that are used by the chief operating decision maker shall be reported for that segment. If amounts are allocated to reported segment profit or loss, assets or liabilities, those amounts shall be allocated on a reasonable basis.
- 26 If the chief operating decision maker uses only one measure of an operating segment's profit or loss, the segment's assets or the segment's liabilities in assessing segment performance and deciding

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<sup>1</sup> For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

how to allocate resources, segment profit or loss, assets and liabilities shall be reported at those measures. If the chief operating decision maker uses more than one measure of an operating segment's profit or loss, the segment's assets or the segment's liabilities, the reported measures shall be those that management believes are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity's financial statements.

- 27 An entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. At a minimum, an entity shall disclose the following:
- (a) the basis of accounting for any transactions between reportable segments.
  - (b) the nature of any differences between the measurements of the reportable segments' profits or losses and the entity's profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of centrally incurred costs that are necessary for an understanding of the reported segment information.
  - (c) the nature of any differences between the measurements of the reportable segments' assets and the entity's assets (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly used assets that are necessary for an understanding of the reported segment information.
  - (d) the nature of any differences between the measurements of the reportable segments' liabilities and the entity's liabilities (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly utilised liabilities that are necessary for an understanding of the reported segment information.

- (e) the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss.
- (f) the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

### **Reconciliations**

28 An entity shall provide reconciliations of all of the following:

- (a) the total of the reportable segments' revenues to the entity's revenue.
- (b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to the entity's profit or loss after those items.
- (c) the total of the reportable segments' assets to the entity's assets if the segment assets are reported in accordance with paragraph 23.
- (d) the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are reported in accordance with paragraph 23.
- (e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items shall be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies shall be separately identified and described.

### **Restatement of previously reported information**

- 29 If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, shall be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive shall be made for each individual item of disclosure. Following a change in the composition of its reportable segments, an entity shall disclose whether it has restated the corresponding items of segment information for earlier periods.
- 30 If an entity has changed the structure of its internal organisation in a manner that causes the composition of its reportable segments to change and if segment information for earlier periods, including interim periods, is not restated to reflect the change, the entity shall disclose in the year in which the change occurs segment information for the current period on both the old basis and the new basis of segmentation, unless the necessary information is not available and the cost to develop it would be excessive.

### **Entity-wide disclosures**

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- 31 Paragraphs 32–34 apply to all entities subject to this Ind AS including those entities that have a single reportable segment. Some entities' business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity's reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity's reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Information required by paragraphs 32–34 shall be provided only if it is not provided as part of the reportable segment information required by this Ind AS.

### **Information about products and services**

- 32 An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements.

### **Information about geographical areas**

- 33 An entity shall report the following geographical information, unless the necessary information is not available and the cost to develop it would be excessive:
- (a) revenues from external customers (i) attributed to the entity's country of domicile and (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues shall be disclosed separately. An entity shall disclose the basis for attributing revenues from external customers to individual countries.
  - (b) non-current assets<sup>2</sup> other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts (i) located in the entity's country of domicile and (ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets shall be disclosed separately.

The amounts reported shall be based on the financial information that is used to produce the entity's financial statements. If the necessary information is not available and the cost to develop it would be excessive, that fact shall be disclosed. An entity may provide, in addition to the information required by this paragraph, subtotals of geographical information about groups of countries.

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<sup>2</sup> For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

### **Information about major customers**

- 34 An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of this Ind AS, a group of entities known to a reporting entity to be under common control shall be considered a single customer. However, judgement is required to assess whether a government (including government agencies and similar bodies whether local, national or international) and entities known to the reporting entity to be under the control of that government are considered a single customer. In assessing this, the reporting entity shall consider the extent of economic integration between those entities.

## Appendix A

### Defined term

*This Appendix is an integral part of the Ind AS.*

- operating segment** An operating segment is a component of an entity:
- (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),
  - (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
  - (c) for which discrete financial information is available.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 108 and the corresponding International Financial Reporting Standard (IFRS) 8, Operating Segments, issued by the International Accounting Standards Board.*

### Comparison with IFRS 8, Operating Segments

1. The transitional provisions given in IFRS 108 has not been given in Ind AS 108, since all transitional provisions related to Ind ASs, wherever considered appropriate, have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.
2. Different terminology is used, as used in existing laws eg, the term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.
3. Paragraph 2 of IFRS 8 requires that the standard shall apply to:
  - (a) the separate or individual financial statements of an entity:
    - (i) whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
    - (ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
  - (b) the consolidated financial statements of a group with a parent:
    - (i) whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

*Ind AS 108*

- (ii) that files, or is in the process of filing, the consolidated financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

The above have been deleted in the Ind AS as the applicability or exemptions to the Indian Accounting Standards is governed by the Companies Act and the Rules made thereunder. However, the paragraph number has been retained in Ind AS 108 to maintain consistency with paragraph numbers of IFRS 8.

## Indian Accounting Standard (Ind AS) 109

# Financial Instruments<sup>#</sup>

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*(The Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

## Chapter 1 Objective

- 1.1 The objective of this Standard is to establish principles for the financial reporting of *financial assets* and *financial liabilities* that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

## Chapter 2 Scope

- 2.1 **This Standard shall be applied by all entities to all types of financial instruments except:**
- (a) **those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 110 *Consolidated Financial Statements*, Ind AS 27 *Separate Financial Statements* or Ind AS 28 *Investments in Associates and Joint Ventures*. However, in some cases, Ind AS 110, Ind AS 27 or Ind AS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in Ind AS 32 *Financial Instruments: Presentation*.**
  - (b) **rights and obligations under leases to which Ind AS 17 *Leases* applies. However:**

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

- (i) lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;
  - (ii) finance lease payables recognised by a lessee are subject to the derecognition requirements of this Standard; and
  - (iii) derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.
- (c) employers' rights and obligations under employee benefit plans, to which Ind AS 19 *Employee Benefits* applies.
- (d) financial instruments issued by the entity that meet the definition of an equity instrument in Ind AS 32 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of Ind AS 32. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a).
- (e) rights and obligations arising under (i) an insurance contract as defined in Ind AS 104 *Insurance Contracts*, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract, or (ii) a contract that is within the scope of Ind AS 104 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in a contract within the scope of Ind AS 104 if the derivative is not itself a contract within the scope of Ind AS 104. Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or Ind AS 104 to such financial guarantee contracts (see paragraphs B2.5–B2.6). The issuer may make that election contract by contract, but the election for each contract is

irrevocable.

- (f) any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination within the scope of Ind AS 103 *Business Combinations* at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.
- (g) loan commitments other than those loan commitments described in paragraph 2.3. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard.
- (h) financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 *Share-based Payment* applies, except for contracts within the scope of paragraphs 2.4–2.7 of this Standard to which this Standard applies.
- (i) rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognises as a provision in accordance with Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*, or for which, in an earlier period, it recognised a provision in accordance with Ind AS 37.
- (j) <sup>1</sup>rights and obligations within the scope of Ind AS 115, *Revenue from Contracts with Customers*, that are financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with this Standard.

**2.2** <sup>2</sup>The impairment requirements of this Standard shall be applied

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<sup>1</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>2</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

to those rights that Ind AS 115 specifies are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses.

- 2.3** The following loan commitments are within the scope of this Standard:
- (a)** loan commitments that the entity designates as financial liabilities at fair value through profit or loss (see paragraph 4.2.2). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.
  - (b)** loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).
  - (c)** commitments to provide a loan at a below-market interest rate (see paragraph 4.2.1(d)).
- 2.4** This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through profit or loss in accordance with paragraph 2.5.
- 2.5** A contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through profit or loss even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage

**requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard (see paragraph 2.4).**

- 2.6 There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:
- (a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
  - (b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
  - (c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
  - (d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 2.4 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

- 2.7 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 2.6(a) or 2.6(d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

## Chapter 3 Recognition and derecognition

### 3.1 Initial recognition

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- 3.1.1 An entity shall recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1.1–4.1.5 and measure it in accordance with paragraphs 5.1.1–5.1.3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 4.2.1 and 4.2.2 and measure it in accordance with paragraph 5.1.1.

#### Regular way purchase or sale of financial assets

- 3.1.2 A *regular way purchase or sale* of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (see paragraphs B3.1.3–B3.1.6).

### 3.2 Derecognition of financial assets

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- 3.2.1 In consolidated financial statements, paragraphs 3.2.2–3.2.9, B3.1.1, B3.1.2 and B3.2.1–B3.2.17 are applied at a consolidated level. Hence, an entity first consolidates all subsidiaries in accordance with Ind AS 110 and then applies those paragraphs to the resulting group.
- 3.2.2 Before evaluating whether, and to what extent, *derecognition* is appropriate under paragraphs 3.2.3–3.2.9, an entity determines whether those paragraphs should be applied to a part of a

**financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety, as follows.**

- (a) Paragraphs 3.2.3–3.2.9 are applied to a part of a financial asset (or a part of a group of similar financial assets) if, and only if, the part being considered for derecognition meets one of the following three conditions.**
  - (i) The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, paragraphs 3.2.3–3.2.9 are applied to the interest cash flows.**
  - (ii) The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of all cash flows of a debt instrument, paragraphs 3.2.3–3.2.9 are applied to 90 per cent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.**
  - (iii) The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of interest cash flows from a financial asset, paragraphs 3.2.3–3.2.9 are applied to 90 per cent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows**

provided that the transferring entity has a fully proportionate share.

- (b) In all other cases, paragraphs 3.2.3–3.2.9 are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers (i) the rights to the first or the last 90 per cent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 per cent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 per cent of the principal amount of the receivables, paragraphs 3.2.3–3.2.9 are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs 3.2.3–3.2.12, the term ‘financial asset’ refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.

**3.2.3** An entity shall derecognise a financial asset when, and only when:

- (a) the contractual rights to the cash flows from the financial asset expire, or
- (b) it transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6.

(See paragraph 3.1.2 for regular way sales of financial assets.)

**3.2.4** An entity transfers a financial asset if, and only if, it either:

- (a) transfers the contractual rights to receive the cash flows of the financial asset, or
- (b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 3.2.5.

**3.2.5** When an entity retains the contractual rights to receive the cash

flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.

- (a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.
- (b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.
- (c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in Ind AS 7 *Statement of Cash Flows*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.

**3.2.6** When an entity transfers a financial asset (see paragraph 3.2.4), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

- (a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.
- (b) if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.
- (c) if the entity neither transfers nor retains substantially all

**the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**

- (i) if the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**
- (ii) if the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 3.2.16).**

3.2.7 The transfer of risks and rewards (see paragraph 3.2.6) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (eg because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (eg because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 3.2.5).

3.2.8 Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that

are more likely to occur.

- 3.2.9 Whether the entity has retained control (see paragraph 3.2.6(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

### **Transfers that qualify for derecognition**

- 3.2.10 **If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognise either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognised at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognised for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 3.2.13.**
- 3.2.11 **If, as a result of a transfer, a financial asset is derecognised in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognise the new financial asset, financial liability or servicing liability at fair value.**
- 3.2.12 **On derecognition of a financial asset in its entirety, the difference between:**
- (a) the carrying amount (measured at the date of derecognition) and**
  - (b) the consideration received (including any new asset obtained less any new liability assumed)**
- shall be recognised in profit or loss.**
- 3.2.13 **If the transferred asset is part of a larger financial asset (eg when an entity transfers interest cash flows that are part of a**

debt instrument, see paragraph 3.2.2(a) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognised and the part that is derecognised, on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognised. The difference between:

- (a) the carrying amount (measured at the date of derecognition) allocated to the part derecognised and
- (b) the consideration received for the part derecognised (including any new asset obtained less any new liability assumed)

shall be recognised in profit or loss.

- 3.2.14 When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be measured. When the entity has a history of selling parts similar to the part that continues to be recognised or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognised, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognised.

### **Transfers that do not qualify for derecognition**

- 3.2.15 If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.

## **Continuing involvement in transferred assets**

- 3.2.16** If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognise the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:
- (a)** When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount').
  - (b)** When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price (see paragraph B3.2.13).
  - (c)** When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.
- 3.2.17** When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net

carrying amount of the transferred asset and the associated liability is:

- (a) the amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or
- (b) equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.

**3.2.18** The entity shall continue to recognise any income arising on the transferred asset to the extent of its continuing involvement and shall recognise any expense incurred on the associated liability.

**3.2.19** For the purpose of subsequent measurement, recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 5.7.1, and shall not be offset.

**3.2.20** If an entity's continuing involvement is in only a part of a financial asset (eg when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 3.2.14 apply. The difference between:

- (a) the carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised and
- (b) the consideration received for the part no longer recognised shall be recognised in profit or loss.

**3.2.21** If the transferred asset is measured at amortised cost, the option in this Standard to designate a financial liability as at fair value through profit or loss is not applicable to the associated liability.

## **All transfers**

- 3.2.22** If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability (see paragraph 42 of Ind AS 32).
- 3.2.23** If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:
- (a) If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its balance sheet (eg as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.
  - (b) If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.
  - (c) If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.
  - (d) Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.

## **3.3. Derecognition of financial liabilities**

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- 3.3.1** An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

- 3.3.2** An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.
- 3.3.3** The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.
- 3.3.4** If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognised and the part that is derecognised based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognised and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognised shall be recognised in profit or loss.

## **Chapter 4 Classification**

### **4.1 Classification of financial assets**

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- 4.1.1** Unless paragraph 4.1.5 applies, an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:
- (a) the entity's business model for managing the financial assets and
  - (b) the contractual cash flow characteristics of the financial asset.
- 4.1.2** A financial asset shall be measured at amortised cost if both of the following conditions are met:

- (a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

**4.1.2A** A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

- (a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
- (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

**4.1.3** For the purpose of applying paragraphs 4.1.2(b) and 4.1.2A(b):

- (a) principal is the fair value of the financial asset at initial recognition. Paragraph B4.1.7B provides additional guidance on the meaning of principal.
- (b) interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs B4.1.7A and B4.1.9A–B4.1.9E provide additional guidance on the meaning of interest, including the meaning of the time value of money.

**4.1.4** A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance

with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However an entity may make an irrevocable election at initial recognition for particular investments in *equity instruments* that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income (see paragraphs 5.7.5–5.7.6).

### **Option to designate a financial asset at fair value through profit or loss**

- 4.1.5 Despite paragraphs 4.1.1–4.1.4, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29–B4.1.32).

## **4.2 Classification of financial liabilities**

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- 4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:
- (a) *financial liabilities at fair value through profit or loss*. Such liabilities, including *derivatives* that are liabilities, shall be subsequently measured at fair value.
  - (b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.
  - (c) *financial guarantee contracts*. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:
    - (i) the amount of the *loss allowance* determined in accordance with Section 5.5 and

- (ii) <sup>3</sup>the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115.
- (d) commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 4.2.1(a) applies) subsequently measure it at the higher of:
  - (i) the amount of the loss allowance determined in accordance with Section 5.5 and
  - (ii) <sup>4</sup>the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115.
- (e) contingent consideration recognised by an acquirer in a business combination to which Ind AS 103 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.

### **Option to designate a financial liability at fair value through profit or loss**

- 4.2.2** An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:
- (a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29–B4.1.32); or
  - (b) a group of financial liabilities or financial assets and

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<sup>3</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>4</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in Ind AS 24 *Related Party Disclosures*), for example, the entity's board of directors and chief executive officer (see paragraphs B4.1.33–B4.1.36).

### 4.3 Embedded derivatives

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- 4.3.1 An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

#### Hybrid contracts with financial asset hosts

- 4.3.2 If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements in paragraphs 4.1.1–4.1.5 to the entire hybrid contract.

#### Other hybrid contracts

- 4.3.3 If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:
- (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs B4.3.5 and B4.3.8);

- (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
  - (c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).
- 4.3.4 If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the balance sheet.
- 4.3.5 Despite paragraphs 4.3.3 and 4.3.4, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through profit or loss unless:
  - (a) the embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or
  - (b) it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.
- 4.3.6 If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through profit or loss.
- 4.3.7 If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded derivative using this method, paragraph 4.3.6 applies and the hybrid contract is designated as at fair value through profit or loss.

## 4.4 Reclassification

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- 4.4.1** When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with paragraphs 4.1.1–4.1.4. See paragraphs 5.6.1–5.6.7, B4.4.1–B4.4.3 and B5.6.1–B5.6.2 for additional guidance on reclassifying financial assets.
- 4.4.2** An entity shall not reclassify any financial liability.
- 4.4.3 The following changes in circumstances are not reclassifications for the purposes of paragraphs 4.4.1–4.4.2:
- (a) an item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;
  - (b) an item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and
  - (c) changes in measurement in accordance with Section 6.7.

## Chapter 5 Measurement

### 5.1 Initial measurement

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- 5.1.1** <sup>5</sup>Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability.
- 5.1.1A** However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2A.
- 5.1.2 When an entity uses settlement date accounting for an asset that is subsequently measured at amortised cost, the asset is recognised

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<sup>5</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

initially at its fair value on the trade date (see paragraphs B3.1.3–B3.1.6).

- 5.1.3 <sup>6</sup>Despite the requirement in paragraph 5.1.1, at initial recognition, an entity shall measure trade receivables at their transaction price (as defined in Ind AS 115) if the trade receivables do not contain a significant financing component in accordance with Ind AS 115 (or when the entity applies the practical expedient in accordance with paragraph 63 of Ind AS 115).

## **5.2 Subsequent measurement of financial assets**

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- 5.2.1 **After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1.1–4.1.5 at:**
- (a) **amortised cost;**
  - (b) **fair value through other comprehensive income; or**
  - (c) **fair value through profit or loss.**
- 5.2.2 **An entity shall apply the impairment requirements in Section 5.5 to financial assets that are measured at amortised cost in accordance with paragraph 4.1.2 and to financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A.**
- 5.2.3 **An entity shall apply the hedge accounting requirements in paragraphs 6.5.8–6.5.14 to a financial asset that is designated as a hedged item.**

## **5.3 Subsequent measurement of financial liabilities**

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- 5.3.1 **After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 4.2.1–4.2.2.**
- 5.3.2 **An entity shall apply the hedge accounting requirements in paragraphs 6.5.8–6.5.14 to a financial liability that is designated as a hedged item.**

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<sup>6</sup> Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016, and thereafter, inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## 5.4 Amortised cost measurement

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### Financial assets

#### Effective interest method

5.4.1 Interest revenue shall be calculated by using the *effective interest method* (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the *effective interest rate* to the *gross carrying amount of a financial asset* except for:

(a) *purchased or originated credit-impaired financial assets*. For those financial assets, the entity shall apply the *credit-adjusted effective interest rate* to the *amortised cost of the financial asset* from initial recognition.

(b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become *credit-impaired financial assets*. For those financial assets, the entity shall apply the *effective interest rate* to the *amortised cost of the financial asset* in subsequent reporting periods.

5.4.2 An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 5.4.1(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) were applied (such as an improvement in the borrower's credit rating).

#### Modification of contractual cash flows

5.4.3 When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a *modification gain or loss* in profit or loss. The gross carrying

amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

#### **Write-off**

- 5.4.4** An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph B3.2.16(r)).

## **5.5 Impairment**

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### **Recognition of expected credit losses**

#### **General approach**

- 5.5.1** <sup>7</sup>An entity shall recognise a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a *contract asset* or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).
- 5.5.2** An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However, the loss allowance shall be recognised in other comprehensive income and shall not reduce the carrying amount of the financial asset in the balance sheet.
- 5.5.3** **Subject to paragraphs 5.5.13–5.5.16, at each reporting date, an**

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<sup>7</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

**entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition.**

- 5.5.4 The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition - whether assessed on an individual or collective basis - considering all reasonable and supportable information, including that which is forward-looking.
- 5.5.5 **Subject to paragraphs 5.5.13–5.5.16, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to *12-month expected credit losses*.**
- 5.5.6 For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.
- 5.5.7 If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 5.5.3 is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.
- 5.5.8 An entity shall recognise in profit or loss, as an *impairment gain* or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

**Determining significant increases in credit risk**

- 5.5.9 At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected

credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

- 5.5.10 An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date (see paragraphs B5.5.22-B5.5.24).
- 5.5.11 If reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on *past due* information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

**Modified financial assets**

- 5.5.12 If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 5.5.3 by comparing:

- (a) the risk of a default occurring at the reporting date (based on the modified contractual terms); and
- (b) the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms).

**Purchased or originated credit-impaired financial assets**

**5.5.13 Despite paragraphs 5.5.3 and 5.5.5, at the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.**

5.5.14 At each reporting date, an entity shall recognise in profit or loss the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

**Simplified approach for trade receivables, contract assets and lease receivables**

**5.5.15 <sup>8</sup>Despite paragraphs 5.5.3 and 5.5.5, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**

- (a) **trade receivables or contract asset that result from transactions that are within the scope of Ind AS 115, and that:**
  - (i) **do not contain a significant financing component in accordance with Ind AS 115 (or when the entity applies the practical expedient in accordance with paragraph 63 of Ind AS 115); or**
  - (ii) **contain a significant financing component in accordance with Ind AS 115, if the entity chooses as its accounting policy to measure the loss**

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<sup>8</sup>Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

**allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all such trade receivables or contract assets but may be applied separately to trade receivables and contract assets.**

- (b) lease receivables that result from transactions that are within the scope of Ind AS 17, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

5.5.16 An entity may select its accounting policy for trade receivables, lease receivables and contract assets independently of each other.

### **Measurement of expected credit losses**

5.5.17 **An entity shall measure expected credit losses of a financial instrument in a way that reflects:**

- (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**
- (b) the time value of money; and**
- (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.**

5.5.18 When measuring expected credit losses, an entity need not necessarily identify every possible scenario. However, it shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

5.5.19 The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice.

- 5.5.20 However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

## **5.6 Reclassification of financial assets**

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- 5.6.1 If an entity reclassifies financial assets in accordance with paragraph 4.4.1, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest. Paragraphs 5.6.2–5.6.7 set out the requirements for reclassifications.
- 5.6.2 If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through profit or loss measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in profit or loss.
- 5.6.3 If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the amortised cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount. (See paragraph B5.6.2 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)
- 5.6.4 If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in other comprehensive income. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph B5.6.1.)

- 5.6.5** If an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset at the reclassification date. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortised cost. This adjustment affects other comprehensive income but does not affect profit or loss and therefore is not a reclassification adjustment (see Ind AS 1 *Presentation of Financial Statements*). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph B5.6.1.)
- 5.6.6** If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the fair value through other comprehensive income measurement category, the financial asset continues to be measured at fair value. (See paragraph B5.6.2 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)
- 5.6.7** If an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the fair value through profit or loss measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1) at the reclassification date.

## **5.7 Gains and losses**

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- 5.7.1** A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in profit or loss unless:
- (a) it is part of a hedging relationship (see paragraphs 6.5.8–6.5.14);

- (b) it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.7.5;
- (c) it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's *credit risk* in other comprehensive income in accordance with paragraph 5.7.7; or
- (d) it is a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A and the entity is required to recognise some changes in fair value in other comprehensive income in accordance with paragraph 5.7.10.

5.7.1A *Dividends* are recognised in profit or loss only when:

- (a) the entity's right to receive payment of the dividend is established;
- (b) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (c) the amount of the dividend can be measured reliably.

**5.7.2** A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 6.5.8–6.5.14) shall be recognised in profit or loss when the financial asset is derecognised, reclassified in accordance with paragraph 5.6.2, through the amortisation process or in order to recognise impairment gains or losses. An entity shall apply paragraphs 5.6.2 and 5.6.4 if it reclassifies financial assets out of the amortised cost measurement category. A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 6.5.8–6.5.14) shall be recognised in profit or loss when the financial liability is derecognised and through the amortisation process. (See paragraph B5.7.2 for guidance on foreign exchange gains or losses.)

**5.7.3** A gain or loss on financial assets or financial liabilities that are hedged items in a hedging relationship shall be recognised in

accordance with paragraphs 6.5.8–6.5.14.

- 5.7.4 If an entity recognises financial assets using settlement date accounting (see paragraphs 3.1.2, B3.1.3 and B3.1.6), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets measured at amortised cost. For assets measured at fair value, however, the change in fair value shall be recognised in profit or loss or in other comprehensive income, as appropriate in accordance with paragraph 5.7.1. The trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements.

### **Investments in equity instruments**

- 5.7.5 At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither *held for trading* nor contingent consideration recognised by an acquirer in a business combination to which Ind AS103 applies. (See paragraph B5.7.3 for guidance on foreign exchange gains or losses.)
- 5.7.6 If an entity makes the election in paragraph 5.7.5, it shall recognise in profit or loss dividends from that investment in accordance with paragraph 5.7.1A.

### **Liabilities designated as at fair value through profit or loss**

- 5.7.7 An entity shall present a gain or loss on a financial liability that is designated as at fair value through profit or loss in accordance with paragraph 4.2.2 or paragraph 4.3.5 as follows:
- (a) The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income (see paragraphs B5.7.13–B5.7.20), and
  - (b) the remaining amount of change in the fair value of the liability shall be presented in profit or loss

unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in profit or loss (in which case paragraph 5.7.8 applies). Paragraphs B5.7.5–B5.7.7 and B5.7.10–B5.7.12 provide guidance on determining whether an accounting mismatch would be created or enlarged.

- 5.7.8 If the requirements in paragraph 5.7.7 would create or enlarge an accounting mismatch in profit or loss, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in profit or loss.
- 5.7.9 Despite the requirements in paragraphs 5.7.7 and 5.7.8, an entity shall present in profit or loss all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through profit or loss.

### **Assets measured at fair value through other comprehensive income**

- 5.7.10 A gain or loss on a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A shall be recognised in other comprehensive income, except for impairment gains or losses (see Section 5.5) and foreign exchange gains and losses (see paragraphs B5.7.2–B5.7.2A), until the financial asset is derecognised or reclassified. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1). If the financial asset is reclassified out of the fair value through other comprehensive income measurement category, the entity shall account for the cumulative gain or loss that was previously recognised in other comprehensive income in accordance with paragraphs 5.6.5 and 5.6.7. Interest calculated using the effective interest method is recognised in profit or loss.
- 5.7.11 As described in paragraph 5.7.10, if a financial asset is measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, the amounts that are recognised in profit or loss are the same as the amounts that

would have been recognised in profit or loss if the financial asset had been measured at amortised cost.

## **Chapter 6 Hedge accounting**

### **6.1 Objective and scope of hedge accounting**

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- 6.1.1 The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5). This approach aims to convey the context of hedging instruments for which hedge accounting is applied in order to allow insight into their purpose and effect.
- 6.1.2 An entity may choose to designate a hedging relationship between a hedging instrument and a hedged item in accordance with paragraphs 6.2.1–6.3.7 and B6.2.1–B6.3.25. For hedging relationships that meet the qualifying criteria, an entity shall account for the gain or loss on the hedging instrument and the hedged item in accordance with paragraphs 6.5.1–6.5.14 and B6.5.1–B6.5.28. When the hedged item is a group of items, an entity shall comply with the additional requirements in paragraphs 6.6.1–6.6.6 and B6.6.1–B6.6.16.
- 6.1.3 [Refer Appendix 1].

### **6.2 Hedging instruments**

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#### **Qualifying instruments**

- 6.2.1 **A derivative measured at fair value through profit or loss may be designated as a hedging instrument, except for some written options (see paragraph B6.2.4).**
- 6.2.2 **A non-derivative financial asset or a non-derivative financial liability measured at fair value through profit or loss may be designated as a hedging instrument unless it is a financial liability designated as at fair value through profit or loss for**

which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in other comprehensive income in accordance with paragraph 5.7.7. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5.

- 6.2.3 For hedge accounting purposes, only contracts with a party external to the reporting entity (ie external to the group or individual entity that is being reported on) can be designated as hedging instruments.

### **Designation of hedging instruments**

- 6.2.4 A qualifying instrument must be designated in its entirety as a hedging instrument. The only exceptions permitted are:
- (a) separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and not the change in its time value (see paragraphs 6.5.15 and B6.5.29–B6.5.33);
  - (b) separating the forward element and the spot element of a forward contract and designating as the hedging instrument only the change in the value of the spot element of a forward contract and not the forward element; similarly, the foreign currency basis spread may be separated and excluded from the designation of a financial instrument as the hedging instrument (see paragraphs 6.5.16 and B6.5.34–B6.5.39); and
  - (c) a proportion of the entire hedging instrument, such as 50 per cent of the nominal amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding.
- 6.2.5 An entity may view in combination, and jointly designate as the

hedging instrument, any combination of the following (including those circumstances in which the risk or risks arising from some hedging instruments offset those arising from others):

- (a) derivatives or a proportion of them; and
- (b) non-derivatives or a proportion of them.

6.2.6 However, a derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph B6.2.4). Similarly, two or more instruments (or proportions of them) may be jointly designated as the hedging instrument only if, in combination, they are not, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph B6.2.4).

## 6.3 Hedged items

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### Qualifying items

6.3.1 A hedged item can be a recognised asset or liability, an unrecognised *firm commitment*, a *forecast transaction* or a net investment in a foreign operation. The hedged item can be:

- (a) a single item; or
- (b) a group of items (subject to paragraphs 6.6.1–6.6.6 and B6.6.1–B6.6.16).

A hedged item can also be a component of such an item or group of items (see paragraphs 6.3.7 and B6.3.7–B6.3.25).

6.3.2 The hedged item must be reliably measurable.

6.3.3 If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.

6.3.4 An aggregated exposure that is a combination of an exposure that could qualify as a hedged item in accordance with paragraph 6.3.1 and a derivative may be designated as a hedged item (see paragraphs B6.3.3–B6.3.4). This includes a forecast transaction of an aggregated exposure (ie uncommitted but anticipated future transactions that would

give rise to an exposure and a derivative) if that aggregated exposure is highly probable and, once it has occurred and is therefore no longer forecast, is eligible as a hedged item.

- 6.3.5 For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions with a party external to the reporting entity can be designated as hedged items. Hedge accounting can be applied to transactions between entities in the same group only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group, except for the consolidated financial statements of an investment entity, as defined in Ind AS 110, where transactions between an investment entity and its subsidiaries measured at fair value through profit or loss will not be eliminated in the consolidated financial statements.
- 6.3.6 However, as an exception to paragraph 6.3.5, the foreign currency risk of an intragroup monetary item (for example, a payable/receivable between two subsidiaries) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with Ind AS 21 *The Effects of Changes in Foreign Exchange Rates*. In accordance with Ind AS 21, foreign exchange rate gains and losses on intragroup monetary items are not fully eliminated on consolidation when the intragroup monetary item is transacted between two group entities that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

### **Designation of hedged items**

- 6.3.7 An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. An entire item comprises all changes in the cash flows or fair value of an item. A component comprises less than the entire fair value change or cash flow variability of an item. In that case, an entity may designate only

the following types of components (including combinations) as hedged items:

- (a) only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component), provided that, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable (see paragraphs B6.3.8–B6.3.15). Risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or other variable (a one-sided risk).
- (b) one or more selected contractual cash flows.
- (c) components of a nominal amount, ie a specified part of the amount of an item (see paragraphs B6.3.16–B6.3.20).

## **6.4 Qualifying criteria for hedge accounting**

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**6.4.1 A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:**

- (a) **the hedging relationship consists only of eligible hedging instruments and eligible hedged items.**
- (b) **at the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the *hedge ratio*).**
- (c) **the hedging relationship meets all of the following hedge effectiveness requirements:**
  - (i) **there is an economic relationship between the hedged item and the hedging instrument (see paragraphs B6.4.4–B6.4.6);**

- (ii) the effect of credit risk does not dominate the value changes that result from that economic relationship (see paragraphs B6.4.7–B6.4.8); and
- (iii) the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (see paragraphs B6.4.9–B6.4.11).

## **6.5 Accounting for qualifying hedging relationships**

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- 6.5.1 An entity applies hedge accounting to hedging relationships that meet the qualifying criteria in paragraph 6.4.1 (which include the entity's decision to designate the hedging relationship).
- 6.5.2 There are three types of hedging relationships:
- (a) fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss.
  - (b) cash flow hedge: a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect profit or loss.
  - (c) hedge of a net investment in a foreign operation as defined in Ind AS 21.

- 6.5.3 If the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5, the hedged exposure referred to in paragraph 6.5.2(a) must be one that could affect other comprehensive income. In that case, and only in that case, the recognised hedge ineffectiveness is presented in other comprehensive income.
- 6.5.4 A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.
- 6.5.5 If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio (see paragraph 6.4.1(c)(iii)) but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again (this is referred to in this Standard as ‘rebalancing’—see paragraphs B6.5.7–B6.5.21).**
- 6.5.6 An entity shall discontinue hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of, and consistent with, the entity’s documented risk management objective. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:
- (a) as a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a ‘clearing organisation’ or ‘clearing agency’) or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are

acting as a counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties the requirement in this subparagraph is met only if each of those parties effects clearing with the same central counterparty.

- (b) other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.

Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it (in which case hedge accounting continues for the remainder of the hedging relationship).

6.5.7 An entity shall apply:

- (a) paragraph 6.5.10 when it discontinues hedge accounting for a fair value hedge for which the hedged item is (or is a component of) a financial instrument measured at amortised cost; and
- (b) paragraph 6.5.12 when it discontinues hedge accounting for cash flow hedges.

### **Fair value hedges**

6.5.8 As long as a fair value hedge meets the qualifying criteria in paragraph 6.4.1, the hedging relationship shall be accounted for as follows:

- (a) the gain or loss on the hedging instrument shall be recognised in profit or loss (or other comprehensive income, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5).

- (b) the hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss. If the hedged item is a financial asset (or a component thereof) that is measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, the hedging gain or loss on the hedged item shall be recognised in profit or loss. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5, those amounts shall remain in other comprehensive income. When a hedged item is an unrecognised firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognised as an asset or a liability with a corresponding gain or loss recognised in profit or loss.**

6.5.9 When a hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire an asset or assume a liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognised in the balance sheet.

6.5.10 Any adjustment arising from paragraph 6.5.8(b) shall be amortised to profit or loss if the hedged item is a financial instrument (or a component thereof) measured at amortised cost. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses. The amortisation is based on a recalculated effective interest rate at the date that amortisation begins. In the case of a financial asset (or a component thereof) that is a hedged item and that is measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, amortisation applies in the same manner but to the amount that represents the cumulative gain or loss previously recognised in accordance with paragraph 6.5.8(b) instead of by adjusting the carrying amount.

### **Cash flow hedges**

6.5.11 **As long as a cash flow hedge meets the qualifying criteria in**

paragraph 6.4.1, the hedging relationship shall be accounted for as follows:

- (a) the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):
  - (i) the cumulative gain or loss on the hedging instrument from inception of the hedge; and
  - (ii) the cumulative change in fair value (present value) of the hedged item (ie the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.
- (b) the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (ie the portion that is offset by the change in the cash flow hedge reserve calculated in accordance with (a)) shall be recognised in other comprehensive income.
- (c) any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that shall be recognised in profit or loss.
- (d) the amount that has been accumulated in the cash flow hedge reserve in accordance with (a) shall be accounted for as follows:
  - (i) if a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see Ind AS 1) and hence it does not affect other comprehensive income.

- (ii) **for cash flow hedges other than those covered by (i), that amount shall be reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment (see Ind AS 1) in the same period or periods during which the hedged expected future cash flows affect profit or loss (for example, in the periods that interest income or interest expense is recognised or when a forecast sale occurs).**
- (iii) **however, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment (see Ind AS 1).**

6.5.12 When an entity discontinues hedge accounting for a cash flow hedge (see paragraphs 6.5.6 and 6.5.7(b)) it shall account for the amount that has been accumulated in the cash flow hedge reserve in accordance with paragraph 6.5.11(a) as follows:

- (a) if the hedged future cash flows are still expected to occur, that amount shall remain in the cash flow hedge reserve until the future cash flows occur or until paragraph 6.5.11(d)(iii) applies. When the future cash flows occur, paragraph 6.5.11(d) applies.
- (b) if the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment (see Ind AS 1). A hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

### **Hedges of a net investment in a foreign operation**

6.5.13 **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see Ind AS 21), shall be accounted for similarly to cash flow hedges:**

- (a) **the portion of the gain or loss on the hedging instrument**

that is determined to be an effective hedge shall be recognised in other comprehensive income (see paragraph 6.5.11); and

- (b) the ineffective portion shall be recognised in profit or loss.

**6.5.14** The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1) in accordance with paragraphs 48–49 of Ind AS 21 on the disposal or partial disposal of the foreign operation.

### **Accounting for the time value of options**

**6.5.15** When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option (see paragraph 6.2.4(a)), it shall account for the time value of the option as follows (see paragraphs B6.5.29–B6.5.33):

- (a) an entity shall distinguish the time value of options by the type of hedged item that the option hedges (see paragraph B6.5.29):
  - (i) a transaction related hedged item; or
  - (ii) a time-period related hedged item.
- (b) the change in fair value of the time value of an option that hedges a transaction related hedged item shall be recognised in other comprehensive income to the extent that it relates to the hedged item and shall be accumulated in a separate component of equity. The cumulative change in fair value arising from the time value of the option that has been accumulated in a separate component of equity (the 'amount') shall be accounted for as follows:
  - (i) if the hedged item subsequently results in the recognition of a non-financial asset or a non-financial liability, or a firm commitment for a non-financial asset or a non-financial liability for which fair value hedge accounting is applied, the entity shall remove the

amount from the separate component of equity and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see Ind AS 1) and hence does not affect other comprehensive income.

- (ii) for hedging relationships other than those covered by (i), the amount shall be reclassified from the separate component of equity to profit or loss as a reclassification adjustment (see Ind AS 1) in the same period or periods during which the hedged expected future cash flows affect profit or loss (for example, when a forecast sale occurs).
  - (iii) however, if all or a portion of that amount is not expected to be recovered in one or more future periods, the amount that is not expected to be recovered shall be immediately reclassified into profit or loss as a reclassification adjustment (see Ind AS 1).
- (c) the change in fair value of the time value of an option that hedges a time-period related hedged item shall be recognised in other comprehensive income to the extent that it relates to the hedged item and shall be accumulated in a separate component of equity. The time value at the date of designation of the option as a hedging instrument, to the extent that it relates to the hedged item, shall be amortised on a systematic and rational basis over the period during which the hedge adjustment for the option's intrinsic value could affect profit or loss (or other comprehensive income, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5). Hence, in each reporting period, the amortisation amount shall be reclassified from the separate component of equity to profit or loss as a reclassification adjustment (see Ind AS 1). However, if hedge accounting is discontinued for the hedging relationship that includes the change in intrinsic value of the option as the hedging instrument, the net amount (ie including cumulative amortisation) that has been accumulated in the separate component of equity shall be immediately

reclassified into profit or loss as a reclassification adjustment (see Ind AS 1).

### **Accounting for the forward element of forward contracts and foreign currency basis spreads of financial instruments**

- 6.5.16 When an entity separates the forward element and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element of the forward contract, or when an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 6.2.4(b)), the entity may apply paragraph 6.5.15 to the forward element of the forward contract or to the foreign currency basis spread in the same manner as it is applied to the time value of an option. In that case, the entity shall apply the application guidance in paragraphs B6.5.34–B6.5.39.

## **6.6 Hedges of a group of items**

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### **Eligibility of a group of items as the hedged item**

- 6.6.1 A group of items (including a group of items that constitute a net position; see paragraphs B6.6.1–B6.6.8) is an eligible hedged item only if:
- (a) it consists of items (including components of items) that are, individually, eligible hedged items;
  - (b) the items in the group are managed together on a group basis for risk management purposes; and
  - (c) in the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group so that offsetting risk positions arise:
    - (i) it is a hedge of foreign currency risk; and
    - (ii) the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect profit or loss, as well as their

**nature and volume (see paragraphs B6.6.7–B6.6.8).**

### **Designation of a component of a nominal amount**

- 6.6.2 A component that is a proportion of an eligible group of items is an eligible hedged item provided that designation is consistent with the entity's risk management objective.
- 6.6.3 A layer component of an overall group of items (for example, a bottom layer) is eligible for hedge accounting only if:
- (a) it is separately identifiable and reliably measurable;
  - (b) the risk management objective is to hedge a layer component;
  - (c) the items in the overall group from which the layer is identified are exposed to the same hedged risk (so that the measurement of the hedged layer is not significantly affected by which particular items from the overall group form part of the hedged layer);
  - (d) for a hedge of existing items (for example, an unrecognised firm commitment or a recognised asset) an entity can identify and track the overall group of items from which the hedged layer is defined (so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships); and
  - (e) any items in the group that contain prepayment options meet the requirements for components of a nominal amount (see paragraph B6.3.20).

### **Presentation**

- 6.6.4 For a hedge of a group of items with offsetting risk positions (ie in a hedge of a net position) whose hedged risk affects different line items in the statement of profit and loss, any hedging gains or losses in that statement shall be presented in a separate line from those affected by the hedged items. Hence, in that statement the amount in the line item that relates to the hedged item itself (for example, revenue or cost of sales) remains unaffected.
- 6.6.5 For assets and liabilities that are hedged together as a group in a fair value hedge, the gain or loss in the balance sheet on the individual assets and liabilities shall be recognised as an adjustment

of the carrying amount of the respective individual items comprising the group in accordance with paragraph 6.5.8(b).

### **Nil net positions**

- 6.6.6 When the hedged item is a group that is a nil net position (ie the hedged items among themselves fully offset the risk that is managed on a group basis), an entity is permitted to designate it in a hedging relationship that does not include a hedging instrument, provided that:
- (a) the hedge is part of a rolling net risk hedging strategy, whereby the entity routinely hedges new positions of the same type as time moves on (for example, when transactions move into the time horizon for which the entity hedges);
  - (b) the hedged net position changes in size over the life of the rolling net risk hedging strategy and the entity uses eligible hedging instruments to hedge the net risk (ie when the net position is not nil);
  - (c) hedge accounting is normally applied to such net positions when the net position is not nil and it is hedged with eligible hedging instruments; and
  - (d) not applying hedge accounting to the nil net position would give rise to inconsistent accounting outcomes, because the accounting would not recognise the offsetting risk positions that would otherwise be recognised in a hedge of a net position.

## **6.7 Option to designate a credit exposure as measured at fair value through profit or loss**

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### **Eligibility of credit exposures for designation at fair value through profit or loss**

- 6.7.1 If an entity uses a credit derivative that is measured at fair value through profit or loss to manage the credit risk of all, or a part of, a financial instrument (credit exposure) it may designate that financial instrument to the extent that it is so managed (ie all or a proportion of it) as measured at fair value through profit or loss if:

- (a) the name of the credit exposure (for example, the borrower, or the holder of a loan commitment) matches the reference entity of the credit derivative ('name matching'); and
- (b) the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of this Standard (for example, an entity may designate loan commitments that are outside the scope of this Standard). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognised. The entity shall document the designation concurrently.

### **Accounting for credit exposures designated at fair value through profit or loss**

- 6.7.2 If a financial instrument is designated in accordance with paragraph 6.7.1 as measured at fair value through profit or loss after its initial recognition, or was previously not recognised, the difference at the time of designation between the carrying amount, if any, and the fair value shall immediately be recognised in profit or loss. For financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, the cumulative gain or loss previously recognised in other comprehensive income shall immediately be reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1).
- 6.7.3 An entity shall discontinue measuring the financial instrument that gave rise to the credit risk, or a proportion of that financial instrument, at fair value through profit or loss if:
  - (a) the qualifying criteria in paragraph 6.7.1 are no longer met, for example:
    - (i) the credit derivative or the related financial instrument that gives rise to the credit risk expires or is sold, terminated or settled; or
    - (ii) the credit risk of the financial instrument is no longer managed using credit derivatives. For example, this

could occur because of improvements in the credit quality of the borrower or the loan commitment holder or changes to capital requirements imposed on an entity; and

- (b) the financial instrument that gives rise to the credit risk is not otherwise required to be measured at fair value through profit or loss (ie the entity's business model has not changed in the meantime so that a reclassification in accordance with paragraph 4.4.1 was required).

6.7.4 When an entity discontinues measuring the financial instrument that gives rise to the credit risk, or a proportion of that financial instrument, at fair value through profit or loss, that financial instrument's fair value at the date of discontinuation becomes its new carrying amount. Subsequently, the same measurement that was used before designating the financial instrument at fair value through profit or loss shall be applied (including amortisation that results from the new carrying amount). For example, a financial asset that had originally been classified as measured at amortised cost would revert to that measurement and its effective interest rate would be recalculated based on its new gross carrying amount on the date of discontinuing measurement at fair value through profit or loss.

## **<sup>9</sup>Chapter 7 Effective date and transition**

### **Effective Date (Section 7.1)**

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- 7.1.1 \*
- 7.1.2 \*
- 7.1.3 \*
- 7.1.4 As a consequence of issuance of Ind AS 115, *Revenue from Contracts with Customers*, paragraphs 2.1, 2.2, 4.2.1, 5.1.1, 5.5.1, 5.5.15, Appendix A and Appendix B were amended. Paragraph 5.1.3 and a definition in Appendix A are added. An entity shall apply those amendments when it applies Ind AS 115.

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<sup>9</sup> Chapter inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

\* Refer Appendix 1

## Appendix A

### Defined terms

*This appendix is an integral part of the Standard.*

<b>12-month expected credit losses</b>	The portion of <b>lifetime expected credit losses</b> that represent the <b>expected credit losses</b> that result from default events on a financial instrument that are possible within the 12 months after the reporting date.
<b>amortised cost of a financial asset or financial liability</b>	The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the <b>effective interest method</b> of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any <b>loss allowance</b> .
<b>contract assets</b>	<sup>10</sup> Those rights that Ind AS 115, <i>Revenue from Contracts with Customers</i> , specifies are accounted for in accordance with this Standard for the purposes of recognising and measuring impairment gains or losses.
<b>credit-impaired financial asset</b>	A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events: <ul style="list-style-type: none"> <li>(a) significant financial difficulty of the issuer or the borrower;</li> <li>(b) a breach of contract, such as a default or <b>past due</b> event;</li> <li>(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's</li> </ul>

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<sup>10</sup> Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016, and thereafter, inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

- (d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- (e) the disappearance of an active market for that financial asset because of financial difficulties; or
- (f) the purchase or origination of a financial asset at a deep discount that reflects the incurred **credit losses**.

It may not be possible to identify a single discrete event-instead, the combined effect of several events may have caused financial assets to become credit-impaired.

**credit loss**

The difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original **effective interest rate** (or **credit-adjusted effective interest rate** for **purchased or originated credit-impaired financial assets**). An entity shall estimate cash flows by considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument. The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. There is a presumption that the expected life of a financial instrument can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.

The rate that exactly discounts the estimated future

<b>credit-adjusted effective interest rate</b>	cash payments or receipts through the expected life of the financial asset to the <b>amortised cost of a financial asset</b> that is a <b>purchased or originated credit-impaired financial asset</b> . When calculating the credit-adjusted effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial asset (for example, prepayment, extension, call and similar options) and <b>expected credit losses</b> . The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1-B5.4.3), <b>transaction costs</b> , and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).
<b>Derecognition</b>	The removal of a previously recognised financial asset or financial liability from an entity's balance sheet.
<b>Derivative</b>	<p>A financial instrument or other contract within the scope of this Standard with all three of the following characteristics.</p> <ul style="list-style-type: none"><li>(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').</li><li>(b) it requires no initial net investment or an initial net investment that is smaller than would be</li></ul>

required for other types of contracts that would be expected to have a similar response to changes in market factors.

(c) it is settled at a future date.

**Dividends**

Distributions of profits to holders of equity instruments in proportion to their holdings of a particular class of capital.

**effective interest method**

The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1–B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

**expected credit losses**

The weighted average of **credit losses** with the respective risks of a default occurring as the weights.

**financial guarantee contract**

A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified

	terms of a debt instrument.
<b>financial liability at fair value through profit or loss</b>	<p>A financial liability that meets one of the following conditions:</p> <ul style="list-style-type: none"><li>(a) it meets the definition of <b>held for trading</b>.</li><li>(b) upon initial recognition it is designated by the entity as at fair value through profit or loss in accordance with paragraph 4.2.2 or 4.3.5.</li><li>(c) it is designated either upon initial recognition or subsequently as at fair value through profit or loss in accordance with paragraph 6.7.1.</li></ul>
<b>firm commitment</b>	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.
<b>forecast transaction</b>	An uncommitted but anticipated future transaction.
<b>gross carrying amount of a financial asset</b>	The <b>amortised cost of a financial asset</b> , before adjusting for any <b>loss allowance</b> .
<b>hedging instrument</b>	a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.
<b>hedge ratio</b>	The relationship between the quantity of the hedging instrument and the quantity of the hedged item in terms of their relative weighting.
<b>held for trading</b>	<p>A financial asset or financial liability that:</p> <ul style="list-style-type: none"><li>(a) is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;</li><li>(b) on initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or</li><li>(c) is a <b>derivative</b> (except for a derivative that is a</li></ul>

	financial guarantee contract or a designated and effective hedging instrument).
<b>impairment gain or loss</b>	Gains or losses that are recognised in profit or loss in accordance with paragraph 5.5.8 and that arise from applying the impairment requirements in Section 5.5.
<b>lifetime expected credit losses</b>	The <b>expected credit losses</b> that result from all possible default events over the expected life of a financial instrument.
<b>loss allowance</b>	The allowance for <b>expected credit losses</b> on financial assets measured in accordance with paragraph 4.1.2, lease receivables and <b>contract assets</b> , the accumulated impairment amount for financial assets measured in accordance with paragraph 4.1.2A and the provision for expected credit losses on loan commitments and <b>financial guarantee contracts</b> .
<b>modification gain or loss</b>	The amount arising from adjusting the <b>gross carrying amount of a financial asset</b> to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of there negotiated or modified financial asset that are discounted at the financial asset's original <b>effective interest rate</b> (or the original <b>credit-adjusted effective interest rate</b> for <b>purchased or originated credit-impaired financial assets</b> ) or, when applicable, the revised <b>effective interest rate</b> calculated in accordance with paragraph 6.5.10. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the <b>expected credit losses</b> , unless the financial asset is a <b>purchased or originated credit-impaired financial asset</b> , in which case an entity shall also consider the initial

	expected credit losses that were considered when calculating the original <b>credit-adjusted effective interest rate</b> .
<b>past due</b>	A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.
<b>purchased or originated credit-impaired financial asset</b>	Purchased or originated financial asset(s) that are <b>credit-impaired</b> on initial recognition.
<b>reclassification date</b>	The first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets.
<b>regular way purchase or sale</b>	A purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the market place concerned.
<b>transaction costs</b>	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

<sup>11</sup>The following terms are defined in paragraph 11 of Ind AS 32, Appendix A of Ind AS 107, Appendix A of Ind AS 113 or Appendix A of Ind AS 115 and are used in this Standard with the meanings specified in Ind AS 32, Ind AS 107, Ind AS 113 or Ind AS 115:

- (a) credit risk;<sup>12</sup>
- (b) equity instrument;
- (c) fair value;

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<sup>11</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

<sup>12</sup> This term (as defined in Ind AS 107) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through profit or loss (see paragraph 5.7.7).

*Ind AS 109*

- (d) financial asset;
- (e) financial instrument;
- (f) financial liability;
- (g) transaction price.

## Appendix B

### Application guidance

*This appendix is an integral part of the Standard.*

#### Scope (Chapter 2)

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- B2.1 Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not within the scope of Ind AS 104 *Insurance Contracts*, they are within the scope of this Standard.
- B2.2 <sup>13</sup>This Standard does not change the requirements relating to royalty agreements based on the volume of sales or service revenues that are accounted for under Ind AS 115, *Revenue from Contracts with Customers*.
- B2.3 Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses Ind AS 28, *Investments in Associates and Joint Ventures* to determine whether the equity method of accounting shall be applied to such an investment.
- B2.4 This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2.1(e) excludes because they arise under contracts within the scope of Ind AS 104.
- B2.5 Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2.1(e)):

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<sup>13</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

- (a) Although a financial guarantee contract meets the definition of an insurance contract in Ind AS 104 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or Ind AS 104 to such financial guarantee contracts. If this Standard applies, paragraph 5.1.1 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 3.2.15–3.2.23 and B3.2.12–B3.2.17 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:
- (i) the amount determined in accordance with Section 5.5; and
  - (ii) <sup>14</sup>the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115 [see paragraph 4.2.1(c)].
- (b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts as defined in this Standard, and are not insurance contracts as defined in

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<sup>14</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

Ind AS 104. Such guarantees are derivatives and the issuer applies this Standard to them.

- (c) <sup>15</sup> If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies Ind AS 115 in determining when it recognises the revenue from the guarantee and from the sale of goods.

B2.6 Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's communications with customers and regulators, contracts, business documentation and financial statements. Furthermore, insurance contracts are often subject to accounting requirements that are distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies. In such cases, an issuer's financial statements typically include a statement that the issuer has used those accounting requirements.

## **Recognition and derecognition (Chapter 3)**

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### **Initial recognition (Section 3.1)**

B3.1.1 As a consequence of the principle in paragraph 3.1.1, an entity recognises all of its contractual rights and obligations under derivatives in its balance sheet as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph B3.2.14). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (see paragraph B3.2.15).

B3.1.2 The following are examples of applying the principle in paragraph 3.1.1:

- (a) Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
- (b) Assets to be acquired and liabilities to be incurred as a result

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<sup>15</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard in accordance with paragraphs 2.4–2.7, its net fair value is recognised as an asset or a liability on the commitment date (see paragraph B4.1.30(c)). In addition, if a previously unrecognised firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognised as an asset or a liability after the inception of the hedge (see paragraphs 6.5.8(b) and 6.5.9).

- (c) A forward contract that is within the scope of this Standard (see paragraph 2.1) is recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.
- (d) Option contracts that are within the scope of this Standard (see paragraph 2.1) are recognised as assets or liabilities when the holder or writer becomes a party to the contract.
- (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

**Regular way purchase or sale of financial assets**

B3.1.3 A regular way purchase or sale of financial assets is recognised using either trade date accounting or settlement date accounting as described in paragraphs B3.1.5 and B3.1.6. An entity shall apply the same method consistently for all purchases and sales of financial

assets that are classified in the same way in accordance with this Standard. For this purpose assets that are mandatorily measured at fair value through profit or loss form a separate classification from assets designated as measured at fair value through profit or loss. In addition, investments in equity instruments accounted for using the option provided in paragraph 5.7.5 form a separate classification.

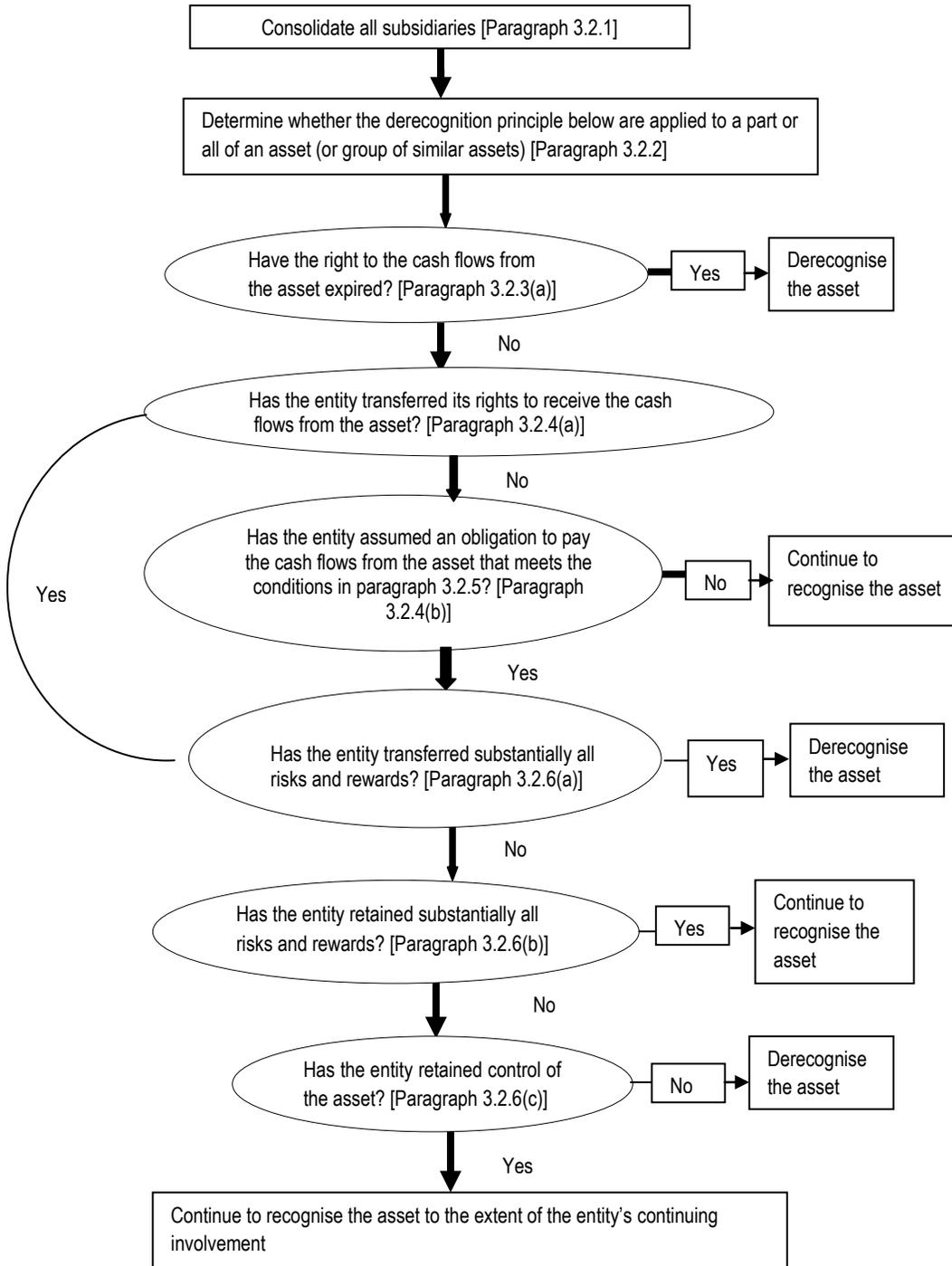
- B3.1.4 A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.
- B3.1.5 The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.
- B3.1.6 The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognised for assets measured at amortised cost; it is recognised in profit or loss for assets classified as financial assets measured at fair value through profit or loss; and it is recognised in other comprehensive income for financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A and for investments in equity instruments accounted for in accordance with paragraph 5.7.5.

### **Derecognition of financial assets (Section 3.2)**

- B3.2.1 <sup>16</sup>The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognised.

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<sup>16</sup> Substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.



*Arrangements under which an entity retains the contractual rights to receive the cash flows of a financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients (paragraph 3.2.4(b))*

- B3.2.2 The situation described in paragraph 3.2.4(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 3.2.5 and 3.2.6 are met.
- B3.2.3 In applying paragraph 3.2.5, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a subsidiary that has acquired the financial asset and passes on cash flows to unrelated third party investors.

*Evaluation of the transfer of risks and rewards of ownership (paragraph 3.2.6)*

- B3.2.4 Examples of when an entity has transferred substantially all the risks and rewards of ownership are:
- (a) an unconditional sale of a financial asset;
  - (b) a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and
  - (c) a sale of a financial asset together with a put or call option that is deeply out of the money (ie an option that is so far out of the money it is highly unlikely to go into the money before expiry).
- B3.2.5 Examples of when an entity has retained substantially all the risks and rewards of ownership are:
- (a) a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;
  - (b) a securities lending agreement;
  - (c) a sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;

- (d) a sale of a financial asset together with a deep in-the-money put or call option (ie an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
- (e) a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

B3.2.6 If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognise the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

*Evaluation of the transfer of control*

B3.2.7 An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option.

B3.2.8 The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

- (a) a contractual right to dispose of the transferred asset has little

practical effect if there is no market for the transferred asset, and

- (b) an ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:
  - (i) the transferee's ability to dispose of the transferred asset must be independent of the actions of others (ie it must be a unilateral ability), and
  - (ii) the transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or 'strings' to the transfer (eg conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset).

B3.2.9 That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

#### **Transfers that qualify for derecognition**

B3.2.10 An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 3.2.13, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying

amount of the receivable between the part of the asset that is derecognised and the part that continues to be recognised. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognised at fair value.

- B3.2.11 When measuring the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 3.2.13, an entity applies the fair value measurement requirements in Ind AS 113, *Fair Value Measurement* in addition to paragraph 3.2.14.

**Transfers that do not qualify for derecognition**

- B3.2.12 The following is an application of the principle outlined in paragraph 3.2.15. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognised because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognised in its entirety and the consideration received is recognised as a liability.

**Continuing involvement in transferred assets**

- B3.2.13 The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 3.2.16.

*All assets*

- (a) <sup>17</sup>If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognised to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ('the guarantee amount'). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognised in profit or loss when (or as) the obligation is satisfied (in accordance with the

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<sup>17</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

principles of Ind AS 115) and the carrying value of the asset is reduced by any loss allowance.

*Assets measured at amortised cost*

- (b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at amortised cost, the associated liability is measured at its cost (ie the consideration received) adjusted for the amortisation of any difference between that cost and the gross carrying amount of the transferred asset at the expiration date of the option. For example, assume that the gross carrying amount of the asset on the date of the transfer is Rs.98 and that the consideration received is Rs.95. The gross carrying amount of the asset on the option exercise date will be Rs.100. The initial carrying amount of the associated liability is Rs.95 and the difference between Rs.95 and Rs.100 is recognised in profit or loss using the effective interest method. If the option is exercised, any difference between the carrying amount of the associated liability and the exercise price is recognised in profit or loss.

*Assets measured at fair value*

- (c) If a call option right retained by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is Rs.80, the option exercise price is Rs.95 and the time value of the option is Rs.5, the carrying amount of the associated liability is Rs.75 (Rs.80 – Rs.5) and the carrying amount of the transferred asset is Rs.80 (ie its fair value).

- (d) If a put option written by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is Rs.120, the option exercise price is Rs.100 and the time value of the option is Rs.5, the carrying amount of the associated liability is Rs.105 (Rs.100 + Rs.5) and the carrying amount of the asset is Rs.100 (in this case the option exercise price).
- (e) If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognised and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of Rs.120 and writing a put with an exercise price of Rs.80. Assume also that the fair value of the asset is Rs.100 at the date of the transfer. The time value of the put and call are Rs.1 and Rs.5 respectively. In this case, the entity recognises an asset of Rs.100 (the fair value of the asset) and a liability of Rs.96 [(Rs.100 + Rs.1) – Rs.5]. This gives a net asset value of Rs.4, which is the fair value of the options held and written by the entity.

### All transfers

- B3.2.14 To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognising both the derivative and either the transferred asset or the liability arising from the transfer would result in recognising the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognised as a derivative asset.
- B3.2.15 To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at amortised cost if it meets the criteria in paragraph 4.1.2.

### Examples

- B3.2.16 The following examples illustrate the application of the derecognition principles of this Standard.
- (a) *Repurchase agreements and securities lending.* If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its balance sheet, for example, as a loaned asset or repurchase receivable.
  - (b) *Repurchase agreements and securities lending—assets that are substantially the same.* If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset

to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

- (c) *Repurchase agreements and securities lending—right of substitution.* If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognised because the transferor retains substantially all the risks and rewards of ownership.
- (d) *Repurchase right of first refusal at fair value.* If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognises the asset because it has transferred substantially all the risks and rewards of ownership.
- (e) *Wash sale transaction.* The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognised.
- (f) *Put options and call options that are deeply in the money.* If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.

- (g) *Put options and call options that are deeply out of the money.* A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognised. This is because the transferor has transferred substantially all the risks and rewards of ownership.
- (h) *Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money.* If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognised. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.
- (i) *A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money.* If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognised to the extent of the transferor's continuing involvement (see paragraph B3.2.9). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognised.
- (j) *Assets subject to a fair value put or call option or a forward repurchase agreement.* A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.

- (k) *Cash-settled call or put options.* An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs B3.2.9 and (g), (h) and (i) above).
- (l) *Removal of accounts provision.* A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the carrying amount and proceeds from the transfer of loan assets are Rs.100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed Rs.10,000, Rs.90,000 of the loans would qualify for derecognition.
- (m) *Clean-up calls.* An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.
- (n) *Subordinated retained interests and credit guarantees.* An entity may provide the transferee with credit enhancement by

subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.

- (o) *Total return swaps.* An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.
- (p) *Interest rate swaps.* An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.
- (q) *Amortising interest rate swaps.* An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognise all of the transferred asset or continues to recognise the transferred asset to the extent of its continuing involvement. Conversely, if the amortisation of

the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

- (r) *Write-off.* An entity has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof.

B3.2.17 This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 per cent and whose principal amount and amortised cost is Rs.10,000. It enters into a transaction in which, in return for a payment of Rs.9,115, the transferee obtains the right to Rs.9,000 of any collections of principal plus interest thereon at 9.5 per cent. The entity retains rights to Rs.1,000 of any collections of principal plus interest thereon at 10 per cent, plus the excess spread of 0.5 per cent on the remaining Rs.9,000 of principal. Collections from prepayments are allocated between the entity and the transferee proportionately in the ratio of 1:9, but any defaults are deducted from the entity's interest of Rs.1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is Rs.10,100 and the fair value of the excess spread of 0.5 per cent is Rs.40.

The entity determines that it has transferred some significant risks and rewards of ownership (for example, significant prepayment risk) but has also retained some significant risks and rewards of ownership (because of its subordinated retained interest) and has retained control. It therefore applies the continuing involvement approach.

To apply this Standard, the entity analyses the transaction as (a) a retention of a fully proportionate retained interest of Rs.1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that Rs.9,090 (90% × Rs.10,100) of the consideration received of Rs.9,115 represents the consideration for a fully proportionate 90 per cent share. The remainder of the consideration received (Rs.25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 per cent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is Rs.65 (Rs.25 + Rs.40).

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 3.2.14 of Ind AS 109 as follows:

	<i>Fair value</i>	<i>Percentage</i>	<i>Allocated carrying amount</i>
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
<b>Total</b>	<b><u>10,100</u></b>		<b><u>10,000</u></b>

The entity computes its gain or loss on the sale of the 90 per cent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, ie Rs.90 (Rs.9,090 – Rs.9,000). The carrying amount of the portion retained by the entity is Rs.1,000.

In addition, the entity recognises the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it recognises an asset of Rs.1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of Rs.1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, ie Rs.1,000 plus the fair value of the subordination of Rs.65).

The entity uses all of the above information to account for the transaction as follows:

	<i>Debit</i>	<i>Credit</i>
Original asset		9,000
Asset recognised for subordination or the		

residual interest	1,000	
Asset for the consideration received in the form of excess spread	40	
Profit or loss (gain on transfer)		90
Liability		1,065
Cash received	9,115	
<b>Total</b>	<b><u>10,155</u></b>	<b><u>10,155</u></b>

Immediately following the transaction, the carrying amount of the asset is Rs.2,040 comprising Rs.1,000, representing the allocated cost of the portion retained, and Rs.1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of Rs.40).

In subsequent periods, the entity recognises the consideration received for the credit enhancement (Rs.65) on a time proportion basis, accrues interest on the recognised asset using the effective interest method and recognises any impairment losses on the recognised assets. As an example of the latter, assume that in the following year there is an impairment loss on the underlying loans of Rs.300. The entity reduces its recognised asset by Rs.600 (Rs.300 relating to its retained interest and Rs.300 relating to the additional continuing involvement that arises from the subordination of its retained interest for impairment losses), and reduces its recognised liability by Rs.300. The net result is a charge to profit or loss for impairment losses of Rs.300.

### **Derecognition of financial liabilities (Section 3.3)**

- B3.3.1 A financial liability (or part of it) is extinguished when the debtor either:
- (a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
  - (b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)

- B3.3.2 If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.
- B3.3.3 Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.
- B3.3.4 If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognise the debt obligation unless the condition in paragraph B3.3.1(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.
- B3.3.5 Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognise a new liability if the derecognition criteria in paragraphs 3.2.1–3.2.23 are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognised, and the entity recognises a new liability relating to the transferred assets.
- B3.3.6 For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.
- B3.3.7 In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility

defaults. In these circumstances the debtor:

- (a) recognises a new financial liability based on the fair value of its obligation for the guarantee, and
- (b) recognises a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

## **Classification (Chapter 4)**

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### **Classification of financial assets (Section 4.1)**

#### **The entity's business model for managing financial assets**

- B4.1.1 Paragraph 4.1.1(a) requires an entity to classify financial assets on the basis of the entity's business model for managing the financial assets, unless paragraph 4.1.5 applies. An entity assesses whether its financial assets meet the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a) on the basis of the business model as determined by the entity's key management personnel (as defined in Ind AS 24 *Related Party Disclosures*).
- B4.1.2 An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into sub portfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash

flows and manages the other loans with an objective of selling them.

- B4.1.2A An entity's business model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the business model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are realised in a way that is different from the entity's expectations at the date that the entity assessed the business model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) nor does it change the classification of the remaining financial assets held in that business model (ie those assets that the entity recognised in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the business model assessment. However, when an entity assesses the business model for newly originated or newly purchased financial assets, it must consider information about how cash flows were realised in the past, along with all other relevant information.
- B4.1.2B An entity's business model for managing financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the business model. An entity will need to use judgement when it assesses its business model for managing financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:
- (a) how the performance of the business model and the financial assets held within that business model are evaluated and

reported to the entity's key management personnel;

- (b) the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; and
- (c) how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

*A business model whose objective is to hold assets in order to collect contractual cash flows*

B4.1.2C Financial assets that are held within a business model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However sales in themselves do not determine the business model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are realised. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions.

B4.1.3 Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future.

B4.1.3A The business model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an

increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a business model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimising potential credit losses due to credit deterioration are integral to such a business model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk.

B4.1.3B Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's business model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the

proceeds from the sales approximate the collection of the remaining contractual cash flows.

B4.1.4 The following are examples of when the objective of an entity's business model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. Furthermore, the examples are not intended to discuss all factors that may be relevant to the assessment of the entity's business model nor specify the relative importance of the factors.

<b>Example 1</b>	<b>Analysis</b>
<p>An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs.</p> <p>The entity performs credit risk management activities with the objective of minimising credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs.</p> <p>Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.</p>	<p>Although the entity considers, among other information, the financial assets' fair values from a liquidity perspective (ie the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets in order to collect the contractual cash flows. Sales would not contradict that objective if they were in response to an increase in the assets' credit risk, for example if the assets no longer meet the credit criteria specified in the entity's documented investment policy. Infrequent sales resulting from unanticipated funding needs (eg in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.</p>
<p><b>Example 2</b></p> <p>An entity's business model is to purchase portfolios of financial</p>	<p><b>Analysis</b></p> <p>The objective of the entity's business model is to hold the</p>

<p>assets, such as loans. Those portfolios may or may not include financial assets that are credit impaired.</p> <p>If payment on the loans is not made on a timely basis, the entity attempts to realise the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity’s objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realising cash flows by selling them.</p> <p>In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.</p>	<p>financial assets in order to collect the contractual cash flows.</p> <p>The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (eg some of the financial assets are credit impaired at initial recognition).</p> <p>Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity’s business model</p>
<p><b>Example 3</b></p> <p>An entity has a business model with the objective of originating loans to customers and subsequently selling those loans to a securitisation vehicle.</p> <p>The securitisation vehicle issues instruments to investors.</p> <p>The originating entity controls the securitisation vehicle and thus consolidates it.</p> <p>The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors.</p> <p>It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated</p>	<p><b>Analysis</b></p> <p>The consolidated group originated the loans with the objective of holding them to collect the contractual cash flows.</p> <p>However, the originating entity has an objective of realising cash flows on the loan portfolio by selling the loans to the securitisation vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.</p>

<p>balance sheet because they are not derecognised by the securitisation vehicle.</p>	
<p><b>Example 4</b></p> <p>A financial institution holds financial assets to meet liquidity needs in a 'stress case' scenario (eg, a run on the bank's deposits). The entity does not anticipate selling these assets except in such scenarios.</p> <p>The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realised.</p> <p>However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realised if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.</p>	<p><b>Analysis</b></p> <p>The objective of the entity's business model is to hold the financial assets to collect contractual cash flows.</p> <p>The analysis would not change even if during a previous stress case scenario the entity had sales that were significant in value in order to meet its liquidity needs. Similarly, recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows.</p> <p>In contrast, if an entity holds financial assets to meet its everyday liquidity needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity's business model is not to hold the financial assets to collect contractual cash flows.</p> <p>Similarly, if the entity is required by its regulator to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's business model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell</p>

	the financial assets, or that activity is at the entity's discretion, is not relevant to the analysis.
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*A business model whose objective is achieved by both collecting contractual cash flows and selling financial assets*

B4.1.4A An entity may hold financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of business model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the business model. There are various objectives that may be consistent with this type of business model. For example, the objective of the business model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such an objective, the entity will both collect contractual cash flows and sell financial assets.

B4.1.4B Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the business model's objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this business model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.

B4.1.4C The following are examples of when the objective of the entity's business model may be achieved by both collecting contractual cash flows and selling financial assets. This list of examples is not exhaustive. Furthermore, the examples are not intended to describe all the factors that may be relevant to the assessment of the entity's business model nor specify the relative importance of the factors.

<b>Example 5</b>	<b>Analysis</b>
An entity anticipates capital expenditure in a few years. The	The objective of the business model is achieved by both

<p>entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.</p> <p>The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return.</p> <p>The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.</p>	<p>collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the portfolio until the need arises for the invested cash.</p> <p>In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only sales that are insignificant in value occur before maturity (unless there is an increase in credit risk). The objective of this contrasting business model is to hold financial assets to collect contractual cash flows.</p>
<p><b>Example 6</b></p> <p>A financial institution holds financial assets to meet its everyday liquidity needs. The entity seeks to minimise the costs of managing those liquidity</p>	<p><b>Analysis</b></p> <p>The objective of the business model is to maximise the return on the portfolio to meet everyday liquidity needs and</p>

<p>needs and therefore actively manages the return on the portfolio. That return consists of collecting contractual payments as well as gains and losses from the sale of financial assets.</p> <p>As a result, the entity holds financial assets to collect contractual cash flows and sells financial assets to reinvest in higher yielding financial assets or to better match the duration of its liabilities. In the past, this strategy has resulted in frequent sales activity and such sales have been significant in value. This activity is expected to continue in the future.</p>	<p>the entity achieves that objective by both collecting contractual cash flows and selling financial assets. In other words, both collecting contractual cash flows and selling financial assets are integral to achieving the business model's objective.</p>
<p><b>Example 7</b></p> <p>An insurer holds financial assets in order to fund insurance contract liabilities. The insurer uses the proceeds from the contractual cash flows on the financial assets to settle insurance contract liabilities as they come due. To ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities, the insurer undertakes significant buying and selling activity on a regular basis to rebalance its portfolio of assets and to meet cash flow needs as they arise.</p>	<p><b>Analysis</b></p> <p>The objective of the business model is to fund the insurance contract liabilities. To achieve this objective, the entity collects contractual cash flows as they come due and sells financial assets to maintain the desired profile of the asset portfolio.</p> <p>Thus both collecting contractual cash flows and selling financial assets are integral to achieving the business model's objective.</p>

*Other business models*

- B4.1.5 Financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash

flows and selling financial assets (but see also paragraph 5.7.5). One business model that results in measurement at fair value through profit or loss is one in which an entity manages the financial assets with the objective of realising cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realise those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a business model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the business model's objective; instead, it is incidental to it.

- B4.1.6 A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 4.2.2(b)) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the business model's objective. Consequently, such portfolios of financial assets must be measured at fair value through profit or loss.

**Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding**

- B4.1.7 Paragraph 4.1.1(b) requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, unless paragraph 4.1.5 applies. To do so, the condition in paragraphs 4.1.2(b) and 4.1.2A(b) requires an entity to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

- B4.1.7A Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs B4.1.9A–B4.1.9E) and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.
- B4.1.7B In accordance with paragraph 4.1.3(a), principal is the fair value of the financial asset at initial recognition. However that principal amount may change over the life of the financial asset (for example, if there are repayments of principal).
- B4.1.8 An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated.
- B4.1.9 Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in

paragraphs 4.1.2(b) and 4.1.2A(b) and cannot be subsequently measured at amortised cost or fair value through other comprehensive income.

*Consideration for the time value of money*

- B4.1.9A Time value of money is the element of interest that provides consideration for only the passage of time. That is, the time value of money element does not provide consideration for other risks or costs associated with holding the financial asset. In order to assess whether the element provides consideration for only the passage of time, an entity applies judgement and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set.
- B4.1.9B However, in some cases, the time value of money element may be modified (ie imperfect). That would be the case, for example, if a financial asset's interest rate is periodically reset but the frequency of that reset does not match the tenor of the interest rate (for example, the interest rate resets every month to a one-year rate) or if a financial asset's interest rate is periodically reset to an average of particular short- and long-term interest rates. In such cases, an entity must assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment.
- B4.1.9C When assessing a modified time value of money element, the objective is to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). For example, if the financial asset under assessment contains a variable interest rate that is reset every month to a one-year interest rate, the entity would compare that financial asset to a financial instrument with identical contractual terms and the identical credit risk except the variable interest rate is reset monthly to a one-month interest rate. If the modified time value of money element could result in contractual (undiscounted) cash flows that are significantly different from the

(undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). To make this determination, the entity must consider the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument. The reason for the interest rate being set in this way is not relevant to the analysis. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment.

B4.1.9D When assessing a modified time value of money element, an entity must consider factors that could affect future contractual cash flows. For example, if an entity is assessing a bond with a five-year term and the variable interest rate is reset every six months to a five-year rate, the entity cannot conclude that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding simply because the interest rate curve at the time of the assessment is such that the difference between a five-year interest rate and a six-month interest rate is not significant. Instead, the entity must also consider whether the relationship between the five-year interest rate and the six-month interest rate could change over the life of the instrument such that the contractual (undiscounted) cash flows over the life of the instrument could be significantly different from the (undiscounted) benchmark cash flows. However, an entity must consider only reasonably possible scenarios instead of every possible scenario. If an entity concludes that the contractual (undiscounted) cash flows could be significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) and therefore cannot be measured at amortised cost or fair value through other comprehensive income.

B4.1.9E In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs B4.1.9A–B4.1.9D, a regulated

interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 4.1.2(b) and 4.1.2A(b) if that regulated interest rate provides consideration that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconsistent with a basic lending arrangement.

*Contractual terms that change the timing or amount of contractual cash flows*

- B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph B4.1.18.)
- B4.1.11 The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:
- (a) a variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial

recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

- (b) a contractual term that permits the issuer (ie the debtor) to prepay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract; and
- (c) a contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (ie an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract.

B4.1.12 Despite paragraph B4.1.10, a financial asset that would otherwise meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortised cost or fair value through other comprehensive income (subject to meeting the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a)) if:

- (a) the entity acquires or originates the financial asset at a premium or discount to the contractual par amount;
- (b) the prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable additional compensation for the early termination of the contract; and
- (c) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

B4.1.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

<p><b>Instrument A</b></p> <p>Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.</p>	<p><b>Analysis</b></p> <p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.</p> <p>However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph B4.1.7A).</p>
<p><b>Instrument B</b></p> <p>Instrument B is a variable interest rate instrument with a stated maturity date that</p>	<p><b>Analysis</b></p> <p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as</p>

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<p>permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term.</p>	<p>long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph B4.1.7A). The fact that the LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument.</p> <p>However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.</p> <p>In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the</p>
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	<p>cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph B4.1.9E for guidance on regulated interest rates.)</p> <p>For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical.</p> <p>The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (eg the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).</p>
<p><b>Instrument C</b></p> <p>Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.</p>	<p><b>Analysis</b></p> <p>The contractual cash flows of both:</p> <ul style="list-style-type: none"> <li>(a) an instrument that has a fixed interest rate and</li> <li>(b) an instrument that has a variable interest rate</li> </ul> <p>are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and</p>

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	<p>costs, as well as a profit margin. (See paragraph B4.1.7A)</p> <p>Consequently, an instrument that is a combination of (a) and (b) (eg a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (eg an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.</p>
<p><b>Instrument D</b></p> <p>Instrument D is a full recourse loan and is secured by collateral.</p>	<p><b>Analysis</b></p> <p>The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.</p>
<p><b>Instrument E</b></p> <p>Instrument E is issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary.</p> <p>However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular</p>	<p><b>Analysis</b></p> <p>The holder would analyse the <b>contractual terms</b> of the financial instrument to determine whether they give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and thus are consistent with a basic lending arrangement.</p> <p>That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the</p>

<p>circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'.</p>	<p>resulting payments, are not <b>contractual terms</b> of the financial instrument.</p> <p>In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if the <b>contractual terms</b> of the financial instrument permit or require the issuer or another entity to impose losses on the holder (eg by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.</p>
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B4.1.14 The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

<p><b>Instrument F</b></p> <p>Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer.</p>	<p><b>Analysis</b></p> <p>The holder would analyse the convertible bond in its entirety.</p> <p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement (see paragraph B4.1.7A); ie the return is linked to the value of the equity of the issuer.</p>
<p><b>Instrument G</b></p> <p>Instrument G is a loan that pays an inverse floating interest rate (ie the interest</p>	<p><b>Analysis</b></p> <p>The contractual cash flows are not solely payments of principal and interest on the principal amount</p>

<p>rate has an inverse relationship to market interest rates).</p>	<p>outstanding. The interest amounts are not consideration for the time value of money on the principal amount outstanding.</p>
<p><b>Instrument H</b> Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.  Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest.</p>	<p><b>Analysis</b> The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.  If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.  The fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity.  Also, the fact that Instrument H is callable does not mean that the</p>

	contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal amount outstanding. Even if the callable amount includes an amount that reasonably compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. (See also Paragraph B4.1.12.)
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- B4.1.15 In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 4.1.2(b), 4.1.2A(b) and 4.1.3 of this Standard.
- B4.1.16 This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 4.1.2(b) and 4.1.2A(b). This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).
- B4.1.17 However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 4.1.2(b) and 4.1.2A(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of

principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

- B4.1.18 A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a *de minimis* effect on the contractual cash flows of the financial asset. To make this determination, an entity must consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial instrument. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than *de minimis* (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.
- B4.1.19 In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralised, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

*Contractually linked instruments*

- B4.1.20 In some types of transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.
- B4.1.21 In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:
- (a) the contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (eg the interest rate on the tranche is not linked to a commodity index);
  - (b) the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.1.23 and B4.1.24; and
  - (c) the exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments).
- B4.1.22 An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments.
- B4.1.23 The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.
- B4.1.24 The underlying pool of instruments may also include instruments

that:

- (a) reduce the cash flow variability of the instruments in paragraph B4.1.23 and, when combined with the instruments in paragraph B4.1.23, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (eg an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph B4.1.23); or
- (b) align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph B4.1.23 to address differences in and only in:
  - (i) whether the interest rate is fixed or floating;
  - (ii) the currency in which the cash flows are denominated, including inflation in that currency; or
  - (iii) the timing of the cash flows.

B4.1.25 If any instrument in the pool does not meet the conditions in either paragraph B4.1.23 or paragraph B4.1.24, the condition in paragraph B4.1.21(b) is not met. In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary. However, an entity must use judgement and perform sufficient analysis to determine whether the instruments in the pool meet the conditions in paragraphs B4.1.23–B4.1.24. (See also paragraph B4.1.18 for guidance on contractual cash flow characteristics that have only a de minimis effect.)

B4.1.26 If the holder cannot assess the conditions in paragraph B4.1.21 at initial recognition, the tranche must be measured at fair value through profit or loss. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs B4.1.23–B4.1.24, the tranche does not meet the conditions in paragraph B4.1.21 and must be measured at fair value through profit or loss. However, if the underlying pool includes instruments that are collateralised by assets that do not meet the conditions in paragraphs B4.1.23–B4.1.24, the ability to take possession of such assets shall be disregarded for the purposes of applying this paragraph unless the entity acquired the tranche with the intention of controlling the

collateral.

**Option to designate a financial asset or financial liability as at fair value through profit or loss (Sections 4.1 and 4.2)**

B4.1.27 Subject to the conditions in paragraphs 4.1.5 and 4.2.2, this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through profit or loss provided that doing so results in more relevant information.

B4.1.28 The decision of an entity to designate a financial asset or financial liability as at fair value through profit or loss is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b) of Ind AS 8 requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through profit or loss, paragraph 4.2.2 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 4.2.2, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

**Designation eliminates or significantly reduces an accounting mismatch**

B4.1.29 Measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as subsequently measured at fair value through profit or loss and a liability the entity considers related would be subsequently measured at amortised cost (with changes in fair value

not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through profit or loss.

B4.1.30 The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 4.1.5 or 4.2.2(a):

- (a) an entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by paragraph 24 of Ind AS 104) and financial assets that it considers to be related and that would otherwise be measured at either fair value through other comprehensive income or amortised cost.
- (b) an entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through profit or loss (for example, those that are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met because, for example, the requirements for hedge effectiveness in paragraph 6.4.1 are not met.
- (c) an entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through profit or loss. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example, the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through profit or loss eliminates the inconsistency in the timing of the recognition of the gains and losses that would otherwise result

from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

B4.1.31 In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through profit or loss may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through profit or loss at its initial recognition and, at that time, any remaining transactions are expected to occur.

B4.1.32 It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through profit or loss if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to Rs.100 and a number of similar financial assets that sum to Rs.50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of Rs.45) as at fair value through profit or loss. However, because designation as at fair value through profit or loss can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (eg changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (ie percentage) of a liability.

**A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis**

B4.1.33 An entity may manage and evaluate the performance of a group of

financial liabilities or financial assets and financial liabilities in such a way that measuring that group at fair value through profit or loss results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, instead of on the nature of its financial instruments.

- B4.1.34 For example, an entity may use this condition to designate financial liabilities as at fair value through profit or loss if it meets the principle in paragraph 4.2.2(b) and the entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued 'structured products' containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments.
- B4.1.35 As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial liabilities as at fair value through profit or loss on the basis of this condition shall so designate all eligible financial liabilities that are managed and evaluated together.
- B4.1.36 Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 4.2.2(b). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity's key management personnel—clearly demonstrates that its performance is evaluated on this basis, no further documentation is required to demonstrate compliance with paragraph 4.2.2(b).

### **Embedded derivatives (Section 4.3)**

- B4.3.1 When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 4.3.3 requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at

fair value at initial recognition and subsequently at fair value through profit or loss.

- B4.3.2 If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.
- B4.3.3 An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.
- B4.3.4 Generally, multiple embedded derivatives in a single hybrid contract are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see Ind AS 32 *Financial Instruments: Presentation*) are accounted for separately from those classified as assets or liabilities. In addition, if a hybrid contract has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.
- B4.3.5 The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 4.3.3(a)) in the following examples. In these examples, assuming the conditions in paragraph 4.3.3(b) and (c) are met, an entity accounts for the embedded derivative separately from the host contract.
- (a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.

- (b) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.
- (c) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (d) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (e) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:
  - (i) the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or
  - (ii) the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the

prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with Ind AS 32.

- (f) Credit derivatives that are embedded in a host debt instrument and allow one party (the 'beneficiary') to transfer the credit risk of a particular reference asset, which it may not own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it.

B4.3.6 An example of a hybrid contract is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through profit or loss, it is required to separate an embedded derivative (ie the indexed principal payment) under paragraph 4.3.3 because the host contract is a debt instrument under paragraph B4.3.2 and the indexed principal payment is not closely related to a host debt instrument under paragraph B4.3.5(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

B4.3.7 In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.

B4.3.8 The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the

host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

- (a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.
- (b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.
- (c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because Ind AS 21 *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognised in profit or loss.
- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is

closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

- (i) the functional currency of any substantial party to that contract;
  - (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
  - (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
- (e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.
- (f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) contingent rentals based on related sales or (iii) contingent rentals based on variable interest rates.
- (g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

- (h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (ie without considering the host contract).

**Instruments containing embedded derivatives**

- B4.3.9 As noted in paragraph B4.3.1, when an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard and with one or more embedded derivatives, paragraph 4.3.3 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through profit or loss. For that reason this Standard permits the entire hybrid contract to be designated as at fair value through profit or loss.
- B4.3.10 Such designation may be used whether paragraph 4.3.3 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 4.3.5 would not justify designating the hybrid contract as at fair value through profit or loss in the cases set out in paragraph 4.3.5(a) and (b) because doing so would not reduce complexity or increase reliability.

**Reassessment of embedded derivatives**

- B4.3.11 In accordance with paragraph 4.3.3, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

Ind AS 109

B4.3.12 Paragraph B4.3.11 does not apply to embedded derivatives in contracts acquired in:

- (a) a business combination (as defined in Ind AS 103 *Business Combinations*);
- (b) a combination of entities or businesses under common control as described in paragraphs B1–B4 of Ind AS 103; or
- (c) the formation of a joint venture as defined in Ind AS 111 *Joint Arrangements* or their possible reassessment at the date of acquisition.<sup>18</sup>

## **Reclassification of financial assets (Section 4.4)**

### **Reclassification of financial assets**

B4.4.1 Paragraph 4.4.1 requires an entity to reclassify financial assets if the entity changes its business model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's business model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line. Examples of a change in business model include the following:

- (a) An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
- (b) A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing

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<sup>18</sup> Ind AS 103 addresses the acquisition of contracts with embedded derivatives in a business combination.

its mortgage loan portfolio for sale.

B4.4.2 A change in the objective of the entity's business model must be effected before the reclassification date. For example, if a financial services firm decides on 15 February to shut down its retail mortgage business and hence must reclassify all affected financial assets on 1 April (ie the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former business model after 15 February.

B4.4.3 The following are not changes in business model:

- (a) a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).
- (b) the temporary disappearance of a particular market for financial assets.
- (c) a transfer of financial assets between parts of the entity with different business models.

## **Measurement (Chapter 5)**

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### **Initial measurement (Section 5.1)**

B5.1.1 The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS 113). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

B5.1.2 If an entity originates a loan that bears an off-market interest rate (eg 5 per cent when the market rate for similar loans is 8 per cent),

and receives an upfront fee as compensation, the entity recognises the loan at its fair value, ie net of the fee it receives.

B5.1.2A The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Ind AS 113). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

- (a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.
- (b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

### **Subsequent measurement (Sections 5.2 and 5.3)**

B5.2.1 If a financial instrument that was previously recognised as a financial asset is measured at fair value through profit or loss and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 4.2.1. However, hybrid contracts with hosts that are assets within the scope of this Standard are always measured in accordance with paragraph 4.3.2.

B5.2.2 The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive income in accordance with either paragraph 5.7.5 or 4.1.2A. An entity acquires a financial asset for Rs.100 plus a purchase commission of Rs.2. Initially, the entity recognises the asset at Rs.102. The reporting period ends one day later, when the quoted

market price of the asset is Rs.100. If the asset were sold, a commission of Rs.3 would be paid. On that date, the entity measures the asset at Rs.100 (without regard to the possible commission on sale) and recognises a loss of Rs.2 in other comprehensive income. If the financial asset is measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, the transaction costs are amortised to profit or loss using the effective interest method.

B5.2.2A The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph B5.1.2A shall be consistent with the requirements of this Standard.

**Investments in equity instruments and contracts on those investments**

B5.2.3 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.2.4 Indicators that cost might not be representative of fair value include:

- (a) a significant change in the performance of the investee compared with budgets, plans or milestones.
- (b) changes in expectation that the investee's technical product milestones will be achieved.
- (c) a significant change in the market for the investee's equity or its products or potential products.
- (d) a significant change in the global economy or the economic environment in which the investee operates.
- (e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.
- (f) internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

- (g) evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

B5.2.5 The list in paragraph B5.2.4 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value.

B5.2.6 Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

## **Amortised cost measurement (Section 5.4)**

### **Effective interest method**

B5.4.1 In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

B5.4.2 Fees that are an integral part of the effective interest rate of a financial instrument include:

- (a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.
- (b) commitment fees received by the entity to originate a loan

when the loan commitment is not measured in accordance with paragraph 4.2.1(a) and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry.

- (c) origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

B5.4.3 <sup>19</sup>Fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with Ind AS 115 include:

- (a) fees charged for servicing a loan;
- (b) commitment fees to originate a loan when the loan commitment is not measured in accordance with paragraph 4.2.1(a) and it is unlikely that a specific lending arrangement will be entered into; and
- (c) loan syndication fees received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants).

B5.4.4 When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or

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<sup>19</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

discounts relate is repriced to market rates before the expected maturity of the financial instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date. For example, if a premium or discount on a floating-rate financial instrument reflects the interest that has accrued on that financial instrument since the interest was last paid, or changes in the market rates since the floating interest rate was reset to the market rates, it will be amortised to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (ie interest rates) is reset to the market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the financial instrument, or other variables that are not reset to the market rates, it is amortised over the expected life of the financial instrument.

- B5.4.5 For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.
- B5.4.6 If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. The adjustment is recognised in profit or loss as income or expense.
- B5.4.7 In some cases a financial asset is considered credit-impaired at

initial recognition because the credit risk is very high, and in the case of a purchase it is acquired at a deep discount. An entity is required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate for financial assets that are considered to be purchased or originated credit-impaired at initial recognition. However, this does not mean that a credit-adjusted effective interest rate should be applied solely because the financial asset has high credit risk at initial recognition.

**Transaction costs**

- B5.4.8 Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

**Write-off**

- B5.4.9 Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset and expects to recover no more than 30 per cent of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining 70 per cent of the financial asset.

**Impairment (Section 5.5)**

**Collective and individual assessment basis**

- B5.5.1 In order to meet the objective of recognising lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of recognising lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

- B5.5.2 Lifetime expected credit losses are generally expected to be recognised before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed. Consequently when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk.
- B5.5.3 However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a customer breaches the contractual terms. If changes in the credit risk for individual financial instruments are not captured before they become past due, a loss allowance based only on credit information at an individual financial instrument level would not faithfully represent the changes in credit risk since initial recognition.
- B5.5.4 In some circumstances an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime expected credit losses on an individual instrument basis. In that case, lifetime expected credit losses shall be recognised on a collective basis that considers comprehensive credit risk information. This comprehensive credit risk information must incorporate not only past due information but also all relevant credit information, including forward-looking macroeconomic information, in order to approximate the result of recognising lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition on an individual instrument level.
- B5.5.5 For the purpose of determining significant increases in credit risk and recognising a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is

designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

- (a) instrument type;
- (b) credit risk ratings;
- (c) collateral type;
- (d) date of initial recognition;
- (e) remaining term to maturity;
- (f) industry;
- (g) geographical location of the borrower; and
- (h) the value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios).

B5.5.6 Paragraph 5.5.4 requires that lifetime expected credit losses are recognised on all financial instruments for which there has been significant increases in credit risk since initial recognition. In order to meet this objective, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition based on shared credit risk characteristics, the entity should recognise lifetime expected credit losses on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments.

**Timing of recognising lifetime expected credit losses**

B5.5.7 The assessment of whether lifetime expected credit losses should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default

occurring. Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs.

- B5.5.8 For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract.
- B5.5.9 The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.
- B5.5.10 The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years.
- B5.5.11 Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition.
- B5.5.12 An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly

since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

- (a) the change in the risk of a default occurring since initial recognition;
- (b) the expected life of the financial instrument; and
- (c) reasonable and supportable information that is available without undue cost or effort that may affect credit risk.

B5.5.13 The methods used to determine whether credit risk has increased significantly on a financial instrument since initial recognition should consider the characteristics of the financial instrument (or group of financial instruments) and the default patterns in the past for comparable financial instruments. Despite the requirement in paragraph 5.5.9, for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring. In such cases, an entity may use changes in the risk of a default occurring over the next 12 months to determine whether credit risk has increased significantly since initial recognition, unless circumstances indicate that a lifetime assessment is necessary.

B5.5.14 However, for some financial instruments, or in some circumstances, it may not be appropriate to use changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be recognised. For example, the change in the risk of a default occurring in the next 12 months may not be a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

- (a) the financial instrument only has significant payment

obligations beyond the next 12 months;

- (b) changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or
- (c) changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months.

**Determining whether credit risk has increased significantly since initial recognition**

B5.5.15 When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument in accordance with paragraph 5.5.17(c). An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition.

B5.5.16 Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region. An entity shall consider reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed. However, some factors or indicators may not be identifiable on an individual financial instrument level. In such a case, the factors or indicators should be assessed for appropriate portfolios, groups of portfolios or portions of a portfolio of financial instruments to determine whether the requirement in paragraph 5.5.3 for the recognition of lifetime expected credit losses has been met.

B5.5.17 The following non-exhaustive list of information may be relevant in assessing changes in credit risk:

- (a) significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.

- (b) other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher income coverage) because of changes in the credit risk of the financial instrument since initial recognition.
- (c) significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
  - (i) the credit spread;
  - (ii) the credit default swap prices for the borrower;
  - (iii) the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost; and
  - (iv) other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
- (d) an actual or expected significant change in the financial instrument's external credit rating.
- (e) an actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally. Internal credit ratings and internal behavioural scoring are more reliable when they are mapped to external ratings or supported by default studies.
- (f) existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.
- (g) an actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality,

increased balance sheet leverage, liquidity, management problems or changes in the scope of business or organisational structure (such as the discontinuance of a segment of the business) that results in a significant change in the borrower's ability to meet its debt obligations.

- (h) significant increases in credit risk on other financial instruments of the same borrower.
- (i) an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.
- (j) significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.
- (k) a significant change in the quality of the guarantee provided by a shareholder (or an individual's parents) if the shareholder (or parents) have an incentive and financial ability to prevent default by capital or cash infusion.
- (l) significant changes, such as reductions in financial support from a parent entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).
- (m) expected changes in the loan documentation including an

expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.

- (n) significant changes in the expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the group (for example, an increase in the expected number or extent of delayed contractual payments or significant increases in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).
- (o) changes in the entity's credit management approach in relation to the financial instrument; ie based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.
- (p) past due information, including the rebuttable presumption as set out in paragraph 5.5.11.

B5.5.18 In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, ie qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into consideration the credit risk characteristics at initial recognition, if both types of information are relevant.

*More than 30 days past due rebuttable presumption*

- B5.5.19 The rebuttable presumption in paragraph 5.5.11 is not an absolute indicator that lifetime expected credit losses should be recognised, but is presumed to be the latest point at which lifetime expected credit losses should be recognised even when using forward-looking information (including macroeconomic factors on a portfolio level).
- B5.5.20 An entity can rebut this presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due.
- B5.5.21 An entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default.

*Financial instruments that have low credit risk at the reporting date*

- B5.5.22 The credit risk on a financial instrument is considered low for the purposes of paragraph 5.5.10, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative

to the credit risk of the jurisdiction within which an entity operates.

- B5.5.23 To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument.
- B5.5.24 Lifetime expected credit losses are not recognised on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognised in accordance with paragraph 5.5.3.

#### **Modifications**

- B5.5.25 In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.
- B5.5.26 Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 5.5.3 are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is

credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit-impaired at initial recognition.

B5.5.27 If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, that financial asset is not automatically considered to have lower credit risk. An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

## **Measurement of expected credit losses**

### **Expected credit losses**

B5.5.28 Expected credit losses are a probability-weighted estimate of credit losses (ie the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

B5.5.29 For financial assets, a credit loss is the present value of the

difference between:

- (a) the contractual cash flows that are due to an entity under the contract; and
- (b) the cash flows that the entity expects to receive.

B5.5.30 For undrawn loan commitments, a credit loss is the present value of the difference between:

- (a) the contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and
- (b) the cash flows that the entity expects to receive if the loan is drawn down.

B5.5.31 An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, ie it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

B5.5.32 For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

B5.5.33 For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is recognised in profit or loss as an impairment gain or loss.

B5.5.34 When measuring a loss allowance for a lease receivable, the cash

flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with Ind AS 17 *Leases*.

B5.5.35 An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 5.5.17. An example of a practical expedient is the calculation of the expected credit losses on trade receivables using a provision matrix. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraphs B5.5.51–B5.5.52) for trade receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc). Depending on the diversity of its customer base, the entity would use appropriate groupings if its historical credit loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as wholesale or retail).

#### **Definition of default**

B5.5.36 Paragraph 5.5.9 requires that when determining whether the credit risk on a financial instrument has increased significantly, an entity shall consider the change in the risk of a default occurring since initial recognition.

B5.5.37 When defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes

shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument.

**Period over which to estimate expected credit losses**

B5.5.38 In accordance with paragraph 5.5.19, the maximum period over which expected credit losses shall be measured is the maximum contractual period over which the entity is exposed to credit risk. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit.

B5.5.39 However, in accordance with paragraph 5.5.20, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as credit cards and overdraft facilities, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

- (a) the financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);
- (b) the contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and
- (c) the financial instruments are managed on a collective basis.

B5.5.40 When determining the period over which the entity is expected to be

exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

- (a) the period over which the entity was exposed to credit risk on similar financial instruments;
- (b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and
- (c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

**Probability-weighted outcome**

B5.5.41 The purpose of estimating expected credit losses is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of expected credit losses shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss.

B5.5.42 Paragraph 5.5.17(a) requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected credit losses shall reflect at least two outcomes in accordance with paragraph 5.5.18.

B5.5.43 For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime

expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months.

**Time value of money**

- B5.5.44 Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph B5.4.5.
- B5.5.45 For purchased or originated credit-impaired financial assets, expected credit losses shall be discounted using the credit-adjusted effective interest rate determined at initial recognition.
- B5.5.46 Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with Ind AS 17.
- B5.5.47 The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment. This is because for the purpose of applying the impairment requirements, a financial asset that is recognised following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment.
- B5.5.48 Expected credit losses on financial guarantee contracts or on loan commitments for which the effective interest rate cannot be determined shall be discounted by applying a discount rate that

reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

**Reasonable and supportable information**

- B5.5.49 For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort.
- B5.5.50 An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.
- B5.5.51 An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments. The information used shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date. An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).

- B5.5.52 Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience.
- B5.5.53 When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions.
- B5.5.54 Expected credit losses reflect an entity's own expectations of credit losses. However, when considering all reasonable and supportable information that is available without undue cost or effort in estimating expected credit losses, an entity should also consider observable market information about the credit risk of the particular financial instrument or similar financial instruments.

### **Collateral**

B5.5.55 For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity. The estimate of expected cash shortfalls on a collateralised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (ie the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it). Consequently, any cash flows that are expected from the realisation of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not recognised as an asset that is separate from the collateralised financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards.

### **Reclassification of financial assets (Section 5.6)**

- B5.6.1 If an entity reclassifies financial assets in accordance with paragraph 4.4.1, paragraph 5.6.1 requires that the reclassification is applied prospectively from the reclassification date. Both the amortised cost measurement category and the fair value through other comprehensive income measurement category require that the effective interest rate is determined at initial recognition. Both of those measurement categories also require that the impairment requirements are applied in the same way. Consequently, when an entity reclassifies a financial asset between the amortised cost measurement category and the fair value through other comprehensive income measurement category:
- (a) the recognition of interest revenue will not change and therefore the entity continues to use the same effective interest rate.
  - (b) the measurement of expected credit losses will not change because both measurement categories apply the same impairment approach. However if a financial asset is reclassified out of the fair value through other comprehensive

income measurement category and into the amortised cost measurement category, a loss allowance would be recognised as an adjustment to the gross carrying amount of the financial asset from the reclassification date. If a financial asset is reclassified out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, the loss allowance would be derecognised (and thus would no longer be recognised as an adjustment to the gross carrying amount) but instead would be recognised as an accumulated impairment amount (of an equal amount) in other comprehensive income and would be disclosed from the reclassification date.

- B5.6.2 However, an entity is not required to separately recognise interest revenue or impairment gains or losses for a financial asset measured at fair value through profit or loss. Consequently, when an entity reclassifies a financial asset out of the fair value through profit or loss measurement category, the effective interest rate is determined on the basis of the fair value of the asset at the reclassification date. In addition, for the purposes of applying Section 5.5 to the financial asset from the reclassification date, the date of the reclassification is treated as the date of initial recognition.

### **Gains and losses (Section 5.7)**

- B5.7.1 Paragraph 5.7.5 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (ie share-by-share) basis. Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity. Dividends on such investments are recognised in profit or loss in accordance with paragraph 5.7.6 unless the dividend clearly represents a recovery of part of the cost of the investment.
- B5.7.1A Unless paragraph 4.1.5 applies, paragraph 4.1.2A requires that a financial asset is measured at fair value through other comprehensive income if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and

interest on the principal amount outstanding and the asset is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. This measurement category recognises information in profit or loss as if the financial asset is measured at amortised cost, while the financial asset is measured in the balance sheet at fair value. Gains or losses, other than those that are recognised in profit or loss in accordance with paragraphs 5.7.10–5.7.11, are recognised in other comprehensive income. When these financial assets are derecognised, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss. This reflects the gain or loss that would have been recognised in profit or loss upon derecognition if the financial asset had been measured at amortised cost.

- B5.7.2 An entity applies Ind AS 21 to financial assets and financial liabilities that are monetary items in accordance with Ind AS 21 and denominated in a foreign currency. Ind AS 21 requires any foreign exchange gains and losses on monetary assets and monetary liabilities to be recognised in profit or loss. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraph 6.5.11), a hedge of a net investment (see paragraph 6.5.13) or a fair value hedge of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5 (see paragraph 6.5.8).
- B5.7.2A For the purpose of recognising foreign exchange gains and losses under Ind AS 21, a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at amortised cost in the foreign currency. Exchange differences on the amortised cost are recognised in profit or loss and other changes in the carrying amount are recognised in accordance with paragraph 5.7.10.
- B5.7.3 Paragraph 5.7.5 permits an entity to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of particular investments in equity instruments. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive income in accordance with

paragraph 5.7.5 includes any related foreign exchange component.

- B5.7.4 If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in profit or loss.

**Liabilities designated as at fair value through profit or loss**

- B5.7.5 When an entity designates a financial liability as at fair value through profit or loss, it must determine whether presenting in other comprehensive income the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in other comprehensive income would result in a greater mismatch in profit or loss than if those amounts were presented in profit or loss.
- B5.7.6 To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of another financial instrument measured at fair value through profit or loss. Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument.
- B5.7.7 That determination is made at initial recognition and is not reassessed. For practical purposes the entity need not enter into all of the assets and liabilities giving rise to an accounting mismatch at exactly the same time. A reasonable delay is permitted provided that any remaining transactions are expected to occur. An entity must apply consistently its methodology for determining whether presenting in other comprehensive income the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss. However, an entity may use different methodologies when there are different economic relationships between the characteristics of the liabilities designated as at fair value through profit or loss and the characteristics of the other financial instruments. Ind AS 107 requires an entity to provide qualitative disclosures in the notes to the financial statements about its methodology for making that determination.
- B5.7.8 If such a mismatch would be created or enlarged, the entity is

required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in profit or loss. If such a mismatch would not be created or enlarged, the entity is required to present the effects of changes in the liability's credit risk in other comprehensive income.

B5.7.9 Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity.

B5.7.10 The following example describes a situation in which an accounting mismatch would be created in profit or loss if the effects of changes in the credit risk of the liability were presented in other comprehensive income. A mortgage bank provides loans to customers and funds those loans by selling bonds with matching characteristics (eg amount outstanding, repayment profile, term and currency) in the market. The contractual terms of the loan permit the mortgage customer to prepay its loan (ie satisfy its obligation to the bank) by buying the corresponding bond at fair value in the market and delivering that bond to the mortgage bank. As a result of that contractual prepayment right, if the credit quality of the bond worsens (and, thus, the fair value of the mortgage bank's liability decreases), the fair value of the mortgage bank's loan asset also decreases. The change in the fair value of the asset reflects the mortgage customer's contractual right to prepay the mortgage loan by buying the underlying bond at fair value (which, in this example, has decreased) and delivering the bond to the mortgage bank. Consequently, the effects of changes in the credit risk of the liability (the bond) will be offset in profit or loss by a corresponding change in the fair value of a financial asset (the loan). If the effects of changes in the liability's credit risk were presented in other comprehensive income there would be an accounting mismatch in profit or loss. Consequently, the mortgage bank is required to present all changes in fair value of the liability (including the effects of changes in the liability's credit risk) in profit or loss.

B5.7.11 In the example in paragraph B5.7.10, there is a contractual linkage between the effects of changes in the credit risk of the liability and changes in the fair value of the financial asset (ie as a result of the mortgage customer's contractual right to prepay the loan by buying the bond at fair value and delivering the bond to the mortgage bank).

However, an accounting mismatch may also occur in the absence of a contractual linkage.

B5.7.12 For the purposes of applying the requirements in paragraphs 5.7.7 and 5.7.8, an accounting mismatch is not caused solely by the measurement method that an entity uses to determine the effects of changes in a liability's credit risk. An accounting mismatch in profit or loss would arise only when the effects of changes in the liability's credit risk (as defined in Ind AS 107) are expected to be offset by changes in the fair value of another financial instrument. A mismatch that arises solely as a result of the measurement method (ie because an entity does not isolate changes in a liability's credit risk from some other changes in its fair value) does not affect the determination required by paragraphs 5.7.7 and 5.7.8. For example, an entity may not isolate changes in a liability's credit risk from changes in liquidity risk. If the entity presents the combined effect of both factors in other comprehensive income, a mismatch may occur because changes in liquidity risk may be included in the fair value measurement of the entity's financial assets and the entire fair value change of those assets is presented in profit or loss. However, such a mismatch is caused by measurement imprecision, not the offsetting relationship described in paragraph B5.7.6 and, therefore, does not affect the determination required by paragraphs 5.7.7 and 5.7.8.

*The meaning of 'credit risk' (paragraphs 5.7.7 and 5.7.8)*

B5.7.13 Ind AS 107 defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 5.7.7(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the credit worthiness of the issuer. For example, if an entity issues a collateralised liability and a non-collateralised liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the collateralised liability will be less than the credit risk of the non-collateralised liability. The credit risk for a collateralised liability may be close to zero.

B5.7.14 For the purposes of applying the requirement in paragraph 5.7.7(a),

credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all).

B5.7.15 The following are examples of asset-specific performance risk:

- (a) a liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.
- (b) a liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk.

*Determining the effects of changes in credit risk*

B5.7.16 For the purposes of applying the requirement in paragraph 5.7.7(a), an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:

- (a) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see paragraphs B5.7.17 and B5.7.18); or
- (b) using an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk.

B5.7.17 Changes in market conditions that give rise to market risk include

changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates.

B5.7.18 If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph B5.7.16(a) can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive income in accordance with paragraph 5.7.7(a).

B5.7.19 The example in paragraph B5.7.18 assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (see paragraph B5.7.16(b)). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in other comprehensive income in accordance with paragraph 5.7.7(a).

B5.7.20 As with all fair value measurements, an entity's measurement

method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs.

## **Hedge accounting (Chapter 6)**

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### **Hedging instruments (Section 6.2)**

#### **Qualifying instruments**

- B6.2.1 Derivatives that are embedded in hybrid contracts, but that are not separately accounted for, cannot be designated as separate hedging instruments.
- B6.2.2 An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.
- B6.2.3 For hedges of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument is determined in accordance with Ind AS 21.

#### *Written options*

- B6.2.4 This Standard does not restrict the circumstances in which a derivative that is measured at fair value through profit or loss may be designated as a hedging instrument, except for some written options. A written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (for example, a written call option used to hedge a callable liability).

#### **Designation of hedging instruments**

- B6.2.5 For hedges other than hedges of foreign currency risk, when an entity designates a non-derivative financial asset or a non-derivative financial liability measured at fair value through profit or loss as a hedging instrument, it may only designate the non-derivative financial instrument in its entirety or a proportion of it.
- B6.2.6 A single hedging instrument may be designated as a hedging instrument of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different

risk positions as hedged items. Those hedged items can be in different hedging relationships.

### **Hedged items (Section 6.3)**

#### **Qualifying items**

- B6.3.1 A firm commitment to acquire a business in a business combination cannot be a hedged item, except for foreign currency risk, because the other risks being hedged cannot be specifically identified and measured. Those other risks are general business risks.
- B6.3.2 An equity method investment cannot be a hedged item in a fair value hedge. This is because the equity method recognises in profit or loss the investor's share of the investee's profit or loss, instead of changes in the investment's fair value. For a similar reason, an investment in a consolidated subsidiary cannot be a hedged item in a fair value hedge. This is because consolidation recognises in profit or loss the subsidiary's profit or loss, instead of changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.
- B6.3.3 Paragraph 6.3.4 permits an entity to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. When designating such a hedged item, an entity assesses whether the aggregated exposure combines an exposure with a derivative so that it creates a different aggregated exposure that is managed as one exposure for a particular risk (or risks). In that case, the entity may designate the hedged item on the basis of the aggregated exposure. For example:
- (a) an entity may hedge a given quantity of highly probable coffee purchases in 15 months' time against price risk (based on US dollars) using a 15-month futures contract for coffee. The highly probable coffee purchases and the futures contract for coffee in combination can be viewed as a 15-month fixed-amount US dollar foreign currency risk exposure for risk management purposes (ie like any fixed-amount US dollar cash outflow in 15 months' time).
  - (b) an entity may hedge the foreign currency risk for the entire

term of a 10-year fixed-rate debt denominated in a foreign currency. However, the entity requires fixed-rate exposure in its functional currency only for a short to medium term (say two years) and floating rate exposure in its functional currency for the remaining term to maturity. At the end of each of the two-year intervals (ie on a two-year rolling basis) the entity fixes the next two years' interest rate exposure (if the interest level is such that the entity wants to fix interest rates). In such a situation an entity may enter into a 10-year fixed-to-floating cross-currency interest rate swap that swaps the fixed-rate foreign currency debt into a variable-rate functional currency exposure. This is overlaid with a two-year interest rate swap that—on the basis of the functional currency—swaps variable-rate debt into fixed-rate debt. In effect, the fixed-rate foreign currency debt and the 10-year fixed-to-floating cross-currency interest rate swap in combination are viewed as a 10-year variable-rate debt functional currency exposure for risk management purposes.

- B6.3.4 When designating the hedged item on the basis of the aggregated exposure, an entity considers the combined effect of the items that constitute the aggregated exposure for the purpose of assessing hedge effectiveness and measuring hedge ineffectiveness. However, the items that constitute the aggregated exposure remain accounted for separately. This means that, for example:
- (a) derivatives that are part of an aggregated exposure are recognised as separate assets or liabilities measured at fair value; and
  - (b) if a hedging relationship is designated between the items that constitute the aggregated exposure, the way in which a derivative is included as part of an aggregated exposure must be consistent with the designation of that derivative as the hedging instrument at the level of the aggregated exposure. For example, if an entity excludes the forward element of a derivative from its designation as the hedging instrument for the hedging relationship between the items that constitute the aggregated exposure, it must also exclude the forward element when including that derivative as a hedged item as part of the aggregated exposure. Otherwise, the aggregated exposure shall include a derivative, either in its entirety or a

proportion of it.

- B6.3.5 Paragraph 6.3.6 states that in consolidated financial statements the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect consolidated profit or loss. For this purpose an entity can be a parent, subsidiary, associate, joint arrangement or branch. If the foreign currency risk of a forecast intragroup transaction does not affect consolidated profit or loss, the intragroup transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same group, unless there is a related external transaction. However, when the foreign currency risk of a forecast intragroup transaction will affect consolidated profit or loss, the intragroup transaction can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same group if there is an onward sale of the inventory to a party external to the group. Similarly, a forecast intragroup sale of plant and equipment from the group entity that manufactured it to a group entity that will use the plant and equipment in its operations may affect consolidated profit or loss. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognised for the plant and equipment may change if the forecast intragroup transaction is denominated in a currency other than the functional currency of the purchasing entity.
- B6.3.6 If a hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss is recognised in, and taken out of, other comprehensive income in accordance with paragraph 6.5.11. The relevant period or periods during which the foreign currency risk of the hedged transaction affects profit or loss is when it affects consolidated profit or loss.

**Designation of hedged items**

- B6.3.7 A component is a hedged item that is less than the entire item. Consequently, a component reflects only some of the risks of the item of which it is a part or reflects the risks only to some extent (for example, when designating a proportion of an item).

*Risk components*

- B6.3.8 To be eligible for designation as a hedged item, a risk component must be a separately identifiable component of the financial or the non-financial item, and the changes in the cash flows or the fair value of the item attributable to changes in that risk component must be reliably measurable.
- B6.3.9 When identifying what risk components qualify for designation as a hedged item, an entity assesses such risk components within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. Such a determination requires an evaluation of the relevant facts and circumstances, which differ by risk and market.
- B6.3.10 When designating risk components as hedged items, an entity considers whether the risk components are explicitly specified in a contract (contractually specified risk components) or whether they are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components). Non-contractually specified risk components can relate to items that are not a contract (for example, forecast transactions) or contracts that do not explicitly specify the component (for example, a firm commitment that includes only one single price instead of a pricing formula that references different underlyings). For example:
- (a) Entity A has a long-term supply contract for natural gas that is priced using a contractually specified formula that references commodities and other factors (for example, gas oil, fuel oil and other components such as transport charges). Entity A hedges the gas oil component in that supply contract using a gas oil forward contract. Because the gas oil component is specified by the terms and conditions of the supply contract it is a contractually specified risk component. Hence, because of the pricing formula, Entity A concludes that the gas oil price exposure is separately identifiable. At the same time, there is a market for gas oil forward contracts. Hence, Entity A concludes that the gas oil price exposure is reliably measurable. Consequently, the gas oil price exposure in the supply contract is a risk component that is eligible for designation as a hedged item.

- (b) Entity B hedges its future coffee purchases based on its production forecast. Hedging starts up to 15 months before delivery for part of the forecast purchase volume. Entity B increases the hedged volume over time (as the delivery date approaches). Entity B uses two different types of contracts to manage its coffee price risk:
- (i) exchange-traded coffee futures contracts; and
  - (ii) coffee supply contracts for Arabica coffee from Colombia delivered to a specific manufacturing site. These contracts price a tonne of coffee based on the exchange-traded coffee futures contract price plus a fixed price differential plus a variable logistics services charge using a pricing formula. The coffee supply contract is an executory contract in accordance with which Entity B takes actual delivery of coffee.

For deliveries that relate to the current harvest, entering into the coffee supply contracts allows Entity B to fix the price differential between the actual coffee quality purchased (Arabica coffee from Colombia) and the benchmark quality that is the underlying of the exchange-traded futures contract. However, for deliveries that relate to the next harvest, the coffee supply contracts are not yet available, so the price differential cannot be fixed. Entity B uses exchange-traded coffee futures contracts to hedge the benchmark quality component of its coffee price risk for deliveries that relate to the current harvest as well as the next harvest. Entity B determines that it is exposed to three different risks: coffee price risk reflecting the benchmark quality, coffee price risk reflecting the difference (spread) between the price for the benchmark quality coffee and the particular Arabica coffee from Colombia that it actually receives, and the variable logistics costs. For deliveries related to the current harvest, after Entity B enters into a coffee supply contract, the coffee price risk reflecting the benchmark quality is a contractually specified risk component because the pricing formula includes an indexation to the exchange-traded coffee futures contract price. Entity B concludes that this risk component is separately identifiable and reliably measurable. For deliveries

related to the next harvest, Entity B has not yet entered into any coffee supply contracts (ie those deliveries are forecast transactions). Hence, the coffee price risk reflecting the benchmark quality is a non-contractually specified risk component. Entity B's analysis of the market structure takes into account how eventual deliveries of the particular coffee that it receives are priced. Hence, on the basis of this analysis of the market structure, Entity B concludes that the forecast transactions also involve the coffee price risk that reflects the benchmark quality as a risk component that is separately identifiable and reliably measurable even though it is not contractually specified. Consequently, Entity B may designate hedging relationships on a risk components basis (for the coffee price risk that reflects the benchmark quality) for coffee supply contracts as well as forecast transactions.

- (c) Entity C hedges part of its future jet fuel purchases on the basis of its consumption forecast up to 24 months before delivery and increases the volume that it hedges over time. Entity C hedges this exposure using different types of contracts depending on the time horizon of the hedge, which affects the market liquidity of the derivatives. For the longer time horizons (12–24 months) Entity C uses crude oil contracts because only these have sufficient market liquidity. For time horizons of 6–12 months Entity C uses gas oil derivatives because they are sufficiently liquid. For time horizons up to six months Entity C uses jet fuel contracts. Entity C's analysis of the market structure for oil and oil products and its evaluation of the relevant facts and circumstances is as follows:
- (i) Entity C operates in a geographical area in which Brent is the crude oil benchmark. Crude oil is a raw material benchmark that affects the price of various refined oil products as their most basic input. Gas oil is a benchmark for refined oil products, which is used as a pricing reference for oil distillates more generally. This is also reflected in the types of derivative financial instruments for the crude oil and refined oil products markets of the environment in which Entity C operates, such as:

- the benchmark crude oil futures contract, which is for Brent crude oil;
  - the benchmark gas oil futures contract, which is used as the pricing reference for distillates—for example, jet fuel spread derivatives cover the price differential between jet fuel and that benchmark gas oil; and
  - the benchmark gas oil crack spread derivative (ie the derivative for the price differential between crude oil and gas oil—a refining margin), which is indexed to Brent crude oil.
- (ii) the pricing of refined oil products does not depend on which particular crude oil is processed by a particular refinery because those refined oil products (such as gas oil or jet fuel) are standardised products.

Hence, Entity C concludes that the price risk of its jet fuel purchases includes a crude oil price risk component based on Brent crude oil and a gas oil price risk component, even though crude oil and gas oil are not specified in any contractual arrangement. Entity C concludes that these two risk components are separately identifiable and reliably measurable even though they are not contractually specified. Consequently, Entity C may designate hedging relationships for forecast jet fuel purchases on a risk components basis (for crude oil or gas oil). This analysis also means that if, for example, Entity C used crude oil derivatives based on West Texas Intermediate (WTI) crude oil, changes in the price differential between Brent crude oil and WTI crude oil would cause hedge ineffectiveness.

- (d) Entity D holds a fixed-rate debt instrument. This instrument is issued in an environment with a market in which a large variety of similar debt instruments are compared by their spreads to a benchmark rate (for example, LIBOR) and variable-rate instruments in that environment are typically indexed to that benchmark rate. Interest rate swaps are frequently used to manage interest rate risk on the basis of that benchmark rate, irrespective of the spread of debt

instruments to that benchmark rate. The price of fixed-rate debt instruments varies directly in response to changes in the benchmark rate as they happen. Entity D concludes that the benchmark rate is a component that can be separately identified and reliably measured. Consequently, Entity D may designate hedging relationships for the fixed-rate debt instrument on a risk component basis for the benchmark interest rate risk.

- B6.3.11 When designating a risk component as a hedged item, the hedge accounting requirements apply to that risk component in the same way as they apply to other hedged items that are not risk components. For example, the qualifying criteria apply, including that the hedging relationship must meet the hedge effectiveness requirements, and any hedge ineffectiveness must be measured and recognised.
- B6.3.12 An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a 'one-sided risk'). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, the entity designates only cash flow losses that result from an increase in the price above the specified level. The hedged risk does not include the time value of a purchased option, because the time value is not a component of the forecast transaction that affects profit or loss.
- B6.3.13 There is a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument. However, in limited cases, it is possible to identify a risk component for inflation risk that is separately identifiable and reliably measurable because of the particular circumstances of the inflation environment and the relevant debt market.
- B6.3.14 For example, an entity issues debt in an environment in which

inflation-linked bonds have a volume and term structure that results in a sufficiently liquid market that allows constructing a term structure of zero-coupon real interest rates. This means that for the respective currency, inflation is a relevant factor that is separately considered by the debt markets. In those circumstances the inflation risk component could be determined by discounting the cash flows of the hedged debt instrument using the term structure of zero-coupon real interest rates (ie in a manner similar to how a risk-free (nominal) interest rate component can be determined). Conversely, in many cases an inflation risk component is not separately identifiable and reliably measurable. For example, an entity issues only nominal interest rate debt in an environment with a market for inflation-linked bonds that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed. In this case the analysis of the market structure and of the facts and circumstances does not support the entity concluding that inflation is a relevant factor that is separately considered by the debt markets. Hence, the entity cannot overcome the rebuttable presumption that inflation risk that is not contractually specified is not separately identifiable and reliably measurable. Consequently, an inflation risk component would not be eligible for designation as the hedged item. This applies irrespective of any inflation hedging instrument that the entity has actually entered into. In particular, the entity cannot simply impute the terms and conditions of the actual inflation hedging instrument by projecting its terms and conditions onto the nominal interest rate debt.

- B6.3.15 A contractually specified inflation risk component of the cash flows of a recognised inflation-linked bond (assuming that there is no requirement to account for an embedded derivative separately) is separately identifiable and reliably measurable, as long as other cash flows of the instrument are not affected by the inflation risk component.

*Components of a nominal amount*

- B6.3.16 There are two types of components of nominal amounts that can be designated as the hedged item in a hedging relationship: a component that is a proportion of an entire item or a layer component. The type of component changes the accounting

outcome. An entity shall designate the component for accounting purposes consistently with its risk management objective.

B6.3.17 An example of a component that is a proportion is 50 per cent of the contractual cash flows of a loan.

B6.3.18 A layer component may be specified from a defined, but open, population, or from a defined nominal amount. Examples include:

- (a) part of a monetary transaction volume, for example, the next FC10 cash flows from sales denominated in a foreign currency after the first FC20 in March 201X;<sup>20</sup>
- (b) a part of a physical volume, for example, the bottom layer, measuring 5 million cubic metres, of the natural gas stored in location XYZ;
- (c) a part of a physical or other transaction volume, for example, the first 100 barrels of the oil purchases in June 201X or the first 100 MWh of electricity sales in June 201X; or
- (d) a layer from the nominal amount of the hedged item, for example, the last Rs.80 million of a Rs.100 million firm commitment, the bottom layer of Rs.20 million of a Rs.100 million fixed-rate bond or the top layer of Rs.30 million from a total amount of Rs.100 million of fixed-rate debt that can be prepaid at fair value (the defined nominal amount is Rs.100 million).

B6.3.19 If a layer component is designated in a fair value hedge, an entity shall specify it from a defined nominal amount. To comply with the requirements for qualifying fair value hedges, an entity shall remeasure the hedged item for fair value changes (ie remeasure the item for fair value changes attributable to the hedged risk). The fair value hedge adjustment must be recognised in profit or loss no later than when the item is derecognised. Consequently, it is necessary to track the item to which the fair value hedge adjustment relates. For a layer component in a fair value hedge, this requires an entity to track the nominal amount from which it is defined. For example, in paragraph B6.3.18(d), the total defined nominal amount of Rs.100 million must be tracked in order to track the bottom layer of Rs.20

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<sup>20</sup> In this Standard monetary amounts are denominated in 'Indian Rupees' (Rs.) and 'foreign currency units' (FC).

million or the top layer of Rs.30 million.

B6.3.20 A layer component that includes a prepayment option is not eligible to be designated as a hedged item in a fair value hedge if the prepayment option's fair value is affected by changes in the hedged risk, unless the designated layer includes the effect of the related prepayment option when determining the change in the fair value of the hedged item.

*Relationship between components and the total cash flows of an item*

B6.3.21 If a component of the cash flows of a financial or a non-financial item is designated as the hedged item, that component must be less than or equal to the total cash flows of the entire item. However, all of the cash flows of the entire item may be designated as the hedged item and hedged for only one particular risk (for example, only for those changes that are attributable to changes in LIBOR or a benchmark commodity price).

B6.3.22 For example, in the case of a financial liability whose effective interest rate is below LIBOR, an entity cannot designate:

- (a) a component of the liability equal to interest at LIBOR (plus the principal amount in case of a fair value hedge); and
- (b) a negative residual component.

B6.3.23 However, in the case of a fixed-rate financial liability whose effective interest rate is (for example) 100 basis points below LIBOR, an entity can designate as the hedged item the change in the value of that entire liability (ie principal plus interest at LIBOR minus 100 basis points) that is attributable to changes in LIBOR. If a fixed-rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day when it first designates the hedged item. For example, assume that an entity originates a fixed-rate financial asset of Rs.100 that has an effective interest rate of 6 per cent at a time when LIBOR is 4 per cent. It begins to hedge that asset some time

later when LIBOR has increased to 8 per cent and the fair value of the asset has decreased to Rs.90. The entity calculates that if it had purchased the asset on the date it first designates the related LIBOR interest rate risk as the hedged item, the effective yield of the asset based on its then fair value of Rs.90 would have been 9.5 per cent. Because LIBOR is less than this effective yield, the entity can designate a LIBOR component of 8 per cent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (ie Rs.90) and the amount repayable on maturity (ie Rs.100).

- B6.3.24 If a variable-rate financial liability bears interest of (for example) three-month LIBOR minus 20 basis points (with a floor at zero basis points), an entity can designate as the hedged item the change in the cash flows of that entire liability (ie three-month LIBOR minus 20 basis points—including the floor) that is attributable to changes in LIBOR. Hence, as long as the three-month LIBOR forward curve for the remaining life of that liability does not fall below 20 basis points, the hedged item has the same cash flow variability as a liability that bears interest at three-month LIBOR with a zero or positive spread. However, if the three-month LIBOR forward curve for the remaining life of that liability (or a part of it) falls below 20 basis points, the hedged item has a lower cash flow variability than a liability that bears interest at three-month LIBOR with a zero or positive spread.
- B6.3.25 A similar example of a non-financial item is a specific type of crude oil from a particular oil field that is priced off the relevant benchmark crude oil. If an entity sells that crude oil under a contract using a contractual pricing formula that sets the price per barrel at the benchmark crude oil price minus Rs.10 with a floor of Rs.15, the entity can designate as the hedged item the entire cash flow variability under the sales contract that is attributable to the change in the benchmark crude oil price. However, the entity cannot designate a component that is equal to the full change in the benchmark crude oil price. Hence, as long as the forward price (for each delivery) does not fall below Rs.25, the hedged item has the same cash flow variability as a crude oil sale at the benchmark crude oil price (or with a positive spread). However, if the forward price for any delivery falls below Rs.25, the hedged item has a lower cash flow variability than a crude oil sale at the benchmark crude oil

price (or with a positive spread).

## **Qualifying criteria for hedge accounting (Section 6.4)**

### **Hedge effectiveness**

- B6.4.1 Hedge effectiveness is the extent to which changes in the fair value or the cash flows of the hedging instrument offset changes in the fair value or the cash flows of the hedged item (for example, when the hedged item is a risk component, the relevant change in fair value or cash flows of an item is the one that is attributable to the hedged risk). Hedge ineffectiveness is the extent to which the changes in the fair value or the cash flows of the hedging instrument are greater or less than those on the hedged item.
- B6.4.2 When designating a hedging relationship and on an ongoing basis, an entity shall analyse the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term. This analysis (including any updates in accordance with paragraph B6.5.21 arising from rebalancing a hedging relationship) is the basis for the entity's assessment of meeting the hedge effectiveness requirements.
- B6.4.3 For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraph 6.5.6 shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

### **Economic relationship between the hedged item and the hedging instrument**

- B6.4.4 The requirement that an economic relationship exists means that the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk. Hence, there must be an expectation that the value of the hedging instrument and the value of the hedged item will systematically change in response to movements in either the same underlying or underlyings that are economically related in such a way that they respond in a similar way to the risk that is being hedged (for example, Brent and WTI crude oil).

- B6.4.5 If the underlyings are not the same but are economically related, there can be situations in which the values of the hedging instrument and the hedged item move in the same direction, for example, because the price differential between the two related underlyings changes while the underlyings themselves do not move significantly. That is still consistent with an economic relationship between the hedging instrument and the hedged item if the values of the hedging instrument and the hedged item are still expected to typically move in the opposite direction when the underlyings move.
- B6.4.6 The assessment of whether an economic relationship exists includes an analysis of the possible behaviour of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. The mere existence of a statistical correlation between two variables does not, by itself, support a valid conclusion that an economic relationship exists.

**The effect of credit risk**

- B6.4.7 Because the hedge accounting model is based on a general notion of offset between gains and losses on the hedging instrument and the hedged item, hedge effectiveness is determined not only by the economic relationship between those items (ie the changes in their underlyings) but also by the effect of credit risk on the value of both the hedging instrument and the hedged item. The effect of credit risk means that even if there is an economic relationship between the hedging instrument and the hedged item, the level of offset might become erratic. This can result from a change in the credit risk of either the hedging instrument or the hedged item that is of such a magnitude that the credit risk dominates the value changes that result from the economic relationship (ie the effect of the changes in the underlyings). A level of magnitude that gives rise to dominance is one that would result in the loss (or gain) from credit risk frustrating the effect of changes in the underlyings on the value of the hedging instrument or the hedged item, even if those changes were significant. Conversely, if during a particular period there is little change in the underlyings, the fact that even small credit risk-related changes in the value of the hedging instrument or the hedged item might affect the value more than the underlyings does not create dominance.
- B6.4.8 An example of credit risk dominating a hedging relationship is when

an entity hedges an exposure to commodity price risk using an uncollateralised derivative. If the counterparty to that derivative experiences a severe deterioration in its credit standing, the effect of the changes in the counterparty's credit standing might outweigh the effect of changes in the commodity price on the fair value of the hedging instrument, whereas changes in the value of the hedged item depend largely on the commodity price changes.

**Hedge ratio**

- B6.4.9 In accordance with the hedge effectiveness requirements, the hedge ratio of the hedging relationship must be the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. Hence, if an entity hedges less than 100 per cent of the exposure on an item, such as 85 per cent, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from 85 per cent of the exposure and the quantity of the hedging instrument that the entity actually uses to hedge those 85 per cent. Similarly, if, for example, an entity hedges an exposure using a nominal amount of 40 units of a financial instrument, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from that quantity of 40 units (ie the entity must not use a hedge ratio based on a higher quantity of units that it might hold in total or a lower quantity of units) and the quantity of the hedged item that it actually hedges with those 40 units.
- B6.4.10 However, the designation of the hedging relationship using the same hedge ratio as that resulting from the quantities of the hedged item and the hedging instrument that the entity actually uses shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would in turn create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, for the purpose of designating a hedging relationship, an entity must adjust the hedge ratio that results from the quantities of the hedged item and the hedging instrument that the entity actually uses if that is needed to avoid such an imbalance.
- B6.4.11 Examples of relevant considerations in assessing whether an

accounting outcome is inconsistent with the purpose of hedge accounting are:

- (a) whether the intended hedge ratio is established to avoid recognising hedge ineffectiveness for cash flow hedges, or to achieve fair value hedge adjustments for more hedged items with the aim of increasing the use of fair value accounting, but without offsetting fair value changes of the hedging instrument; and
- (b) whether there is a commercial reason for the particular weightings of the hedged item and the hedging instrument, even though that creates hedge ineffectiveness. For example, an entity enters into and designates a quantity of the hedging instrument that is not the quantity that it determined as the best hedge of the hedged item because the standard volume of the hedging instruments does not allow it to enter into that exact quantity of hedging instrument (a 'lot size issue'). An example is an entity that hedges 100 tonnes of coffee purchases with standard coffee futures contracts that have a contract size of 37,500 lbs (pounds). The entity could only use either five or six contracts (equivalent to 85.0 and 102.1 tonnes respectively) to hedge the purchase volume of 100 tonnes. In that case, the entity designates the hedging relationship using the hedge ratio that results from the number of coffee futures contracts that it actually uses, because the hedge ineffectiveness resulting from the mismatch in the weightings of the hedged item and the hedging instrument would not result in an accounting outcome that is inconsistent with the purpose of hedge accounting.

**Frequency of assessing whether the hedge effectiveness requirements are met**

B6.4.12 An entity shall assess at the inception of the hedging relationship, and on an ongoing basis, whether a hedging relationship meets the hedge effectiveness requirements. At a minimum, an entity shall perform the ongoing assessment at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. The assessment relates to expectations about hedge effectiveness and is therefore

only forward-looking.

**Methods for assessing whether the hedge effectiveness requirements are met**

- B6.4.13 This Standard does not specify a method for assessing whether a hedging relationship meets the hedge effectiveness requirements. However, an entity shall use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness. Depending on those factors, the method can be a qualitative or a quantitative assessment.
- B6.4.14 For example, when the critical terms (such as the nominal amount, maturity and underlying) of the hedging instrument and the hedged item match or are closely aligned, it might be possible for an entity to conclude on the basis of a qualitative assessment of those critical terms that the hedging instrument and the hedged item have values that will generally move in the opposite direction because of the same risk and hence that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs B6.4.4–B6.4.6).
- B6.4.15 The fact that a derivative is in or out of the money when it is designated as a hedging instrument does not in itself mean that a qualitative assessment is inappropriate. It depends on the circumstances whether hedge ineffectiveness arising from that fact could have a magnitude that a qualitative assessment would not adequately capture.
- B6.4.16 Conversely, if the critical terms of the hedging instrument and the hedged item are not closely aligned, there is an increased level of uncertainty about the extent of offset. Consequently, the hedge effectiveness during the term of the hedging relationship is more difficult to predict. In such a situation it might only be possible for an entity to conclude on the basis of a quantitative assessment that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs B6.4.4–B6.4.6). In some situations a quantitative assessment might also be needed to assess whether the hedge ratio used for designating the hedging relationship meets the hedge effectiveness requirements (see paragraphs B6.4.9–B6.4.11). An entity can use the same or different

methods for those two different purposes.

- B6.4.17 If there are changes in circumstances that affect hedge effectiveness, an entity may have to change the method for assessing whether a hedging relationship meets the hedge effectiveness requirements in order to ensure that the relevant characteristics of the hedging relationship, including the sources of hedge ineffectiveness, are still captured.
- B6.4.18 An entity's risk management is the main source of information to perform the assessment of whether a hedging relationship meets the hedge effectiveness requirements. This means that the management information (or analysis) used for decision-making purposes can be used as a basis for assessing whether a hedging relationship meets the hedge effectiveness requirements.
- B6.4.19 An entity's documentation of the hedging relationship includes how it will assess the hedge effectiveness requirements, including the method or methods used. The documentation of the hedging relationship shall be updated for any changes to the methods (see paragraph B6.4.17).

### **Accounting for qualifying hedging relationships (Section 6.5)**

- B6.5.1 An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed-rate debt instrument arising from changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.
- B6.5.2 The purpose of a cash flow hedge is to defer the gain or loss on the hedging instrument to a period or periods in which the hedged expected future cash flows affect profit or loss. An example of a cash flow hedge is the use of a swap to change floating rate debt (whether measured at amortised cost or fair value) to fixed-rate debt (ie a hedge of a future transaction in which the future cash flows being hedged are the future interest payments). Conversely, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value through profit or loss, is an example of an item that cannot be the hedged item in a cash flow hedge, because any gain or loss on the hedging instrument that would be

deferred could not be appropriately reclassified to profit or loss during a period in which it would achieve offset. For the same reason, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value with changes in fair value presented in other comprehensive income also cannot be the hedged item in a cash flow hedge.

- B6.5.3 A hedge of a firm commitment (for example, a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, in accordance with paragraph 6.5.4, a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

**Measurement of hedge ineffectiveness**

- B6.5.4 When measuring hedge ineffectiveness, an entity shall consider the time value of money. Consequently, the entity determines the value of the hedged item on a present value basis and therefore the change in the value of the hedged item also includes the effect of the time value of money.
- B6.5.5 To calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (this is commonly referred to as a 'hypothetical derivative'), and, for example for a hedge of a forecast transaction, would be calibrated using the hedged price (or rate) level. For example, if the hedge was for a two-sided risk at the current market level, the hypothetical derivative would represent a hypothetical forward contract that is calibrated to a value of nil at the time of designation of the hedging relationship. If the hedge was for example for a one-sided risk, the hypothetical derivative would represent the intrinsic value of a hypothetical option that at the time of designation of the hedging relationship is at the money if the hedged price level is the current market level, or out of the money if the hedged price level is above (or, for a hedge of a long position, below) the current market level. Using a hypothetical derivative is one possible way of calculating the change in the value of the hedged item. The hypothetical derivative replicates the hedged item and hence results in the same outcome as if that change in value

was determined by a different approach. Hence, using a 'hypothetical derivative' is not a method in its own right but a mathematical expedient that can only be used to calculate the value of the hedged item. Consequently, a 'hypothetical derivative' cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item). An example is debt denominated in a foreign currency (irrespective of whether it is fixed-rate or variable-rate debt). When using a hypothetical derivative to calculate the change in the value of such debt or the present value of the cumulative change in its cash flows, the hypothetical derivative cannot simply impute a charge for exchanging different currencies even though actual derivatives under which different currencies are exchanged might include such a charge (for example, cross-currency interest rate swaps).

- B6.5.6 The change in the value of the hedged item determined using a hypothetical derivative may also be used for the purpose of assessing whether a hedging relationship meets the hedge effectiveness requirements.

**Rebalancing the hedging relationship and changes to the hedge ratio**

- B6.5.7 Rebalancing refers to the adjustments made to the designated quantities of the hedged item or the hedging instrument of an already existing hedging relationship for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements. Changes to designated quantities of a hedged item or of a hedging instrument for a different purpose do not constitute rebalancing for the purpose of this Standard.
- B6.5.8 Rebalancing is accounted for as a continuation of the hedging relationship in accordance with paragraphs B6.5.9–B6.5.21. On rebalancing, the hedge ineffectiveness of the hedging relationship is determined and recognised immediately before adjusting the hedging relationship.
- B6.5.9 Adjusting the hedge ratio allows an entity to respond to changes in the relationship between the hedging instrument and the hedged item that arise from their underlyings or risk variables. For example, a hedging relationship in which the hedging instrument and the hedged item have different but related underlyings changes in

response to a change in the relationship between those two underlyings (for example, different but related reference indices, rates or prices). Hence, rebalancing allows the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that can be compensated for by adjusting the hedge ratio.

B6.5.10 For example, an entity hedges an exposure to Foreign Currency A using a currency derivative that references Foreign Currency B and Foreign Currencies A and B are pegged (ie their exchange rate is maintained within a band or at an exchange rate set by a central bank or other authority). If the exchange rate between Foreign Currency A and Foreign Currency B were changed (ie a new band or rate was set), rebalancing the hedging relationship to reflect the new exchange rate would ensure that the hedging relationship would continue to meet the hedge effectiveness requirement for the hedge ratio in the new circumstances. In contrast, if there was a default on the currency derivative, changing the hedge ratio could not ensure that the hedging relationship would continue to meet that hedge effectiveness requirement. Hence, rebalancing does not facilitate the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that cannot be compensated for by adjusting the hedge ratio.

B6.5.11 Not every change in the extent of offset between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flows constitutes a change in the relationship between the hedging instrument and the hedged item. An entity analyses the sources of hedge ineffectiveness that it expected to affect the hedging relationship during its term and evaluates whether changes in the extent of offset are:

- (a) fluctuations around the hedge ratio, which remains valid (ie continues to appropriately reflect the relationship between the hedging instrument and the hedged item); or
- (b) an indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item.

An entity performs this evaluation against the hedge effectiveness

requirement for the hedge ratio, ie to ensure that the hedging relationship does not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, this evaluation requires judgement.

B6.5.12 Fluctuation around a constant hedge ratio (and hence the related hedge ineffectiveness) cannot be reduced by adjusting the hedge ratio in response to each particular outcome. Hence, in such circumstances, the change in the extent of offset is a matter of measuring and recognising hedge ineffectiveness but does not require rebalancing.

B6.5.13 Conversely, if changes in the extent of offset indicate that the fluctuation is around a hedge ratio that is different from the hedge ratio that is currently used for that hedging relationship, or that there is a trend leading away from that hedge ratio, hedge ineffectiveness can be reduced by adjusting the hedge ratio, whereas retaining the hedge ratio would increasingly produce hedge ineffectiveness. Hence, in such circumstances, an entity must evaluate whether the hedging relationship reflects an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. If the hedge ratio is adjusted, it also affects the measurement and recognition of hedge ineffectiveness because, on rebalancing, the hedge ineffectiveness of the hedging relationship must be determined and recognised immediately before adjusting the hedging relationship in accordance with paragraph B6.5.8.

B6.5.14 Rebalancing means that, for hedge accounting purposes, after the start of a hedging relationship an entity adjusts the quantities of the hedging instrument or the hedged item in response to changes in circumstances that affect the hedge ratio of that hedging relationship. Typically, that adjustment should reflect adjustments in the quantities of the hedging instrument and the hedged item that it actually uses. However, an entity must adjust the hedge ratio that

results from the quantities of the hedged item or the hedging instrument that it actually uses if:

- (a) the hedge ratio that results from changes to the quantities of the hedging instrument or the hedged item that the entity actually uses would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting; or
- (b) an entity would retain quantities of the hedging instrument and the hedged item that it actually uses, resulting in a hedge ratio that, in new circumstances, would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (ie an entity must not create an imbalance by omitting to adjust the hedge ratio).

B6.5.15 Rebalancing does not apply if the risk management objective for a hedging relationship has changed. Instead, hedge accounting for that hedging relationship shall be discontinued (despite that an entity might designate a new hedging relationship that involves the hedging instrument or hedged item of the previous hedging relationship as described in paragraph B6.5.28).

B6.5.16 If a hedging relationship is rebalanced, the adjustment to the hedge ratio can be effected in different ways:

- (a) the weighting of the hedged item can be increased (which at the same time reduces the weighting of the hedging instrument) by:
  - (i) increasing the volume of the hedged item; or
  - (ii) decreasing the volume of the hedging instrument.
- (b) the weighting of the hedging instrument can be increased (which at the same time reduces the weighting of the hedged item) by:
  - (i) increasing the volume of the hedging instrument; or
  - (ii) decreasing the volume of the hedged item.

Changes in volume refer to the quantities that are part of the hedging relationship. Hence, decreases in volumes do not

necessarily mean that the items or transactions no longer exist, or are no longer expected to occur, but that they are not part of the hedging relationship. For example, decreasing the volume of the hedging instrument can result in the entity retaining a derivative, but only part of it might remain a hedging instrument of the hedging relationship. This could occur if the rebalancing could be effected only by reducing the volume of the hedging instrument in the hedging relationship, but with the entity retaining the volume that is no longer needed. In that case, the undesignated part of the derivative would be accounted for at fair value through profit or loss (unless it was designated as a hedging instrument in a different hedging relationship).

- B6.5.17 Adjusting the hedge ratio by increasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the value of the hedged item also include the change in the value of the additional volume of the hedged item. These changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of Rs.80 (the forward price at inception of the hedging relationship) and added a volume of 10 tonnes on rebalancing when the forward price was Rs.90, the hedged item after rebalancing would comprise two layers: 100 tonnes hedged at Rs.80 and 10 tonnes hedged at Rs.90.
- B6.5.18 Adjusting the hedge ratio by decreasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedging instrument was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and reduces that volume by 10 tonnes on rebalancing, a nominal amount of 90 tonnes of the hedging instrument volume would remain

(see paragraph B6.5.16 for the consequences for the derivative volume (ie the 10 tonnes) that is no longer a part of the hedging relationship).

- B6.5.19 Adjusting the hedge ratio by increasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the fair value of the hedging instrument also include the changes in the value of the additional volume of the hedging instrument. The changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and added a volume of 10 tonnes on rebalancing, the hedging instrument after rebalancing would comprise a total derivative volume of 110 tonnes. The change in the fair value of the hedging instrument is the total change in the fair value of the derivatives that make up the total volume of 110 tonnes. These derivatives could (and probably would) have different critical terms, such as their forward rates, because they were entered into at different points in time (including the possibility of designating derivatives into hedging relationships after their initial recognition).
- B6.5.20 Adjusting the hedge ratio by decreasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedged item was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of Rs.80 and reduces that volume by 10 tonnes on rebalancing, the hedged item after rebalancing would be 90 tonnes hedged at Rs.80. The 10 tonnes of the hedged item that are no longer part of the hedging relationship would be accounted for in accordance with the requirements for the discontinuation of hedge accounting (see paragraphs 6.5.6–6.5.7 and B6.5.22–B6.5.28).

B6.5.21 When rebalancing a hedging relationship, an entity shall update its analysis of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its (remaining) term (see paragraph B6.4.2). The documentation of the hedging relationship shall be updated accordingly.

**Discontinuation of hedge accounting**

B6.5.22 Discontinuation of hedge accounting applies prospectively from the date on which the qualifying criteria are no longer met.

B6.5.23 An entity shall not de-designate and thereby discontinue a hedging relationship that:

- (a) still meets the risk management objective on the basis of which it qualified for hedge accounting (ie the entity still pursues that risk management objective); and
- (b) continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

B6.5.24 For the purposes of this Standard, an entity's risk management strategy is distinguished from its risk management objectives. The risk management strategy is established at the highest level at which an entity determines how it manages its risk. Risk management strategies typically identify the risks to which the entity is exposed and set out how the entity responds to them. A risk management strategy is typically in place for a longer period and may include some flexibility to react to changes in circumstances that occur while that strategy is in place (for example, different interest rate or commodity price levels that result in a different extent of hedging). This is normally set out in a general document that is cascaded down through an entity through policies containing more specific guidelines. In contrast, the risk management objective for a hedging relationship applies at the level of a particular hedging relationship. It relates to how the particular hedging instrument that has been designated is used to hedge the particular exposure that has been designated as the hedged item. Hence, a risk management strategy can involve many different hedging relationships whose risk management objectives relate to executing that overall risk management strategy. For example:

- (a) an entity has a strategy of managing its interest rate exposure on debt funding that sets ranges for the overall entity for the mix between variable-rate and fixed-rate funding. The strategy is to maintain between 20 per cent and 40 per cent of the debt at fixed rates. The entity decides from time to time how to execute this strategy (ie where it positions itself within the 20 per cent to 40 per cent range for fixed-rate interest exposure) depending on the level of interest rates. If interest rates are low the entity fixes the interest for more debt than when interest rates are high. The entity's debt is Rs.100 of variable-rate debt of which Rs.30 is swapped into a fixed-rate exposure. The entity takes advantage of low interest rates to issue an additional Rs.50 of debt to finance a major investment, which the entity does by issuing a fixed-rate bond. In the light of the low interest rates, the entity decides to set its fixed interest-rate exposure to 40 per cent of the total debt by reducing by Rs.20 the extent to which it previously hedged its variable-rate exposure, resulting in Rs.60 of fixed-rate exposure. In this situation the risk management strategy itself remains unchanged. However, in contrast the entity's execution of that strategy has changed and this means that, for Rs.20 of variable-rate exposure that was previously hedged, the risk management objective has changed (ie at the hedging relationship level). Consequently, in this situation hedge accounting must be discontinued for Rs.20 of the previously hedged variable-rate exposure. This could involve reducing the swap position by a Rs.20 nominal amount but, depending on the circumstances, an entity might retain that swap volume and, for example, use it for hedging a different exposure or it might become part of a trading book. Conversely, if an entity instead swapped a part of its new fixed-rate debt into a variable-rate exposure, hedge accounting would have to be continued for its previously hedged variable-rate exposure.
- (b) some exposures result from positions that frequently change, for example, the interest rate risk of an open portfolio of debt instruments. The addition of new debt instruments and the derecognition of debt instruments continuously change that exposure (ie it is different from simply running off a position

that matures). This is a dynamic process in which both the exposure and the hedging instruments used to manage it do not remain the same for long. Consequently, an entity with such an exposure frequently adjusts the hedging instruments used to manage the interest rate risk as the exposure changes. For example, debt instruments with 24 months' remaining maturity are designated as the hedged item for interest rate risk for 24 months. The same procedure is applied to other time buckets or maturity periods. After a short period of time, the entity discontinues all, some or a part of the previously designated hedging relationships for maturity periods and designates new hedging relationships for maturity periods on the basis of their size and the hedging instruments that exist at that time. The discontinuation of hedge accounting in this situation reflects that those hedging relationships are established in such a way that the entity looks at a new hedging instrument and a new hedged item instead of the hedging instrument and the hedged item that were designated previously. The risk management strategy remains the same, but there is no risk management objective that continues for those previously designated hedging relationships, which as such no longer exist. In such a situation, the discontinuation of hedge accounting applies to the extent to which the risk management objective has changed. This depends on the situation of an entity and could, for example, affect all or only some hedging relationships of a maturity period, or only part of a hedging relationship.

- (c) an entity has a risk management strategy whereby it manages the foreign currency risk of forecast sales and the resulting receivables. Within that strategy the entity manages the foreign currency risk as a particular hedging relationship only up to the point of the recognition of the receivable. Thereafter, the entity no longer manages the foreign currency risk on the basis of that particular hedging relationship. Instead, it manages together the foreign currency risk from receivables, payables and derivatives (that do not relate to forecast transactions that are still pending) denominated in the same foreign currency. For accounting purposes, this works as a 'natural' hedge because the gains and losses from the foreign

currency risk on all of those items are immediately recognised in profit or loss. Consequently, for accounting purposes, if the hedging relationship is designated for the period up to the payment date, it must be discontinued when the receivable is recognised, because the risk management objective of the original hedging relationship no longer applies. The foreign currency risk is now managed within the same strategy but on a different basis. Conversely, if an entity had a different risk management objective and managed the foreign currency risk as one continuous hedging relationship specifically for that forecast sales amount and the resulting receivable until the settlement date, hedge accounting would continue until that date.

B6.5.25 The discontinuation of hedge accounting can affect:

- (a) a hedging relationship in its entirety; or
- (b) a part of a hedging relationship (which means that hedge accounting continues for the remainder of the hedging relationship).

B6.5.26 A hedging relationship is discontinued in its entirety when, as a whole, it ceases to meet the qualifying criteria. For example:

- (a) the hedging relationship no longer meets the risk management objective on the basis of which it qualified for hedge accounting (ie the entity no longer pursues that risk management objective);
- (b) the hedging instrument or instruments have been sold or terminated (in relation to the entire volume that was part of the hedging relationship); or
- (c) there is no longer an economic relationship between the hedged item and the hedging instrument or the effect of credit risk starts to dominate the value changes that result from that economic relationship.

B6.5.27 A part of a hedging relationship is discontinued (and hedge accounting continues for its remainder) when only a part of the hedging relationship ceases to meet the qualifying criteria. For example:

- (a) on rebalancing of the hedging relationship, the hedge ratio

might be adjusted in such a way that some of the volume of the hedged item is no longer part of the hedging relationship (see paragraph B6.5.20); hence, hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship; or

- (b) when the occurrence of some of the volume of the hedged item that is (or is a component of) a forecast transaction is no longer highly probable, hedge accounting is discontinued only for the volume of the hedged item whose occurrence is no longer highly probable. However, if an entity has a history of having designated hedges of forecast transactions and having subsequently determined that the forecast transactions are no longer expected to occur, the entity's ability to predict forecast transactions accurately is called into question when predicting similar forecast transactions. This affects the assessment of whether similar forecast transactions are highly probable (see paragraph 6.3.3) and hence whether they are eligible as hedged items.

B6.5.28 An entity can designate a new hedging relationship that involves the hedging instrument or hedged item of a previous hedging relationship for which hedge accounting was (in part or in its entirety) discontinued. This does not constitute a continuation of a hedging relationship but is a restart. For example:

- (a) a hedging instrument experiences such a severe credit deterioration that the entity replaces it with a new hedging instrument. This means that the original hedging relationship failed to achieve the risk management objective and is hence discontinued in its entirety. The new hedging instrument is designated as the hedge of the same exposure that was hedged previously and forms a new hedging relationship. Hence, the changes in the fair value or the cash flows of the hedged item are measured starting from, and by reference to, the date of designation of the new hedging relationship instead of the date on which the original hedging relationship was designated.
- (b) a hedging relationship is discontinued before the end of its term. The hedging instrument in that hedging relationship can be designated as the hedging instrument in another hedging

relationship (for example, when adjusting the hedge ratio on rebalancing by increasing the volume of the hedging instrument or when designating a whole new hedging relationship).

**Accounting for the time value of options**

B6.5.29 An option can be considered as being related to a time period because its time value represents a charge for providing protection for the option holder over a period of time. However, the relevant aspect for the purpose of assessing whether an option hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects profit or loss. Hence, an entity shall assess the type of hedged item (see paragraph 6.5.15(a)) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

- (a) the time value of an option relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the time value has the character of costs of that transaction. An example is when the time value of an option relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges a commodity purchase, whether it is a forecast transaction or a firm commitment, against the commodity price risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the time value of the option in the initial measurement of the particular hedged item, the time value affects profit or loss at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity, whether it is a forecast transaction or a firm commitment, would include the time value of the option as part of the cost related to that sale (hence, the time value would be recognised in profit or loss in the same period as the revenue from the hedged sale).
- (b) the time value of an option relates to a time-period related hedged item if the nature of the hedged item is such that the time value has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged

item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against a fair value decrease for six months using a commodity option with a corresponding life, the time value of the option would be allocated to profit or loss (ie amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange option, which would result in allocating the time value of the option over that 18-month period.

B6.5.30 The characteristics of the hedged item, including how and when the hedged item affects profit or loss, also affect the period over which the time value of an option that hedges a time-period related hedged item is amortised, which is consistent with the period over which the option's intrinsic value can affect profit or loss in accordance with hedge accounting. For example, if an interest rate option (a cap) is used to provide protection against increases in the interest expense on a floating rate bond, the time value of that cap is amortised to profit or loss over the same period over which any intrinsic value of the cap would affect profit or loss:

- (a) if the cap hedges increases in interest rates for the first three years out of a total life of the floating rate bond of five years, the time value of that cap is amortised over the first three years; or
- (b) if the cap is a forward start option that hedges increases in interest rates for years two and three out of a total life of the floating rate bond of five years, the time value of that cap is amortised during years two and three.

B6.5.31 The accounting for the time value of options in accordance with paragraph 6.5.15 also applies to a combination of a purchased and a written option (one being a put option and one being a call option) that at the date of designation as a hedging instrument has a net nil time value (commonly referred to as a 'zero-cost collar'). In that case, an entity shall recognise any changes in time value in other comprehensive income, even though the cumulative change in time value over the total period of the hedging relationship is nil. Hence, if the time value of the option relates to:

- (a) a transaction related hedged item, the amount of time value at the end of the hedging relationship that adjusts the hedged item or that is reclassified to profit or loss (see paragraph 6.5.15(b)) would be nil.
- (b) a time-period related hedged item, the amortisation expense related to the time value is nil.

B6.5.32 The accounting for the time value of options in accordance with paragraph 6.5.15 applies only to the extent that the time value relates to the hedged item (aligned time value). The time value of an option relates to the hedged item if the critical terms of the option (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the option and the hedged item are not fully aligned, an entity shall determine the aligned time value, ie how much of the time value included in the premium (actual time value) relates to the hedged item (and therefore should be treated in accordance with paragraph 6.5.15). An entity determines the aligned time value using the valuation of the option that would have critical terms that perfectly match the hedged item.

B6.5.33 If the actual time value and the aligned time value differ, an entity shall determine the amount that is accumulated in a separate component of equity in accordance with paragraph 6.5.15 as follows:

- (a) if, at inception of the hedging relationship, the actual time value is higher than the aligned time value, the entity shall:
  - (i) determine the amount that is accumulated in a separate component of equity on the basis of the aligned time value; and
  - (ii) account for the differences in the fair value changes between the two time values in profit or loss.
- (b) if, at inception of the hedging relationship, the actual time value is lower than the aligned time value, the entity shall determine the amount that is accumulated in a separate component of equity by reference to the lower of the cumulative change in fair value of:
  - (i) the actual time value; and
  - (ii) the aligned time value.

Any remainder of the change in fair value of the actual time value shall be recognised in profit or loss.

**Accounting for the forward element of forward contracts and foreign currency basis spreads of financial instruments**

B6.5.34 A forward contract can be considered as being related to a time period because its forward element represents charges for a period of time (which is the tenor for which it is determined). However, the relevant aspect for the purpose of assessing whether a hedging instrument hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects profit or loss. Hence, an entity shall assess the type of hedged item (see paragraphs 6.5.16 and 6.5.15(a)) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

- (a) the forward element of a forward contract relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the forward element has the character of costs of that transaction. An example is when the forward element relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges an inventory purchase denominated in a foreign currency, whether it is a forecast transaction or a firm commitment, against foreign currency risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the forward element in the initial measurement of the particular hedged item, the forward element affects profit or loss at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity denominated in a foreign currency against foreign currency risk, whether it is a forecast transaction or a firm commitment, would include the forward element as part of the cost that is related to that sale (hence, the forward element would be recognised in profit or loss in the same period as the revenue from the hedged sale).
- (b) the forward element of a forward contract relates to a time-period related hedged item if the nature of the hedged item is such that the forward element has the character of a cost for obtaining protection against a risk over a particular period of

time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against changes in fair value for six months using a commodity forward contract with a corresponding life, the forward element of the forward contract would be allocated to profit or loss (ie amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange forward contract, which would result in allocating the forward element of the forward contract over that 18-month period.

B6.5.35 The characteristics of the hedged item, including how and when the hedged item affects profit or loss, also affect the period over which the forward element of a forward contract that hedges a time-period related hedged item is amortised, which is over the period to which the forward element relates. For example, if a forward contract hedges the exposure to variability in three-month interest rates for a three-month period that starts in six months' time, the forward element is amortised during the period that spans months seven to nine.

B6.5.36 The accounting for the forward element of a forward contract in accordance with paragraph 6.5.16 also applies if, at the date on which the forward contract is designated as a hedging instrument, the forward element is nil. In that case, an entity shall recognise any fair value changes attributable to the forward element in other comprehensive income, even though the cumulative fair value change attributable to the forward element over the total period of the hedging relationship is nil. Hence, if the forward element of a forward contract relates to:

- (a) a transaction related hedged item, the amount in respect of the forward element at the end of the hedging relationship that adjusts the hedged item or that is reclassified to profit or loss (see paragraphs 6.5.15(b) and 6.5.16) would be nil.
- (b) a time-period related hedged item, the amortisation amount related to the forward element is nil.

B6.5.37 The accounting for the forward element of forward contracts in

accordance with paragraph 6.5.16 applies only to the extent that the forward element relates to the hedged item (aligned forward element). The forward element of a forward contract relates to the hedged item if the critical terms of the forward contract (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the forward contract and the hedged item are not fully aligned, an entity shall determine the aligned forward element, ie how much of the forward element included in the forward contract (actual forward element) relates to the hedged item (and therefore should be treated in accordance with paragraph 6.5.16). An entity determines the aligned forward element using the valuation of the forward contract that would have critical terms that perfectly match the hedged item.

B6.5.38 If the actual forward element and the aligned forward element differ, an entity shall determine the amount that is accumulated in a separate component of equity in accordance with paragraph 6.5.16 as follows:

- (a) if, at inception of the hedging relationship, the absolute amount of the actual forward element is higher than that of the aligned forward element the entity shall:
  - (i) determine the amount that is accumulated in a separate component of equity on the basis of the aligned forward element; and
  - (ii) account for the differences in the fair value changes between the two forward elements in profit or loss.
- (b) if, at inception of the hedging relationship, the absolute amount of the actual forward element is lower than that of the aligned forward element, the entity shall determine the amount that is accumulated in a separate component of equity by reference to the lower of the cumulative change in fair value of:
  - (i) the absolute amount of the actual forward element; and
  - (ii) the absolute amount of the aligned forward element.

Any remainder of the change in fair value of the actual forward element shall be recognised in profit or loss.

B6.5.39 When an entity separates the foreign currency basis spread from a

financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 6.2.4(b)), the application guidance in paragraphs B6.5.34–B6.5.38 applies to the foreign currency basis spread in the same manner as it is applied to the forward element of a forward contract.

## **Hedge of a group of items (Section 6.6)**

### **Hedge of a net position**

#### *Eligibility for hedge accounting and designation of a net position*

- B6.6.1 A net position is eligible for hedge accounting only if an entity hedges on a net basis for risk management purposes. Whether an entity hedges in this way is a matter of fact (not merely of assertion or documentation). Hence, an entity cannot apply hedge accounting on a net basis solely to achieve a particular accounting outcome if that would not reflect its risk management approach. Net position hedging must form part of an established risk management strategy. Normally this would be approved by key management personnel as defined in Ind AS 24.
- B6.6.2 For example, Entity A, whose functional currency is its local currency, has a firm commitment to pay FC150,000 for advertising expenses in nine months' time and a firm commitment to sell finished goods for FC150,000 in 15 months' time. Entity A enters into a foreign currency derivative that settles in nine months' time under which it receives FC100 and pays Rs.70. Entity A has no other exposures to FC. Entity A does not manage foreign currency risk on a net basis. Hence, Entity A cannot apply hedge accounting for a hedging relationship between the foreign currency derivative and a net position of FC100 (consisting of FC150,000 of the firm purchase commitment—ie advertising services—and FC149,900 (of the FC150,000) of the firm sale commitment) for a nine-month period.
- B6.6.3 If Entity A did manage foreign currency risk on a net basis and did not enter into the foreign currency derivative (because it increases its foreign currency risk exposure instead of reducing it), then the entity would be in a natural hedged position for nine months. Normally, this hedged position would not be reflected in the financial statements because the transactions are recognised in different

reporting periods in the future. The nil net position would be eligible for hedge accounting only if the conditions in paragraph 6.6.6 are met.

- B6.6.4 When a group of items that constitute a net position is designated as a hedged item, an entity shall designate the overall group of items that includes the items that can make up the net position. An entity is not permitted to designate a non-specific abstract amount of a net position. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. The entity cannot designate an abstract amount of a net position up to FC20. Instead, it must designate a gross amount of purchases and a gross amount of sales that together give rise to the hedged net position. An entity shall designate gross positions that give rise to the net position so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships.

*Application of the hedge effectiveness requirements to a hedge of a net position*

- B6.6.5 When an entity determines whether the hedge effectiveness requirements of paragraph 6.4.1(c) are met when it hedges a net position, it shall consider the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining whether the hedge effectiveness requirements of paragraph 6.4.1(c) are met, the entity shall consider the relationship between:
- (a) the fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the firm sale commitments; and
  - (b) the foreign currency risk related changes in the value of the firm purchase commitments.
- B6.6.6 Similarly, if in the example in paragraph B6.6.5 the entity had a nil net position it would consider the relationship between the foreign

currency risk related changes in the value of the firm sale commitments and the foreign currency risk related changes in the value of the firm purchase commitments when determining whether the hedge effectiveness requirements of paragraph 6.4.1(c) are met.

*Cash flow hedges that constitute a net position*

- B6.6.7 When an entity hedges a group of items with offsetting risk positions (ie a net position), the eligibility for hedge accounting depends on the type of hedge. If the hedge is a fair value hedge, then the net position may be eligible as a hedged item. If, however, the hedge is a cash flow hedge, then the net position can only be eligible as a hedged item if it is a hedge of foreign currency risk and the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect profit or loss and also specifies their nature and volume.
- B6.6.8 For example, an entity has a net position that consists of a bottom layer of FC100 of sales and a bottom layer of FC150 of purchases. Both sales and purchases are denominated in the same foreign currency. In order to sufficiently specify the designation of the hedged net position, the entity specifies in the original documentation of the hedging relationship that sales can be of Product A or Product B and purchases can be of Machinery Type A, Machinery Type B and Raw Material A. The entity also specifies the volumes of the transactions by each nature. The entity documents that the bottom layer of sales (FC100) is made up of a forecast sales volume of the first FC70 of Product A and the first FC30 of Product B. If those sales volumes are expected to affect profit or loss in different reporting periods, the entity would include that in the documentation, for example, the first FC70 from sales of Product A that are expected to affect profit or loss in the first reporting period and the first FC30 from sales of Product B that are expected to affect profit or loss in the second reporting period. The entity also documents that the bottom layer of the purchases (FC150) is made up of purchases of the first FC60 of Machinery Type A, the first FC40 of Machinery Type B and the first FC50 of Raw Material A. If those purchase volumes are expected to affect profit or loss in different reporting periods, the entity would include in the documentation a disaggregation of the purchase volumes by the reporting periods in which they are expected to affect profit or loss

(similarly to how it documents the sales volumes). For example, the forecast transaction would be specified as:

- (a) the first FC60 of purchases of Machinery Type A that are expected to affect profit or loss from the third reporting period over the next ten reporting periods;
- (b) the first FC40 of purchases of Machinery Type B that are expected to affect profit or loss from the fourth reporting period over the next 20 reporting periods; and
- (c) the first FC50 of purchases of Raw Material A that are expected to be received in the third reporting period and sold, ie affect profit or loss, in that and the next reporting period.

Specifying the nature of the forecast transaction volumes would include aspects such as the depreciation pattern for items of property, plant and equipment of the same kind, if the nature of those items is such that the depreciation pattern could vary depending on how the entity uses those items. For example, if the entity uses items of Machinery Type A in two different production processes that result in straight-line depreciation over ten reporting periods and the units of production method respectively, its documentation of the forecast purchase volume for Machinery Type A would disaggregate that volume by which of those depreciation patterns will apply.

- B6.6.9 For a cash flow hedge of a net position, the amounts determined in accordance with paragraph 6.5.11 shall include the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. However, the changes in the value of the items in the net position that have a similar effect as the hedging instrument are recognised only once the transactions that they relate to are recognised, such as when a forecast sale is recognised as revenue. For example, an entity has a group of highly probable forecast sales in nine months' time for FC100 and a group of highly probable forecast purchases in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining the amounts that are recognised in the cash flow hedge reserve in accordance with paragraph 6.5.11(a)–6.5.11(b), the entity compares:

- (a) the fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the highly probable forecast sales; with
- (b) the foreign currency risk related changes in the value of the highly probable forecast purchases.

However, the entity recognises only amounts related to the forward exchange contract until the highly probable forecast sales transactions are recognised in the financial statements, at which time the gains or losses on those forecast transactions are recognised (ie the change in the value attributable to the change in the foreign exchange rate between the designation of the hedging relationship and the recognition of revenue).

B6.6.10 Similarly, if in the example the entity had a nil net position it would compare the foreign currency risk related changes in the value of the highly probable forecast sales with the foreign currency risk related changes in the value of the highly probable forecast purchases. However, those amounts are recognised only once the related forecast transactions are recognised in the financial statements.

**Layers of groups of items designated as the hedged item**

B6.6.11 For the same reasons noted in paragraph B6.3.19, designating layer components of groups of existing items requires the specific identification of the nominal amount of the group of items from which the hedged layer component is defined.

B6.6.12 A hedging relationship can include layers from several different groups of items. For example, in a hedge of a net position of a group of assets and a group of liabilities, the hedging relationship can comprise, in combination, a layer component of the group of assets and a layer component of the group of liabilities.

**Presentation of hedging instrument gains or losses**

B6.6.13 If items are hedged together as a group in a cash flow hedge, they might affect different line items in the statement of profit and loss. The presentation of hedging gains or losses in that statement depends on the group of items.

B6.6.14 If the group of items does not have any offsetting risk positions (for

example, a group of foreign currency expenses that affect different line items in the statement of profit and loss that are hedged for foreign currency risk) then the reclassified hedging instrument gains or losses shall be apportioned to the line items affected by the hedged items. This apportionment shall be done on a systematic and rational basis and shall not result in the grossing up of the net gains or losses arising from a single hedging instrument.

B6.6.15 If the group of items does have offsetting risk positions (for example, a group of sales and expenses denominated in a foreign currency hedged together for foreign currency risk) then an entity shall present the hedging gains or losses in a separate line item in the statement of profit and loss. Consider, for example, a hedge of the foreign currency risk of a net position of foreign currency sales of FC100 and foreign currency expenses of FC80 using a forward exchange contract for FC20. The gain or loss on the forward exchange contract that is reclassified from the cash flow hedge reserve to profit or loss (when the net position affects profit or loss) shall be presented in a separate line item from the hedged sales and expenses. Moreover, if the sales occur in an earlier period than the expenses, the sales revenue is still measured at the spot exchange rate in accordance with Ind AS 21. The related hedging gain or loss is presented in a separate line item, so that profit or loss reflects the effect of hedging the net position, with a corresponding adjustment to the cash flow hedge reserve. When the hedged expenses affect profit or loss in a later period, the hedging gain or loss previously recognised in the cash flow hedge reserve on the sales is reclassified to profit or loss and presented as a separate line item from those that include the hedged expenses, which are measured at the spot exchange rate in accordance with Ind AS 21.

B6.6.16 For some types of fair value hedges, the objective of the hedge is not primarily to offset the fair value change of the hedged item but instead to transform the cash flows of the hedged item. For example, an entity hedges the fair value interest rate risk of a fixed-rate debt instrument using an interest rate swap. The entity's hedge objective is to transform the fixed-interest cash flows into floating interest cash flows. This objective is reflected in the accounting for the hedging relationship by accruing the net interest accrual on the interest rate swap in profit or loss. In the case of a hedge of a net position (for example, a net position of a fixed-rate asset and a fixed-rate

liability), this net interest accrual must be presented in a separate line item in the statement of profit and loss. This is to avoid the grossing up of a single instrument's net gains or losses into offsetting gross amounts and recognising them in different line items (for example, this avoids grossing up a net interest receipt on a single interest rate swap into gross interest revenue and gross interest expense).

## **Effective date and transition (Chapter 7)**

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### **Transition (Section 7.2)**

#### **Financial assets held for trading**

B7.2.1 At the date of initial application of this Standard, an entity must determine whether the objective of the entity's business model for managing any of its financial assets meets the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a) or if a financial asset is eligible for the election in paragraph 5.7.5. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had purchased the assets at the date of initial application.

#### **Impairment**

B7.2.2 On transition, an entity should seek to approximate the credit risk on initial recognition by considering all reasonable and supportable information that is available without undue cost or effort. An entity is not required to undertake an exhaustive search for information when determining, at the date of transition, whether there have been significant increases in credit risk since initial recognition. If an entity is unable to make this determination without undue cost or effort paragraph 7.2.20 applies.

B7.2.3 In order to determine the loss allowance on financial instruments initially recognised (or loan commitments or financial guarantee contracts to which the entity became a party to the contract) prior to the date of initial application, both on transition and until the derecognition of those items an entity shall consider information that is relevant in determining or approximating the credit risk at initial recognition. In order to determine or approximate the initial credit risk, an entity may consider internal and external information,

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including portfolio information, in accordance with paragraphs B5.5.1–B5.5.6.

- B7.2.4 An entity with little historical information may use information from internal reports and statistics (that may have been generated when deciding whether to launch a new product), information about similar products or peer group experience for comparable financial instruments, if relevant.

## **Definitions (Appendix A)**

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### **Derivatives**

- BA.1 Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of Rs.1,000 if six-month LIBOR increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.
- BA.2 The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (eg a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (eg a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 2.5 (see paragraphs 2.4–2.7).

- BA.3 One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.
- BA.4 A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognised as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 3.1.2 and B3.1.3–B3.1.6).
- BA.5 The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

### **Financial assets and liabilities held for trading**

- BA.6 Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.
- BA.7 Financial liabilities held for trading include:
- (a) derivative liabilities that are not accounted for as hedging

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instruments;

- (b) obligations to deliver financial assets borrowed by a short seller (ie an entity that sells financial assets it has borrowed and does not yet own);
- (c) financial liabilities that are incurred with an intention to repurchase them in the near term (eg a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and
- (d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

BA.8 The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

## Appendix C

### Hedges of a Net Investment in a Foreign Operation

*(This appendix is an integral part of Ind AS 109)*

#### Background

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- 1 Many reporting entities have investments in foreign operations (as defined in Ind AS 21 paragraph 8). Such foreign operations may be subsidiaries, associates, joint ventures or branches. Ind AS 21 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive income until it disposes of the foreign operation.
- 2 Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements.<sup>21</sup> The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.
- 3 Ind AS 109 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognised in other comprehensive income and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.
- 4 An entity with many foreign operations may be exposed to a number

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<sup>21</sup>This will be the case for consolidated financial statements, financial statements in which investments such as associates & joint ventures are accounted for using the equity method, and financial statements that include a branch or a joint operation as defined in Ind AS 111, Joint Arrangements.

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of foreign currency risks. This Appendix provides guidance on identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation.

- 5 Ind AS 109 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This Appendix provides guidance on where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting.
- 6 Ind AS 21 and Ind AS 109 require cumulative amounts recognised in other comprehensive income relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be reclassified from equity to profit or loss as a reclassification adjustment when the parent disposes of the foreign operation. This Appendix provides guidance on how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item.

## **Scope**

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- 7 This Appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with Ind AS 109. For convenience this Appendix refers to such an entity as a parent entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a parent entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.
- 8 This Appendix applies only to hedges of net investments in foreign operations; it should not be applied by analogy to other types of hedge accounting.

## **Issues**

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- 9 Investments in foreign operations may be held directly by a parent

entity or indirectly by its subsidiary or subsidiaries. The issues addressed in this Appendix are:

- (a) *the nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated:*
  - (i) whether the parent entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the parent entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the parent entity's consolidated financial statements and the functional currency of the foreign operation;
  - (ii) if the parent entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate parent entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate parent entity (ie whether the fact that the net investment in the foreign operation is held through an intermediate parent affects the economic risk to the ultimate parent).
- (b) *where in a group the hedging instrument can be held:*
  - (i) whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity in the group, regardless of its functional currency, can hold the hedging instrument;
  - (ii) whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.
- (c) *what amounts should be reclassified from equity to profit or loss as reclassification adjustments on disposal of the foreign*

*operation:*

- (i) when a foreign operation that was hedged is disposed of, what amounts from the parent entity's foreign currency translation reserve in respect of the hedging instrument and in respect of that foreign operation should be reclassified from equity to profit or loss in the parent entity's consolidated financial statements;
- (ii) whether the method of consolidation affects the determination of the amounts to be reclassified from equity to profit or loss.

## **Accounting Principle**

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### **Nature of the hedged risk and amount of the hedged item for which a hedging relationship may be designated**

- 10 Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the parent entity's functional currency.
- 11 In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the parent entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a parent depends on whether any lower level parent of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the parent's consolidated financial statements.
- 12 The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity (the immediate, intermediate or ultimate parent entity) of that foreign operation. The fact that the net investment is held through an intermediate parent does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate parent entity.

- 13 An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one parent entity within the group (for example, both a direct and an indirect parent entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate parent. A hedging relationship designated by one parent entity in its consolidated financial statements need not be maintained by another higher level parent entity. However, if it is not maintained by the higher level parent entity, the hedge accounting applied by the lower level parent must be reversed before the higher level parent's hedge accounting is recognised.

### **Where the hedging instrument can be held**

- 14 A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the group, as long as the designation, documentation and effectiveness requirements of Ind AS 109 paragraph 6.4.1 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the group should be clearly documented because of the possibility of different designations at different levels of the group.
- 15 For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the parent entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognised in profit or loss, in other comprehensive income, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognised in profit or loss or in other comprehensive income. As part of the application of hedge accounting, the total effective portion of the change is included in other comprehensive income. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a

non-derivative instrument or by the method of consolidation.

### **Disposal of a hedged foreign operation**

- 16 When a foreign operation that was hedged is disposed of, the amount reclassified to profit or loss as a reclassification adjustment from the foreign currency translation reserve in the consolidated financial statements of the parent in respect of the hedging instrument is the amount that Ind AS 109 paragraph 6.5.14 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.
- 17 The amount reclassified to profit or loss from the foreign currency translation reserve in the consolidated financial statements of a parent in respect of the net investment in that foreign operation in accordance with Ind AS 21 paragraph 48 is the amount included in that parent's foreign currency translation reserve in respect of that foreign operation. In the ultimate parent's consolidated financial statements, the aggregate net amount recognised in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate parent uses the direct or the step-by-step method of consolidation<sup>22</sup> may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation. The use of the step-by-step method of consolidation may result in the reclassification to profit or loss of an amount different from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by Ind AS 21. However, it is an accounting policy choice that should be followed consistently for all net investments.

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<sup>22</sup>The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate parent. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate parent(s) and then translated into the functional currency of the ultimate parent (or the presentation currency if different).

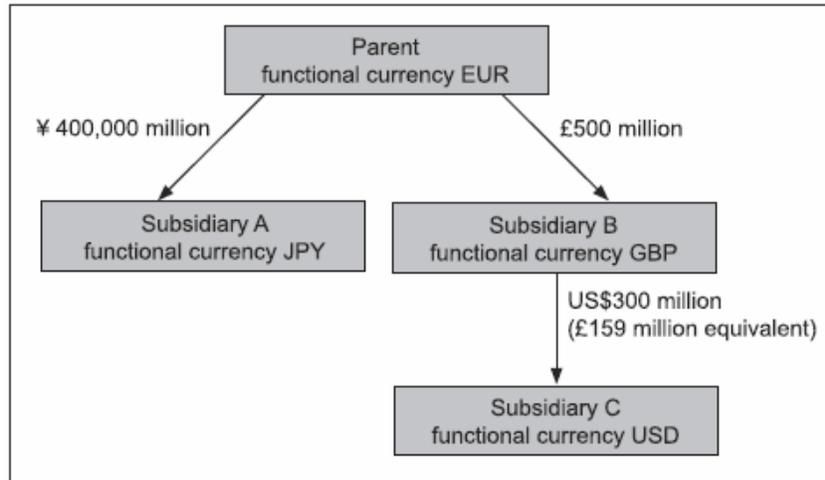
## Application guidance to Appendix C

*This application guidance is an integral part of the Appendix C.*

AG1 This application guidance illustrates the application of the Appendix C using the corporate structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with Ind AS 109, although this testing is not discussed in this appendix. Parent, being the ultimate parent entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the subsidiaries is wholly owned. Parent's £500 million net investment in Subsidiary B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Subsidiary B's US\$300 million net investment in Subsidiary C (functional currency US dollars (USD)). In other words, Subsidiary B's net assets other than its investment in Subsidiary C are £341 million.

### **Nature of hedged risk for which a hedging relationship may be designated (paragraphs 10–13)**

AG2 Parent can hedge its net investment in each of Subsidiaries A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Parent can hedge the USD/GBP foreign exchange risk between the functional currencies of Subsidiary B and Subsidiary C. In its consolidated financial statements, Subsidiary B can hedge its net investment in Subsidiary C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Parent could designate the forward foreign exchange risk.



### **Amount of hedged item for which a hedging relationship may be designated (paragraphs 10–13)**

- AG3 Parent wishes to hedge the foreign exchange risk from its net investment in Subsidiary C. Assume that Subsidiary A has an external borrowing of US\$300 million. The net assets of Subsidiary A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US\$300 million.
- AG4 The hedged item can be an amount of net assets equal to or less than the carrying amount of Parent's net investment in Subsidiary C (US\$300 million) in its consolidated financial statements. In its consolidated financial statements Parent can designate the US\$300 million external borrowing in Subsidiary A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US\$300 million net assets of Subsidiary C. In this case, both the EUR/USD foreign exchange difference on the US\$300 million external borrowing in Subsidiary A and the EUR/USD foreign exchange difference on the US\$300 million net investment in Subsidiary C are included in the foreign currency translation reserve in Parent's consolidated financial statements after the application of hedge accounting.
- AG5 In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Subsidiary A would be recognised in Parent's consolidated financial

statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in profit or loss, and
- JPY/EUR spot foreign exchange rate change in other comprehensive income.

Instead of the designation in paragraph AG4, in its consolidated financial statements Parent can designate the US\$300 million external borrowing in Subsidiary A as a hedge of the GBP/USD spot foreign exchange risk between Subsidiary C and Subsidiary B. In this case, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Subsidiary A would instead be recognised in Parent's consolidated financial statements as follows:

- the GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Subsidiary C,
- GBP/JPY spot foreign exchange rate change, translated to euro, in profit or loss, and
- JPY/EUR spot foreign exchange rate change in other comprehensive income.

- AG6 Parent cannot designate the US\$300 million external borrowing in Subsidiary A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Subsidiary B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the group comprising Subsidiary B and Subsidiary C.

### **Where in a group can the hedging instrument be held (paragraphs 14 and 15)?**

- AG7 As noted in paragraph AG5, the total change in value in respect of foreign exchange risk of the US\$300 million external borrowing in Subsidiary A would be recorded in both profit or loss (USD/JPY spot risk) and other comprehensive income (EUR/JPY spot risk) in Parent's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph AG4

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because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Parent against the US dollar functional currency of Subsidiary C, in accordance with the hedge documentation. The method of consolidation (ie direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

### **Amounts reclassified to profit or loss on disposal of a foreign operation (paragraphs 16 and 17)**

AG8 When Subsidiary C is disposed of, the amounts reclassified to profit or loss in Parent's consolidated financial statements from its foreign currency translation reserve (FCTR) are:

- (a) in respect of the US\$300 million external borrowing of Subsidiary A, the amount that Ind AS 109 requires to be identified, ie the total change in value in respect of foreign exchange risk that was recognised in other comprehensive income as the effective portion of the hedge; and
- (b) in respect of the US\$300 million net investment in Subsidiary C, the amount determined by the entity's consolidation method. If Parent uses the direct method, its FCTR in respect of Subsidiary C will be determined directly by the EUR/USD foreign exchange rate. If Parent uses the step-by-step method, its FCTR in respect of Subsidiary C will be determined by the FCTR recognised by Subsidiary B reflecting the GBP/USD foreign exchange rate, translated to Parent's functional currency using the EUR/GBP foreign exchange rate. Parent's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be reclassified when it disposes of Subsidiary C to be the amount that it would have recognised if it had always used the direct method, depending on its accounting policy.

### **Hedging more than one foreign operation (paragraphs 11, 13 and 15)**

AG9 The following examples illustrate that in the consolidated financial statements of Parent, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies

of Subsidiaries B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Parent's consolidated financial statements when both foreign operations are hedged are US\$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Parent's consolidated profit or loss. Of course, it would be possible for Parent to designate US\$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

**Parent holds both USD and GBP hedging instruments**

- AG10 Parent may wish to hedge the foreign exchange risk in relation to its net investment in Subsidiary B as well as that in relation to Subsidiary C. Assume that Parent holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Subsidiary B and Subsidiary C. The designations Parent can make in its consolidated financial statements include, but are not limited to, the following:
- (a) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Subsidiary C with the risk being the spot foreign exchange exposure (EUR/USD) between Parent and Subsidiary C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Subsidiary B with the risk being the spot foreign exchange exposure (EUR/GBP) between Parent and Subsidiary B.
  - (b) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Subsidiary C with the risk being the spot foreign exchange exposure (GBP/USD) between Subsidiary B and Subsidiary C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Subsidiary B with the risk being the spot foreign exchange exposure (EUR/GBP) between Parent and Subsidiary B.
- AG11 The EUR/USD risk from Parent's net investment in Subsidiary C is a different risk from the EUR/GBP risk from Parent's net investment in

Subsidiary B. However, in the case described in paragraph AG10(a), by its designation of the USD hedging instrument it holds, Parent has already fully hedged the EUR/USD risk from its net investment in Subsidiary C. If Parent also designated a GBP instrument it holds as a hedge of its £500 million net investment in Subsidiary B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Subsidiary C, would be hedged twice for GBP/EUR risk in Parent's consolidated financial statements.

- AG12 In the case described in paragraph AG10(b), if Parent designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Subsidiary B and Subsidiary C, only the GBP/USD part of the change in the value of its US\$300 million hedging instrument is included in Parent's foreign currency translation reserve relating to Subsidiary C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Parent's consolidated profit or loss, as in paragraph AG5. Because the designation of the USD/GBP risk between Subsidiaries B and C does not include the GBP/EUR risk, Parent is also able to designate up to £500 million of its net investment in Subsidiary B with the risk being the spot foreign exchange exposure (GBP/EUR) between Parent and Subsidiary B.

**Subsidiary B holds the USD hedging instrument**

- AG13 Assume that Subsidiary B holds US\$300 million of external debt the proceeds of which were transferred to Parent by an inter-company loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Subsidiary B's net assets are unchanged. Subsidiary B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Subsidiary C in its consolidated financial statements. Parent could maintain Subsidiary B's designation of that hedging instrument as a hedge of its US\$300 million net investment in Subsidiary C for the GBP/USD risk (see paragraph 13) and Parent could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Subsidiary B. The first hedge, designated by Subsidiary B, would be assessed by reference to Subsidiary B's functional currency (pounds sterling) and the second hedge, designated by Parent, would be assessed by reference to Parent's functional currency (euro). In this case, only the GBP/USD risk from

Parent's net investment in Subsidiary C has been hedged in Parent's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Parent's £500 million net investment in Subsidiary B may be hedged in the consolidated financial statements of Parent.

- AG14 However, the accounting for Parent's £159 million loan payable to Subsidiary B must also be considered. If Parent's loan payable is not considered part of its net investment in Subsidiary B because it does not satisfy the conditions in Ind AS 21 paragraph 15, the GBP/EUR foreign exchange difference arising on translating it would be included in Parent's consolidated profit or loss. If the £159 million loan payable to Subsidiary B is considered part of Parent's net investment, that net investment would be only £341 million and the amount Parent could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.
- AG15 If Parent reversed the hedging relationship designated by Subsidiary B, Parent could designate the US\$300 million external borrowing held by Subsidiary B as a hedge of its US\$300 million net investment in Subsidiary C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Subsidiary B. In this case the effectiveness of both hedges would be computed by reference to Parent's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Subsidiary B and the GBP/EUR change in value of Parent's loan payable to Subsidiary B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Parent's consolidated financial statements. Because Parent has already fully hedged the EUR/USD risk from its net investment in Subsidiary C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Subsidiary B.

## Appendix D

### Extinguishing Financial Liabilities with Equity Instruments

*(This appendix is an integral part of Ind AS 109)*

#### Background

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- 1 A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'.

#### Scope

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- 2 This Appendix addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.
- 3 An entity shall not apply this Appendix to transactions in situations where:
  - (a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.
  - (b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.
  - (c) extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

#### Issues

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- 4 This Appendix addresses the following issues:
  - (a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance

with paragraph 3.3.3 of Ind AS 109?

- (b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?
- (c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

## **Accounting principles**

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- 5 The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 3.3.3 of Ind AS 109. An entity shall remove a financial liability (or part of a financial liability) from its balance sheet when, and only when, it is extinguished in accordance with paragraph 3.3.1 of Ind AS 109.
- 6 When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.
- 7 If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 47 of Ind AS 113 is not applied.
- 8 If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.
- 9 The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration

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paid, shall be recognised in profit or loss, in accordance with paragraph 3.3.3 of Ind AS 109. The equity instruments issued shall be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished.

- 10 When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph 8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 3.3.2 of Ind AS 109.
- 11 An entity shall disclose a gain or loss recognised in accordance with paragraphs 9 and 10 as a separate line item in profit or loss or in the notes.

## Appendix E

### References to matters contained in other Indian Accounting Standards

*This appendix is an integral part of the Ind AS.*

This appendix lists the appendices which are part of other Indian Accounting Standards and make reference to Ind AS 109, *Financial Instruments*.

1. Appendix A, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation* contained in Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
2. <sup>23</sup>Appendix D, *Service Concession Arrangements* contained in Ind AS 115, *Revenue from Contracts with Customers*.
3. Appendix B, *Evaluating the Substance of Transactions Involving the Legal Form of Lease* contained in Ind AS 17, *Leases*.

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<sup>23</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Appendix 1

*Note: This Appendix is not a part of this Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences, if any, between Indian Accounting Standard (Ind AS) 109 and the corresponding International Financial Reporting Standard (IFRS) 9, Financial Instruments, IFRIC 16, Hedges of Net Investment in a Foreign Operation and IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments.*

### **Comparison with IFRS 9, *Financial Instruments*, IFRIC 16 and IFRIC 19**

1. Different terminology is used in this standard, e.g., the term 'balance sheet' is used instead of 'Statement of financial position', and 'Statement of profit and loss' is used instead of 'Statement of Profit and Loss and comprehensive income'.
2. Option to apply requirements of IAS 39 for fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities as provided in IFRS 9 has been removed in Ind AS 109. Accordingly, paragraph 6.1.3 has been deleted and following paragraphs have been modified:
  - (i) Paragraph 5.2.3
  - (ii) Paragraph 5.3.2
  - (iii) Paragraph 5.7.1
  - (iv) Paragraphs 5.7.2-5.7.3
3. <sup>24</sup>Paragraphs 7.1.1 to 7.1.3 related to effective date have not been included in Ind AS 109 as these paragraphs are not relevant in Indian context. However, in order to maintain consistency with paragraph numbers of IFRS 9, these paragraph numbers are retained in Ind AS 109.

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<sup>24</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

## Indian Accounting Standard (Ind AS) 110

# Consolidated Financial Statements<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Indian Accounting Standard (Ind AS) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

### Meeting the objective

- 2 To meet the objective in paragraph 1, this Ind AS:
  - (a) requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements;
  - (b) defines the principle of *control*, and establishes control as the basis for consolidation;
  - (c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;
  - (d) sets out the accounting requirements for the preparation of consolidated financial statements; and
  - (e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.
- 3 This Ind AS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see Ind AS 103, *Business Combinations*).

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

## Scope

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- 4 An entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:
- (a) A parent need not present consolidated financial statements if it meets all the following conditions:
    - (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
    - (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
    - (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
    - (iv) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.
  - (b) Omitted<sup>2</sup>
  - (c) Omitted<sup>3</sup>
- 4A <sup>4</sup>This Ind AS does not apply to post employment benefit plans or other long-term employee benefit plans to which Ind AS 19, *Employee Benefits*, applies.

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<sup>1</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>2</sup> Refer Appendix 1. Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>3</sup> Refer Appendix 1. Omitted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

<sup>4</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

- 4B <sup>5</sup>A parent that is an investment entity shall not present consolidated financial statements if it is required, in accordance with paragraph 31 of this Ind AS, to measure all of its subsidiaries at fair value through profit or loss.

## Control

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- 5 **An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.**
- 6 **An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.**
- 7 **Thus, an investor controls an investee if and only if the investor has all the following:**
- (a) **power over the investee (see paragraphs 10–14);**
  - (b) **exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and**
  - (c) **the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18).**
- 8 An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).
- 9 Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant Ind ASs, such as Ind AS 111, *Joint Arrangements*, Ind AS 28, *Investments in Associates and Joint Ventures*, or Ind AS 109, *Financial Instruments*.

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<sup>5</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

## Power

- 10 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns.
- 11 Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.
- 12 An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.
- 13 If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.
- 14 An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has *significant influence*. However, an investor that holds only protective rights does not have power over an investee (see paragraphs B26–B28), and consequently does not control the investee.

## Returns

- 15 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's

performance. The investor's returns can be only positive, only negative or both positive and negative.

- 16 Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

### **Link between power and returns**

- 17 An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.
- 18 Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent in accordance with paragraphs B58–B72 does not control an investee when it exercises decision-making rights delegated to it.

## **Accounting requirements**

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- 19 **A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**
- 20 Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
- 21 Paragraphs B86–B93 set out guidance for the preparation of consolidated financial statements.

### **Non-controlling interests**

- 22 A parent shall present non-controlling interests in the consolidated balance sheet within equity, separately from the equity of the owners of the parent.
- 23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

- 24 Paragraphs B94–B96 set out guidance for the accounting for non-controlling interests in consolidated financial statements.

### **Loss of control**

- 25 If a parent loses control of a subsidiary, the parent:
- (a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.
  - (b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.
  - (c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.
- 26 Paragraphs B97–B99 set out guidance for the accounting for the loss of control.

## **Determining whether an entity is an investment entity**

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- 27 **A parent shall determine whether it is an investment entity. An investment entity is an entity that:**
- (a) **obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;**
  - (b) **commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and**
  - (c) **measures and evaluates the performance of substantially all of its investments on a fair value basis.**

**Paragraphs B85A–B85M provide related application guidance.**

- 28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:

- (a) it has more than one investment (see paragraphs B85O–B85P);
- (b) it has more than one investor (see paragraphs B85Q–B85S);
- (c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and
- (d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of Ind AS 112, *Disclosure of Interests in Other Entities*.

- 29 If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, as described in paragraph 27, or the typical characteristics of an investment entity, as described in paragraph 28, a parent shall reassess whether it is an investment entity.
- 30 A parent that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status prospectively from the date at which the change in status occurred (see paragraphs B100–B101).

### **Investment entities: exception to consolidation**

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- 31 **Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply Ind AS 103 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.**
- 32 <sup>6</sup>Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with

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<sup>6</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

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paragraphs 19–26 of this Ind AS and apply the requirements of Ind AS 103 to the acquisition of any such subsidiary.

- 33 A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>consolidated financial statements</b>	The financial statements of a <b>group</b> in which the assets, liabilities, equity, income, expenses and cash flows of the <b>parent</b> and its <b>subsidiaries</b> are presented as those of a single economic entity.
<b>control of an investee</b>	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
<b>decision maker</b>	An entity with decision-making rights that is either a principal or an agent for other parties.
<b>group</b>	A <b>parent</b> and its <b>subsidiaries</b> .
<b>investment entity</b>	An entity that: (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.
<b>non-controlling interest</b>	Equity in a <b>subsidiary</b> not attributable, directly or indirectly, to a <b>parent</b> .
<b>parent</b>	An entity that <b>controls</b> one or more entities.
<b>power</b>	Existing rights that give the current ability to direct the <b>relevant activities</b> .
<b>protective rights</b>	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

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**relevant activities** For the purpose of this Ind AS, relevant activities are activities of the investee that significantly affect the investee's returns.

**removal rights** Rights to deprive the decision maker of its decision-making authority.

**subsidiary** An entity that is controlled by another entity.

The following terms are defined in Ind AS 111, Ind AS 112, *Disclosure of Interests in Other Entities*, Ind AS 28 or Ind AS 24, *Related Party Disclosures*, and are used in this Ind AS with the meanings specified in those Ind ASs:

- associate
- interest in another entity
- joint venture
- key management personnel
- related party
- significant influence.

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS. It describes the application of paragraphs 1-33 and has the same authority as the other parts of the Ind AS.*

- B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying Ind AS 110.

### Assessing control

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- B2 To determine whether it controls an investee an investor shall assess whether it has all the following:
- (a) power over the investee;
  - (b) exposure, or rights, to variable returns from its involvement with the investee; and
  - (c) the ability to use its power over the investee to affect the amount of the investor's returns.
- B3 Consideration of the following factors may assist in making that determination:
- (a) the purpose and design of the investee (see paragraphs B5-B8);
  - (b) what the relevant activities are and how decisions about those activities are made (see paragraphs B11-B13);
  - (c) whether the rights of the investor give it the current ability to direct the relevant activities (see paragraphs B14-B54);
  - (d) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B55-B57); and
  - (e) whether the investor has the ability to use its power over the investee to affect the amount of the investor's return (see paragraphs B58-B72).
- B4 When assessing control of an investee, an investor shall consider

the nature of its relationship with other parties (see paragraphs B73-B75).

### **Purpose and design of an investee**

- B5 When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.
- B6 When an investee's purpose and design are considered, it may be clear that an investee is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares in the investee. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the investee's operating and financing policies (see paragraphs B34–B50). In the most straightforward case, the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.
- B7 To determine whether an investor controls an investee in more complex cases, it may be necessary to consider some or all of the other factors in paragraph B3.
- B8 An investee may be designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. In such cases, an investor's consideration of the purpose and design of the investee shall also include consideration of the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved with the investee and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

### **Power**

- B9 To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and

rights that are not protective shall be considered (see paragraphs B22–B28).

- B10 The determination about whether an investor has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee.

**Relevant activities and direction of relevant activities**

- B11 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:
- (a) selling and purchasing of goods or services;
  - (b) managing financial assets during their life (including upon default);
  - (c) selecting, acquiring or disposing of assets;
  - (d) researching and developing new products or processes; and
  - (e) determining a funding structure or obtaining funding.
- B12 Examples of decisions about relevant activities include but are not limited to:
- (a) establishing operating and capital decisions of the investee, including budgets; and
  - (b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.
- B13 In some situations, activities both before and after a particular set of circumstances arises or event occurs may be relevant activities. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision-making rights (see paragraph 13). The investors shall reconsider this assessment over time if relevant facts or circumstances change.

**Application examples**

**Example 1**

Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, the other investor will manufacture and market it—this investor has the unilateral ability to make all decisions about the manufacture and marketing of the project. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, each investor needs to determine whether it is able to direct the activities that *most* significantly affect the investee’s returns. Accordingly, each investor needs to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that *most* significantly affects the investee’s returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:

- (a) the purpose and design of the investee;
- (b) the factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product;
- (c) the effect on the investee’s returns resulting from each investor’s decision-making authority with respect to the factors in (b); and
- (d) the investors’ exposure to variability of returns.  
In this particular example, the investors would also consider:
- (e) the uncertainty of, and effort required in, obtaining regulatory approval (considering the investor’s record of successfully developing and obtaining regulatory approval of medical products); and
- (f) which investor controls the medical product once the development phase is successful.

**Example 2**

An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager. The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee. The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investee's asset portfolio is the relevant activity of the investee. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that *most* significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

**Rights that give an investor power over an investee**

B14 Power arises from rights. To have power over an investee, an

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investor must have existing rights that give the investor the current ability to direct the relevant activities. The rights that may give an investor power can differ between investees.

- B15 Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:
- (a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B34–B50);
  - (b) rights to appoint, reassign or remove members of an investee’s key management personnel who have the ability to direct the relevant activities;
  - (c) rights to appoint or remove another entity that directs the relevant activities;
  - (d) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
  - (e) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.
- B16 Generally, when an investee has a range of operating and financing activities that significantly affect the investee’s returns and when substantive decision-making with respect to these activities is required continuously, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.
- B17 When voting rights cannot have a significant effect on an investee’s returns, such as when voting rights relate to administrative tasks only and contractual arrangements determine the direction of the relevant activities, the investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. To determine whether an investor has rights sufficient to give it power, the investor shall consider the purpose and design of the investee (see paragraphs B5–B8) and the requirements in paragraphs B51–B54 together with paragraphs B18–B20.
- B18 In some circumstances it may be difficult to determine whether an investor’s rights are sufficient to give it power over an investee. In such cases, to enable the assessment of power to be made, the

investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs B19 and B20, may provide evidence that the investor's rights are sufficient to give it power over the investee:

- (a) The investor can, without having the contractual right to do so, appoint or approve the investee's key management personnel who have the ability to direct the relevant activities.
- (b) The investor can, without having the contractual right to do so, direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor.
- (c) The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
- (d) The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person).
- (e) The majority of the members of the investee's governing body are related parties of the investor.

B19 Sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the following suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:

- (a) The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor.
- (b) The investee's operations are dependent on the investor, such as in the following situations:

- (i) The investee depends on the investor to fund a significant portion of its operations.
  - (ii) The investor guarantees a significant portion of the investee's obligations.
  - (iii) The investee depends on the investor for critical services, technology, supplies or raw materials.
  - (iv) The investor controls assets such as licences or trademarks that are critical to the investee's operations.
  - (v) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.
- (c) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.
- (d) The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.
- B20 The greater an investor's exposure, or rights, to variability of returns from its involvement with an investee, the greater is the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power. However, the extent of the investor's exposure does not, in itself, determine whether an investor has power over the investee.
- B21 When the factors set out in paragraph B18 and the indicators set out in paragraphs B19 and B20 are considered together with an investor's rights, greater weight shall be given to the evidence of power described in paragraph B18.
- Substantive rights*
- B22 An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

- B23 Determining whether rights are substantive requires judgement, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:
- (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:
    - (i) financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.
    - (ii) an exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.
    - (iii) terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.
    - (iv) the absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that would allow the holder to exercise its rights.
    - (v) the inability of the holder of the rights to obtain the information necessary to exercise its rights.
    - (vi) operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the incumbent manager).
    - (vii) legal or regulatory requirements that prevent the holder from exercising its rights (eg where a foreign investor is prohibited from exercising its rights).
  - (b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are

substantive. However, a board of directors whose members are independent of the decision maker may serve as a mechanism for numerous investors to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors are more likely to be substantive than if the same rights were exercisable individually by a large number of investors.

- (c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in an investee (see paragraphs B47–B50) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the investor would benefit for other reasons (eg by realising synergies between the investor and the investee) from the exercise or conversion of the instrument.

B24 To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

<b>Application examples</b>
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<b>Example 3</b>
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<p>The investee has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.</p>
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<p>The above fact pattern applies to examples 3A–3D described below. Each example is considered in isolation.</p>
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**Example 3A**

An investor holds a majority of the voting rights in the investee. The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.

**Example 3B**

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in example 3A above (ie the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

**Example 3C**

An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 3B.

**Example 3D**

An investor is party to a forward contract to acquire the majority of shares in the investee, with no other related rights over the investee. The forward contract's settlement date is in six months. In contrast to the examples above, the investor does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

B25 Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate.

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Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs B26–B28), substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

*Protective rights*

- B26 In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs B13 and B53).
- B27 Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee (see paragraph 14).
- B28 Examples of protective rights include but are not limited to:
- (a) a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
  - (b) the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
  - (c) the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

**Franchises**

- B29 A franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically give franchisors some decision-making rights with respect to the operations of the franchisee.
- B30 Generally, franchisors' rights do not restrict the ability of parties

other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the franchisee's returns.

- B31 It is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the relevant activities of the franchisee.
- B32 By entering into the franchise agreement the franchisee has made a unilateral decision to operate its business in accordance with the terms of the franchise agreement, but for its own account.
- B33 Control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

**Voting rights**

- B34 Often an investor has the current ability, through voting or similar rights, to direct the relevant activities. An investor considers the requirements in this section (paragraphs B35–B50) if the relevant activities of an investee are directed through voting rights.

*Power with a majority of the voting rights*

- B35 An investor that holds more than half of the voting rights of an investee has power in the following situations, unless paragraph B36 or paragraph B37 applies:
- (a) the relevant activities are directed by a vote of the holder of the majority of the voting rights, or
  - (b) a majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

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*Majority of the voting rights but no power*

- B36 For an investor that holds more than half of the voting rights of an investee, to have power over an investee, the investor's voting rights must be substantive, in accordance with paragraphs B22–B25, and must provide the investor with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the investor, the investor does not have power over the investee.
- B37 An investor does not have power over an investee, even though the investor holds the majority of the voting rights in the investee, when those voting rights are not substantive. For example, an investor that has more than half of the voting rights in an investee cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

*Power without a majority of the voting rights*

- B38 An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:
- (a) a contractual arrangement between the investor and other vote holders (see paragraph B39);
  - (b) rights arising from other contractual arrangements (see paragraph B40);
  - (c) the investor's voting rights (see paragraphs B41–B45);
  - (d) potential voting rights (see paragraphs B47–B50); or
  - (e) a combination of (a)–(d).

*Contractual arrangement with other vote holders*

- B39 A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. However, a contractual arrangement might ensure that

the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

*Rights from other contractual arrangements*

- B40 Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities. For example, the rights specified in a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns. However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

*The investor's voting rights*

- B41 An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.
- B42 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:
- (a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:
    - (i) the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
    - (ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
    - (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

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- (b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B47–B50);
  - (c) rights arising from other contractual arrangements (see paragraph B40); and
  - (d) any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.
- B43 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph B42 (a)–(c) alone, that the investor has power over the investee.

**Application examples**

**Example 4**

An investor acquires 48 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

**Example 5**

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not

conclusive in determining whether the investor has rights sufficient to give it power. However, investor A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the investee. The fact that investor A might not have exercised this right or the likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

- B44 In other situations, it may be clear after considering the factors listed in paragraph B42 (a)–(c) alone that an investor does not have power.

**Application example**

**Example 6**

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

- B45 However, the factors listed in paragraph B42 (a)–(c) alone may not be conclusive. If an investor, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders' meetings. This includes the assessment of the factors set out in paragraph B18 and the indicators in paragraphs B19 and B20. The fewer voting rights the investor holds, and the fewer parties that would need to act together to outvote the investor, the more reliance would be placed on the additional facts and circumstances to assess whether the investor's rights are sufficient to give it power. When the facts and circumstances in paragraphs B18–B20 are considered together with the investor's rights, greater weight shall be given to the evidence of power in paragraph B18 than to the indicators of

power in paragraphs B19 and B20.

**Application examples**

**Example 7**

An investor holds 45 per cent of the voting rights of an investee. Eleven other shareholders each hold 5 per cent of the voting rights of the investee. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. In this case, the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that may provide evidence that the investor has, or does not have, power shall be considered.

**Example 8**

An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the investee have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

B46 If it is not clear, having considered the factors listed in paragraph B42 (a)–(d), that the investor has power, the investor does not control the investee.

*Potential voting rights*

B47 When assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from

convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs B22–B25).

- B48 When considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the investor has with the investee. This includes an assessment of the various terms and conditions of the instrument as well as the investor's apparent expectations, motives and reasons for agreeing to those terms and conditions.
- B49 If the investor also has voting or other decision-making rights relating to the investee's activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.
- B50 Substantive potential voting rights alone, or in combination with other rights, can give an investor the current ability to direct the relevant activities. For example, this is likely to be the case when an investor holds 40 per cent of the voting rights of an investee and, in accordance with paragraph B23, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

<b>Application examples</b>
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<b>Example 9</b>
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<p>Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.</p>
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**Example 10**

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

**Power when voting or similar rights do not have a significant effect on the investee's returns**

- B51 In assessing the purpose and design of an investee (see paragraphs B5–B8), an investor shall consider the involvement and decisions made at the investee's inception as part of its design and evaluate whether the transaction terms and features of the involvement provide the investor with rights that are sufficient to give it power. Being involved in the design of an investee alone is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.
- B52 In addition, an investor shall consider contractual arrangements such as call rights, put rights and liquidation rights established at the investee's inception. When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.
- B53 For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed

so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.

**Application examples**

**Example 11**

An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors. Therefore, only the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee's returns.

In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables

outside the legal boundaries of the investee.

**Example 12**

The only assets of an investee are receivables. When the purpose and design of the investee are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.

- B54 An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to variability of returns and thus increase the incentive for the investor to obtain rights sufficient to give it power. Therefore a commitment to ensure that an investee operates as designed may be an indicator that the investor has power, but does not, by itself, give an investor power, nor does it prevent another party from having power.

**Exposure, or rights, to variable returns from an investee**

- B55 When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.
- B56 Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this Ind AS because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (ie how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends

on the investee's ability to generate sufficient income to pay the fee.

B57 Examples of returns include:

- (a) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee) and changes in the value of the investor's investment in that investee.
- (b) remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.
- (c) returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

## **Link between power and returns**

### **Delegated power**

B58 When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

B59 An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-

making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee by considering the requirements in paragraphs B5–B54. Paragraphs B60–B72 provide guidance on determining whether a decision maker is an agent or a principal.

- B60 A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:
- (a) the scope of its decision-making authority over the investee (paragraphs B62 and B63).
  - (b) the rights held by other parties (paragraphs B64–B67).
  - (c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).
  - (d) the decision maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

- B61 Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph B60 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph B65).

*The scope of the decision-making authority*

- B62 The scope of a decision maker's decision-making authority is evaluated by considering:
- (a) the activities that are permitted according to the decision-making agreement(s) and specified by law, and
  - (b) the discretion that the decision maker has when making decisions about those activities.
- B63 A decision maker shall consider the purpose and design of the investee, the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved

and the level of involvement the decision maker had in the design of an investee. For example, if a decision maker is significantly involved in the design of the investee (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

*Rights held by other parties*

- B64 Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of an investee. Substantive removal or other rights may indicate that the decision maker is an agent.
- B65 When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the less the weighting that shall be placed on this factor.
- B66 Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs B22–B25 for additional guidance on rights and whether they are substantive.)
- B67 Consideration of the rights held by other parties shall include an assessment of any rights exercisable by an investee's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph B23 (b)).

*Remuneration*

- B68 The greater the magnitude of, and variability associated with, the

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decision maker's remuneration relative to the returns expected from the activities of the investee, the more likely the decision maker is a principal.

B69 In determining whether it is a principal or an agent the decision maker shall also consider whether the following conditions exist:

- (a) The remuneration of the decision maker is commensurate with the services provided.
- (b) The remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.

B70 A decision maker cannot be an agent unless the conditions set out in paragraph B69 (a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

*Exposure to variability of returns from other interests*

B71 A decision maker that holds other interests in an investee (eg investments in the investee or provides guarantees with respect to the performance of the investee), shall consider its exposure to variability of returns from those interests in assessing whether it is an agent. Holding other interests in an investee indicates that the decision maker may be a principal.

B72 In evaluating its exposure to variability of returns from other interests in the investee a decision maker shall consider the following:

- (a) the greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
- (b) whether its exposure to variability of returns is different from that of the other investors and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee.

The decision maker shall evaluate its exposure relative to the total variability of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the

investee but shall not ignore the decision maker's maximum exposure to variability of returns of the investee through other interests that the decision maker holds.

**Application examples**

**Example 13**

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund.

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager's exposure to variability of returns from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

**Example 14**

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker

(fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund's profits if a specified profit level is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 14A–14C described below. Each example is considered in isolation.

**Example 14A**

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of returns from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

**Example 14B**

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only

for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (ie if the remuneration or other factors are different), control may arise when the level of investment is different.

**Example 14C**

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of returns of the fund from its remuneration and investment, the substantive

rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

**Example 15**

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (ie 1 per cent of assets under management) and performance-related fees (ie 10 per cent of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity in the investee. The remaining 65 per cent of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity and from its remuneration.

Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity creates subordinated exposure to losses and rights to returns of the investee, which are of such significance that it indicates that the asset manager is a principal.

Thus, the asset manager concludes that it controls the investee.

**Example 16**

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of returns from the activities of the conduit because of its rights to any residual returns of the conduit and the provision of credit enhancement and liquidity facilities (ie the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that *most* significantly affect the conduit's returns (ie the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual returns of the conduit and the provision of credit

enhancement and liquidity facilities expose the sponsor to variability of returns from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

### **Relationship with other parties**

- B73 When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents'). The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor.
- B74 Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.
- B75 The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the investor:
- (a) the investor's related parties.
  - (b) a party that received its interest in the investee as a contribution or loan from the investor.
  - (c) a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).
  - (d) a party that cannot finance its operations without subordinated financial support from the investor.
  - (e) an investee for which the majority of the members of its governing body or for which its key management personnel

are the same as those of the investor.

- (f) a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients.

### **Control of specified assets**

- B76 An investor shall consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity.
- B77 An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied:

Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.
- B78 When the condition in paragraph B77 is satisfied, an investor shall identify the activities that significantly affect the returns of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the investee. When assessing control of the deemed separate entity, the investor shall also consider whether it has exposure or rights to variable returns from its involvement with that deemed separate entity and the ability to use its power over that portion of the investee to affect the amount of the investor's returns.
- B79 If the investor controls the deemed separate entity, the investor shall consolidate that portion of the investee. In that case, other parties exclude that portion of the investee when assessing control of, and in consolidating, the investee.

### **Continuous assessment**

- B80 An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7.
- B81 If there is a change in how power over an investee can be exercised, that change must be reflected in how an investor assesses its power over an investee. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.
- B82 An event can cause an investor to gain or lose power over an investee without the investor being involved in that event. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have lapsed.
- B83 An investor also considers changes affecting its exposure, or rights, to variable returns from its involvement with an investee. For example, an investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations, because the investor would fail to satisfy paragraph 7(b) (eg if a contract to receive performance-related fees is terminated).
- B84 An investor shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the investor and other parties can mean that an investor no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the investor, or of other parties, occur, the investor shall reconsider its status as a principal or an agent.
- B85 An investor's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (eg a change in the investee's returns driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 7 or changes the overall relationship between a principal and an agent.

## Determining whether an entity is an investment entity

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B85A An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. An entity that possesses the three elements of the definition of an investment entity set out in paragraph 27 is an investment entity. Paragraphs B85B–B85M describe the elements of the definition in more detail.

### Business purpose

B85B The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both. Documents that indicate what the entity's investment objectives are, such as the entity's offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's business purpose. Further evidence may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees); for example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments (see paragraph B85I).

B85C <sup>7</sup>An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity, subject to the entity continuing to meet the definition of an investment entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary,

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<sup>7</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

- (a) providing management services and strategic advice to an investee; and
- (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

B85E <sup>8</sup>If an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32. If the subsidiary that provides the investment-related services or activities is itself an investment entity, the investment entity parent shall measure that subsidiary at fair value through profit or loss in accordance with paragraph 31.

#### **Exit strategies**

B85F An entity's investment plans also provide evidence of its business purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-

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<sup>8</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

performance, are not considered exit strategies for the purpose of this assessment.

- B85G Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialized property dealers or the open market.
- B85H An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

#### **Earnings from investments**

- B85I An entity is not investing solely for capital appreciation, investment income, or both, if the entity or another member of the group containing the entity (ie the group that is controlled by the investment entity's ultimate parent) obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee. Such benefits include:
- (a) the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, products or services of any investee; for example, by holding an option to purchase an asset from an investee if the asset's development is deemed successful;
  - (b) joint arrangements (as defined in Ind AS 111) or other agreements between the entity or another group member and

an investee to develop, produce, market or provide products or services;

- (c) financial guarantees or assets provided by an investee to serve as collateral for borrowing arrangements of the entity or another group member (however, an investment entity would still be able to use an investment in an investee as collateral for any of its borrowings);
- (d) an option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity;
- (e) except as described in paragraph B85J, transactions between the entity or another group member and an investee that:
  - (i) are on terms that are unavailable to entities that are not related parties of either the entity, another group member or the investee;
  - (ii) are not at fair value; or
  - (iii) represent a substantial portion of the investee's or the entity's business activity, including business activities of other group entities.

**B85J** An investment entity may have a strategy to invest in more than one investee in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation and investment income from those investees. Notwithstanding paragraph B85I(e), an entity is not disqualified from being classified as an investment entity merely because such investees trade with each other.

### **Fair value measurement**

**B85K** An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its subsidiaries or using the equity method for its interests in associates or joint ventures. In order to demonstrate that it meets this element of the definition, an investment entity:

- (a) provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with Ind ASs; and
- (b) reports fair value information internally to the entity's key management personnel (as defined in Ind AS 24), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

B85L In order to meet the requirement in B85K(a), an investment entity would:

- (a) [Refer Appendix 1]
- (b) elect the exemption from applying the equity method in Ind AS 28 for its investments in associates and joint ventures; and
- (c) measure its financial assets at fair value using the requirements in Ind AS 109.

B85M An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity in paragraph 27(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

### **Typical characteristics of an investment entity**

B85N In determining whether it meets the definition of an investment entity, an entity shall consider whether it displays the typical characteristics of one (see paragraph 28). The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity but indicates that additional judgement is required in determining whether the entity is an investment entity.

#### **More than one investment**

B85O An investment entity typically holds several investments to diversify its risk and maximise its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single

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investment in another investment entity that itself holds several investments.

B85P There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

- (a) is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;
- (b) has not yet made other investments to replace those it has disposed of;
- (c) is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (eg when the required minimum investment is too high for an individual investor); or
- (d) is in the process of liquidation.

**More than one investor**

B85Q Typically, an investment entity would have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85R Alternatively, an investment entity may be formed by, or for, a single investor that represents or supports the interests of a wider group of investors (eg a pension fund, government investment fund or family trust).

B85S There may also be times when the entity temporarily has a single investor. For example, an investment entity may have only a single investor when the entity:

- (a) is within its initial offering period, which has not expired and the entity is actively identifying suitable investors;

- (b) has not yet identified suitable investors to replace ownership interests that have been redeemed; or
- (c) is in the process of liquidation

**Unrelated investors**

- B85T Typically, an investment entity has several investors that are not related parties (as defined in Ind AS 24) of the entity or other members of the group containing the entity. Having unrelated investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).
- B85U However, an entity may still qualify as an investment entity even though its investors are related to the entity. For example, an investment entity may set up a separate 'parallel' fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity's main investment fund. This 'parallel' fund may qualify as an investment entity even though all of its investors are related parties.

**Ownership interests**

- B85V An investment entity is typically, but is not required to be, a separate legal entity. Ownership interests in an investment entity are typically in the form of equity or similar interests (eg partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. However, having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.
- B85W In addition, an entity that has significant ownership interests in the form of debt that, in accordance with other applicable Ind ASs, does not meet the definition of equity, may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

## Accounting requirements

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**Consolidation procedures**

- B86 Consolidated financial statements:

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- (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
- (b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Ind AS 103 explains how to account for any related goodwill).
- (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. Ind AS12, *Income Taxes*, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

### **Uniform accounting policies**

- B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

### **Measurement**

- B88 An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of profit and loss after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

### **Potential voting rights**

- B89 When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in

equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph B90 applies.

- B90 In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns.
- B91 Ind AS 109 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of Ind AS 109. In all other cases, instruments containing potential voting rights in a subsidiary are accounted for in accordance with Ind AS 109.

### **Reporting date**

- B92 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.
- B93 If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of

the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

#### **Non-controlling interests**

- B94 An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- B95 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

#### **Changes in the proportion held by non-controlling interests**

- B96 When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

#### **Loss of control**

- B97 A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:
- (a) They are entered into at the same time or in contemplation of each other.
  - (b) They form a single transaction designed to achieve an overall

commercial effect.

- (c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
- (d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

B98 If a parent loses control of a subsidiary, it shall:

- (a) derecognise:
  - (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
  - (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).
- (b) recognise:
  - (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
  - (ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and
  - (iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.
- (c) reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.
- (d) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

B99 If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in

relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

## **Accounting for a change in investment entity status**

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- B100 When an entity ceases to be an investment entity, it shall apply Ind AS 103 to any subsidiary that was previously measured at fair value through profit or loss in accordance with paragraph 31. The date of the change of status shall be the deemed acquisition date. The fair value of the subsidiary at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All subsidiaries shall be consolidated in accordance with paragraphs 19–24 of this Ind AS from the date of change of status.
- B101 When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status, except for any subsidiary that shall continue to be consolidated in accordance with paragraph 32. The investment entity shall apply the requirements of paragraphs 25 and 26 to those subsidiaries that it ceases to consolidate as though the investment entity had lost control of those subsidiaries at that date.

## Appendix C

### References to matters contained in other Indian Accounting Standards

*This Appendix is an integral part of the Ind AS.*

1. Appendix A, *Distribution of Non-cash Assets to Owners* contained, in Ind AS 10, *Events after the Reporting Period*, makes reference to this Standard also.
2. Appendix A, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*, contained in Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, makes reference to this Standard also.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 110 and the corresponding International Financial Reporting Standard (IFRS) 10, Consolidated Financial Statements, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 10, Consolidated Financial Statements**

- 1 IFRS 10 requires all investments to be measured at fair value to qualify for the exemption from consolidation available to an investment entity. Since, Ind AS 40, *Investment Properties* requires all investment properties to be measured at cost initially and cost less depreciation subsequently, sub- paragraph (a) of B85L have been deleted as this deal with investment property measured at fair value which is not relevant in the Indian context.
- 2 Different terminology is used, as used in existing laws eg, the term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.
- 3 Appendix C of IFRS 10 dealing with effective date, transition and withdrawal of other IFRSs has not been included in Ind AS 10, due to the following reasons:
  - (i) Effective date is not relevant as the date of application will be notified under the Companies Act.
  - (ii) Transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.
  - (iii) Paragraphs dealing with withdrawal of other IFRSs are not relevant.

*Consolidated Financial Statements*

4      <sup>9</sup>Following paragraph numbers appear as 'Deleted' in IFRS 10. In order to maintain consistency with paragraph numbers of IFRS 10, the paragraph numbers are retained in Ind AS 110:

(i)     Paragraph 4(b)

(ii)    Paragraph 4(c)

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<sup>9</sup> Inserted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

## Indian Accounting Standard (Ind AS) 111

# Joint Arrangements<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1** The objective of this Indian Accounting Standard (Ind AS) is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (ie *joint arrangements*).

### Meeting the objective

- 2** To meet the objective in paragraph 1, this Ind AS defines *joint control* and requires an entity that is a *party to a joint arrangement* to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

## Scope

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- 3** This Ind AS shall be applied by all entities that are a party to a joint arrangement.

## Joint arrangements

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- 4** A joint arrangement is an arrangement of which two or more parties have joint control.
- 5** A joint arrangement has the following characteristics:
- (a) The parties are bound by a contractual arrangement (see paragraphs B2–B4).
  - (b) The contractual arrangement gives two or more of those

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015.

parties joint control of the arrangement (see paragraphs 7–13).

- 6 A joint arrangement is either a *joint operation* or a *joint venture*.

### Joint control

- 7 **Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.**
- 8 An entity that is a party to an arrangement shall assess whether the contractual arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities).
- 9 Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.
- 10 In a joint arrangement, no single party controls the arrangement on its own. A party with joint control of an arrangement can prevent any of the other parties, or a group of the parties, from controlling the arrangement.
- 11 An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This Ind AS distinguishes between parties that have joint control of a joint arrangement (*joint operators* or *joint venturers*) and parties that participate in, but do not have joint control of, a joint arrangement.
- 12 An entity will need to apply judgement when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs B5–B11).
- 13 If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.

## **Types of joint arrangement**

- 14** An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.
- 15** A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.
- 16** A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.
- 17** An entity applies judgement when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances (see paragraphs B12–B33).
- 18** Sometimes the parties are bound by a framework agreement that sets up the general contractual terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties' rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement.
- 19** If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.

## Financial statements of parties to a joint arrangement

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### Joint operations

- 20 A joint operator shall recognise in relation to its interest in a joint operation:
- (a) its assets, including its share of any assets held jointly;
  - (b) its liabilities, including its share of any liabilities incurred jointly;
  - (c) its revenue from the sale of its share of the output arising from the joint operation;
  - (d) its share of the revenue from the sale of the output by the joint operation; and
  - (e) its expenses, including its share of any expenses incurred jointly.
- 21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Ind ASs applicable to the particular assets, liabilities, revenues and expenses.
- 21A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in Ind AS 103, it shall apply, to the extent of its share in accordance with paragraph 20, all of the principles on business combinations accounting in Ind AS 103, and other Ind ASs, that do not conflict with the guidance in this Ind AS and disclose the information that is required in those Ind ASs in relation to business combinations. This applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes a business. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs B33A–B33D.
- 22 The accounting for transactions such as the sale, contribution or purchase of assets between an entity and a joint operation in which it is a joint operator is specified in paragraphs B34–B37.

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- 23 A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 20–22 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the Ind ASs applicable to that interest.

### **Joint ventures**

- 24 **A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28, *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method as specified in that standard.**
- 25 A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with Ind AS 109, *Financial Instruments*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with Ind AS 28.

### **Separate financial statements**

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- 26 **In its separate financial statements, a joint operator or joint venturer shall account for its interest in:**
- (a) a joint operation in accordance with paragraphs 20–22;
  - (b) a joint venture in accordance with paragraph 10 of Ind AS 27, *Separate Financial Statements*.
- 27 **In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:**
- (a) a joint operation in accordance with paragraph 23;
  - (b) a joint venture in accordance with Ind AS 109, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of Ind AS 27.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>joint arrangement</b>	An arrangement of which two or more parties have <b>joint control</b> .
<b>joint control</b>	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
<b>joint operation</b>	A <b>joint arrangement</b> whereby the parties that have <b>joint control</b> of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.
<b>joint operator</b>	A party to a <b>joint operation</b> that has <b>joint control</b> of that joint operation.
<b>joint venture</b>	A <b>joint arrangement</b> whereby the parties that have <b>joint control</b> of the arrangement have rights to the net assets of the arrangement.
<b>joint venturer</b>	A party to a <b>joint venture</b> that has <b>joint control</b> of that joint venture.
<b>party to a joint arrangement</b>	An entity that participates in a <b>joint arrangement</b> , regardless of whether that entity has <b>joint control</b> of the arrangement.
<b>separate vehicle</b>	A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

The following terms are defined in Ind AS 27, Ind AS 28 or Ind AS 110, *Consolidated Financial Statements*, and are used in this Ind AS with the meanings specified in those Ind ASs:

- control of an investee
- equity method

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- power
- protective rights
- relevant activities
- separate financial statements
- significant influence.

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS. It describes the application of paragraphs 1–27 and has the same authority as the other parts of this Ind AS.*

- B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying Ind AS 111.

### Joint arrangements

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#### Contractual arrangement (paragraph 5)

- B2 Contractual arrangements can be evidenced in several ways. An enforceable contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties. Statutory mechanisms can also create enforceable arrangements, either on their own or in conjunction with contracts between the parties.
- B3 When joint arrangements are structured through a separate vehicle (see paragraphs B19–B33), the contractual arrangement, or some aspects of the contractual arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.
- B4 The contractual arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The contractual arrangement generally deals with such matters as:
- (a) the purpose, activity and duration of the joint arrangement.
  - (b) how the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
  - (c) the decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-

making process reflected in the contractual arrangement establishes joint control of the arrangement (see paragraphs B5–B11).

- (d) the capital or other contributions required of the parties.
- (e) how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

### **Joint Control (paragraphs 7-13)**

- B5 In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. Ind AS 110 defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to variable returns from their involvement with the arrangement and have the ability to affect those returns through their power over the arrangement. When all the parties, or a group of the parties, considered collectively, are able to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities), the parties control the arrangement collectively.
- B6 After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgement.
- B7 Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the contractual arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties

agreeing.

- B8 In other circumstances, the contractual arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

**Application examples**

**Example 1**

Assume that three parties establish an arrangement: A has 50 per cent of the voting rights in the arrangement, B has 30 per cent and C has 20 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing.

**Example 2**

Assume an arrangement has three parties: A has 50 per cent of the voting rights in the arrangement and B and C each have 25 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of either B or C. In this example, A, B and C collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75 per cent of the voting rights (ie either A and B or A and C). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to

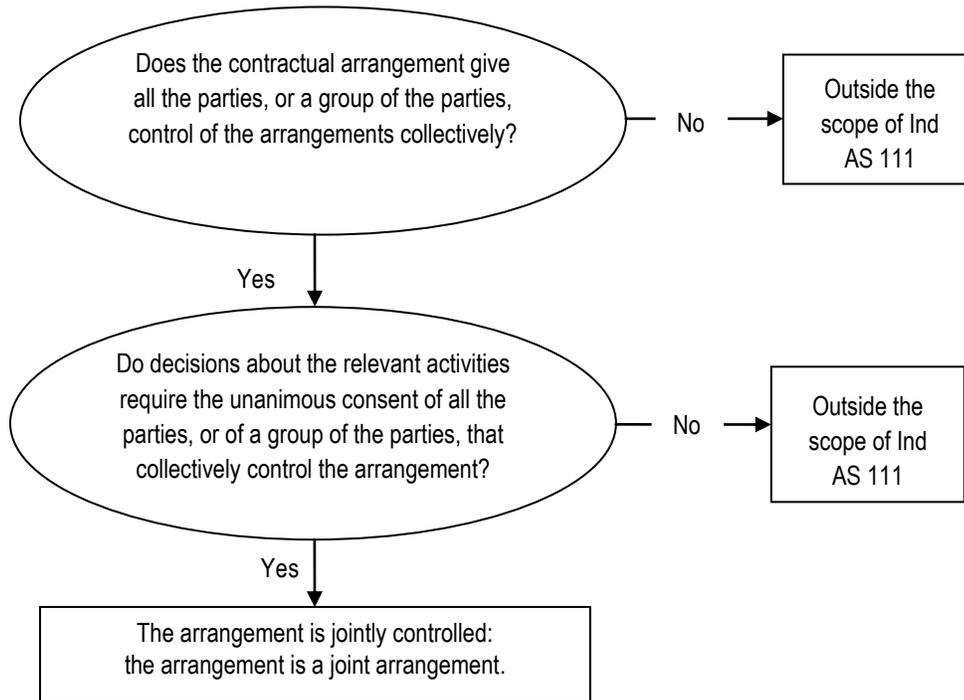
agree unanimously to decisions about the relevant activities of the arrangement.

**Example 3**

Assume an arrangement in which A and B each have 35 per cent of the voting rights in the arrangement with the remaining 30 per cent being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. A and B have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A and B agreeing.

- B9 The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.
- B10 A contractual arrangement might include clauses on the resolution of disputes, such as arbitration. These provisions may allow for decisions to be made in the absence of unanimous consent among the parties that have joint control. The existence of such provisions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement.

## Assessing joint control



- B11 When an arrangement is outside the scope of Ind AS 111, an entity accounts for its interest in the arrangement in accordance with relevant Ind ASs, such as Ind AS 110, Ind AS 28 or Ind AS 109.

## Types of joint arrangement (paragraphs 14–19)

- B12 Joint arrangements are established for a variety of purposes (eg as a way for parties to share costs and risks, or as a way to provide the parties with access to new technology or new markets), and can be established using different structures and legal forms.
- B13 Some arrangements do not require the activity that is the subject of the arrangement to be undertaken in a separate vehicle. However, other arrangements involve the establishment of a separate vehicle.
- B14 The classification of joint arrangements required by this Ind AS depends upon the parties' rights and obligations arising from the

arrangement in the normal course of business. This Ind AS classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs B16–B33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture.

### **Classification of a joint arrangement**

- B15 As stated in paragraph B14, the classification of joint arrangements requires the parties to assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the following:
- (a) the structure of the joint arrangement (see paragraphs B16–B21).
  - (b) when the joint arrangement is structured through a separate vehicle:
    - (i) the legal form of the separate vehicle (see paragraphs B22–B24);
    - (ii) the terms of the contractual arrangement (see paragraphs B25–B28); and
    - (iii) when relevant, other facts and circumstances (see paragraphs B29–B33).

### **Structure of the joint arrangement**

#### *Joint arrangements not structured through a separate vehicle*

- B16 A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses.
- B17 The contractual arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties

## *Joint Arrangements*

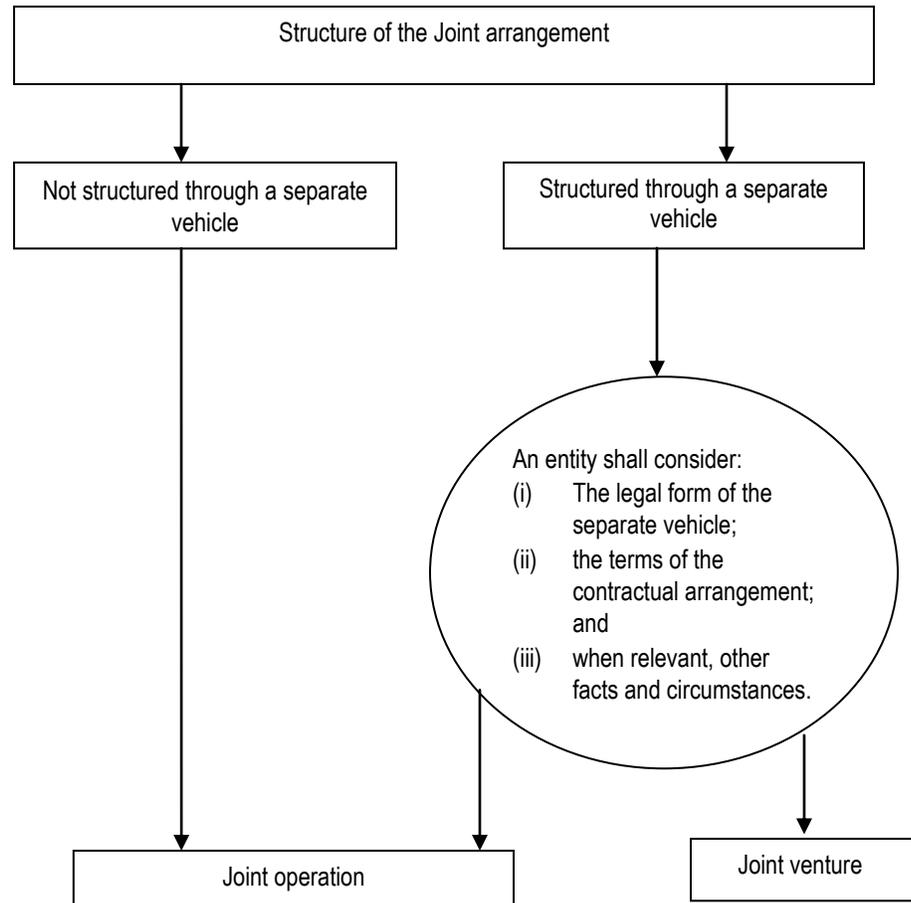
intend to undertake those activities together. For example, the parties to a joint arrangement could agree to manufacture a product together, with each party being responsible for a specific task and each using its own assets and incurring its own liabilities. The contractual arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them. In such a case, each joint operator recognises in its financial statements the assets and liabilities used for the specific task, and recognises its share of the revenues and expenses in accordance with the contractual arrangement.

- B18 In other cases, the parties to a joint arrangement might agree, for example, to share and operate an asset together. In such a case, the contractual arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each joint operator accounts for its share of the joint asset and its agreed share of any liabilities, and recognises its share of the output, revenues and expenses in accordance with the contractual arrangement.

### *Joint arrangements structured through a separate vehicle*

- B19 A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.
- B20 Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets, and obligations for the liabilities, relating to the arrangement that are held in the separate vehicle.
- B21 As stated in paragraph B15, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them:
- (a) rights to the assets, and obligations for the liabilities, relating to the arrangement (ie the arrangement is a joint operation);  
or
  - (b) rights to the net assets of the arrangement (ie the arrangement is a joint venture).

**Classification of a joint arrangement: assessment of the parties' rights and obligations arising from the arrangement**



**The legal form of the separate vehicle**

- B22 The legal form of the separate vehicle is relevant when assessing the type of joint arrangement. The legal form assists in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle, such as whether the parties have interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.
- B23 For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (ie the assets and liabilities

held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture. However, the terms agreed by the parties in their contractual arrangement (see paragraphs B25–B28) and, when relevant, other facts and circumstances (see paragraphs B29–B33) can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.

- B24 The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (ie the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

**Assessing the terms of the contractual arrangement**

- B25 In many cases, the rights and obligations agreed to by the parties in their contractual arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured.
- B26 In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.

<b>Application example</b>
<p><b>Example 4</b></p> <p>Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, the assessment of the rights and</p>

obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement.

However, the parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. Such contractual modifications to the features of a corporation can cause an arrangement to be a joint operation.

B27 The following table compares common terms in contractual arrangements of parties to a joint operation and common terms in contractual arrangements of parties to a joint venture. The examples of the contractual terms provided in the following table are not exhaustive.

<b>Assessing the terms of the contractual arrangement</b>		
	<b>Joint operation</b>	<b>Joint venture</b>
<b>The terms of the contractual arrangement</b>	The contractual arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (ie it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).
<b>Rights to assets</b>	The contractual arrangement establishes that the parties to the joint arrangement share all interests (eg rights, title or ownership) in the assets relating to the arrangement	The contractual arrangement establishes that the assets brought into the arrangement or subsequently acquired by the joint

*Joint Arrangements*

	in a specified proportion (eg in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	arrangement are the arrangement's assets. The parties have no interests (ie no rights, title or ownership) in the assets of the arrangement.
<b>Obligations for liabilities</b>	The contractual arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (eg in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The contractual arrangement establishes that the joint arrangement is liable for the debts and obligations of the arrangement.
		The contractual arrangement establishes that the parties to the joint arrangement are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.
	The contractual arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The contractual arrangement states that creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the

		arrangement.
<b>Revenues, expenses, profit or loss</b>	The contractual arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. For example, the contractual arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly, which could differ from their ownership interest in the joint arrangement. In other instances, the parties might have agreed to share the profit or loss relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement establishes each party's share in the profit or loss relating to the activities of the arrangement.
<b>Guarantees</b>	The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not,	

	by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee).
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B28 When the contractual arrangement specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, they are parties to a joint operation and do not need to consider other facts and circumstances (paragraphs B29–B33) for the purposes of classifying the joint arrangement.

**Assessing other facts and circumstances**

B29 When the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

B30 A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The contractual terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

B31 When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

B32 The effect of an arrangement with such a design and purpose is that

the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

**Application example**

**Example 5**

Assume that two parties structure a joint arrangement in an incorporated entity (entity C) in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of entity C (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity C are the assets and liabilities of entity C. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity C. Accordingly, the legal form of entity C and the terms of the contractual arrangement indicate that the arrangement is a joint venture.

However, the parties also consider the following aspects of the arrangement:

- The parties agreed to purchase all the output produced by entity C in a ratio of 50:50. Entity C cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by entity C. On the basis of this operating model, the arrangement is

intended to operate at a break-even level.

From the fact pattern above, the following facts and circumstances are relevant:

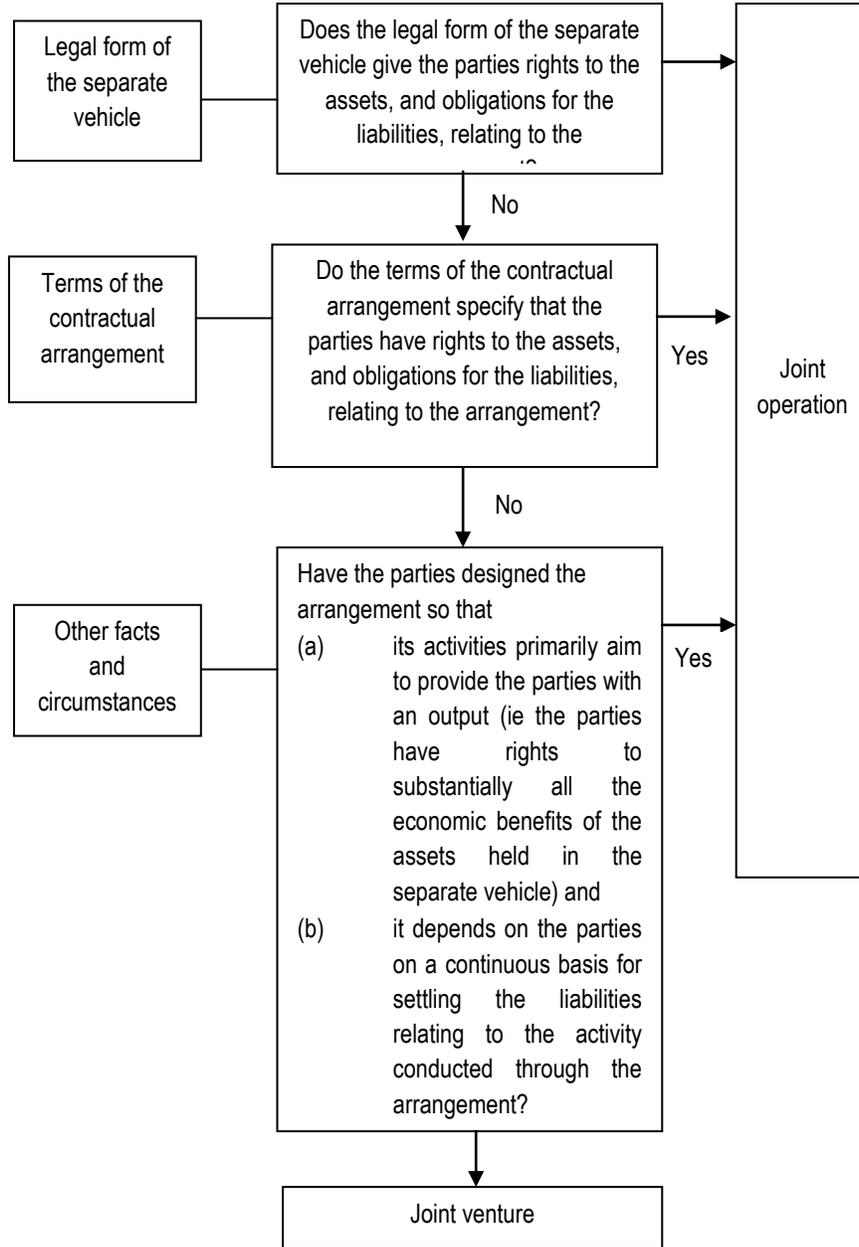
- The obligation of the parties to purchase all the output produced by entity C reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity C.
- The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity C.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in entity C assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

- B33 The following flow chart reflects the assessment an entity follows to classify an arrangement when the joint arrangement is structured through a separate vehicle:

**Classification of a joint arrangement structured through a separate vehicle**



## Financial statements of parties to a joint arrangement (paragraphs 21A-22)

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### Accounting for acquisitions of interests in joint operations

- B33A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in Ind AS 103, it shall apply, to the extent of its share in accordance with paragraph 20, all of the principles on business combinations accounting in Ind AS 103, and other Ind ASs, that do not conflict with the guidance in this Ind AS and disclose the information required by those Ind ASs in relation to business combinations. The principles on business combinations accounting that do not conflict with the guidance in this Ind AS include but are not limited to:
- (a) measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in Ind AS 103 and other Ind ASs;
  - (b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with Ind AS 32 *Financial Instruments: Presentation* and Ind AS109;
  - (c) recognising deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets or liabilities, except for deferred tax liabilities that arise from the initial recognition of goodwill, as required by Ind AS 103 and Ind AS 12 *Income Taxes* for business combinations;
  - (d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and
  - (e) testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as

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required by Ind AS 36 *Impairment of Assets* for goodwill acquired in a business combination.

- B33B Paragraphs 21A and B33A also apply to the formation of a joint operation if, and only if, an existing business, as defined in Ind AS 103, is contributed to the joint operation on its formation by one of the parties that participate in the joint operation. However, those paragraphs do not apply to the formation of a joint operation if all of the parties that participate in the joint operation only contribute assets or groups of assets that do not constitute businesses to the joint operation on its formation.
- B33C A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in Ind AS 103, by acquiring an additional interest in the joint operation. In such cases, previously held interests in the joint operation are not remeasured if the joint operator retains joint control.
- B33D Paragraphs 21A and B33A - B33C do not apply for the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory. For such transactions, accounting specified in Appendix C of Ind AS 103 shall be applicable.

### **Accounting for sales or contributions of assets to a joint operation**

- B34 When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.
- B35 When such transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognised fully by the joint operator.

**Accounting for purchases of assets from a joint operation**

- B36 When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a purchase of assets, it shall not recognise its share of the gains and losses until it resells those assets to a third party.
- B37 When such transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognise its share of those losses.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 111 and the corresponding International Financial Reporting Standard (IFRS) 11, Joint Arrangements, issued by the International Accounting Standards Board.*

### Comparison with IFRS 11, *Joint Arrangements*

- 1 Appendix C of IFRS 11 dealing with effective date, transition and withdrawal of other IFRSs has not been included in Ind AS 111, due to the following reasons:
  - (i) Effective date is not relevant as the date of application will be notified under the Companies Act.
  - (ii) Transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards*, corresponding to IFRS 1, *First-time Adoption of International Financial Reporting Standards*.
  - (iii) The paragraph which relate to withdrawal of other IFRSs is not relevant.
- 2 Paragraph B33D refers to the accounting specified in Appendix C '*Business Combinations under Common Control*' of Ind AS 103 for the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory. IFRS 11 scopes out the same as IFRS 3, *Business Combinations*, does not deal with business combinations under common control.

## Indian Accounting Standard (Ind AS) 112

# Disclosure of Interests in Other Entities<sup>#</sup>

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

## Objective

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- 1 **The objective of this Indian Accounting Standard (Ind AS) is to require an entity to disclose information that enables users of its financial statements to evaluate:**
- (a) **the nature of, and risks associated with, its *interests in other entities*; and**
  - (b) **the effects of those interests on its financial position, financial performance and cash flows.**

## Meeting the objective

- 2 To meet the objective in paragraph 1, an entity shall disclose:
- (a) the significant judgements and assumptions it has made in determining:
    - (i) the nature of its interest in another entity or arrangement;
    - (ii) the type of joint arrangement in which it has an interest (paragraphs 7–9);
    - (iii) that it meets the definition of an investment entity, if applicable (paragraph 9A); and
  - (b) information about its interests in:
    - (i) subsidiaries (paragraphs 10–19);
    - (ii) arrangements and associates (paragraphs 20–23); and

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015 and was amended vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016 and G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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- (iii) *structured entities* that are not controlled by the entity (unconsolidated structured entities) (paragraphs 24–31).
- 3 If the disclosures required by this Ind AS, together with disclosures required by other Ind ASs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.
- 4 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in this Ind AS. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraphs B2–B6).

## Scope

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- 5 This Ind AS shall be applied by an entity that has an interest in any of the following:
  - (a) subsidiaries
  - (b) joint arrangements (ie joint operations or joint ventures)
  - (c) associates
  - (d) unconsolidated structured entities.
- 5A <sup>1</sup>Except as described in paragraph B17, the requirements in this Ind AS apply to an entity's interests listed in paragraph 5 that are classified (or included in a disposal group that is classified) as held for sale or discontinued operations in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*
- 6 This Ind AS does not apply to:
  - (a) post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19, *Employee Benefits*, applies.

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<sup>1</sup> Inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

### Disclosure of Interests in Other Entities

- (b) <sup>2</sup>an entity's separate financial statements to which Ind AS 27, *Separate Financial Statements*, applies. However,
  - (i) if an entity has interests in unconsolidated structured entities and prepares separate financial statements as its only financial statements, it shall apply the requirements in paragraphs 24–31 when preparing those separate financial statements.
  - (ii) an investment entity that prepares financial statements in which all of its subsidiaries are measured at fair value through profit or loss in accordance with paragraph 31 of Ind AS 110 shall present the disclosures relating to investment entities required by this Ind AS.
- (c) an interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.
- (d) an interest in another entity that is accounted for in accordance with Ind AS 109, *Financial Instruments*. However, an entity shall apply this Ind AS:
  - (i) when that interest is an interest in an associate or a joint venture that, in accordance with Ind AS 28, *Investments in Associates and Joint Ventures*, is measured at fair value through profit or loss; or
  - (ii) when that interest is an interest in an unconsolidated structured entity.

## **Significant judgements and assumptions**

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- 7 An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:**

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<sup>2</sup> Substituted vide Notification No. G.S.R. 365(E) dated 30<sup>th</sup> March, 2016.

Ind AS 112

- (a) that it has control of another entity, ie an investee as described in paragraphs 5 and 6 of Ind AS 110, *Consolidated Financial Statements*;
  - (b) that it has joint control of an arrangement or significant influence over another entity; and
  - (c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.
- 8 The significant judgements and assumptions disclosed in accordance with paragraph 7 include those made by the entity when changes in facts and circumstances are such that the conclusion about whether it has control, joint control or significant influence changes during the reporting period.
- 9 To comply with paragraph 7, an entity shall disclose, for example, significant judgements and assumptions made in determining that:
- (a) it does not control another entity even though it holds more than half of the voting rights of the other entity.
  - (b) it controls another entity even though it holds less than half of the voting rights of the other entity.
  - (c) it is an agent or a principal (see paragraphs B58–B72 of Ind AS 110).
  - (d) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity.
  - (e) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

### **Investment entity status**

- 9A **When a parent determines that it is an investment entity in accordance with paragraph 27 of Ind AS 110, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investment entity (see**

**paragraph 28 of Ind AS 110), it shall disclose its reasons for concluding that it is nevertheless an investment entity.**

- 9B When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:
- (a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;
  - (b) the total gain or loss, if any, calculated in accordance with paragraph B101 of Ind AS 110; and
  - (c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

## **Interests in subsidiaries**

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- 10 **An entity shall disclose information that enables users of its consolidated financial statements**
- (a) **to understand:**
    - (i) **the composition of the group; and**
    - (ii) **the interest that non-controlling interests have in the group's activities and cash flows (paragraph 12); and**
  - (b) **to evaluate:**
    - (i) **the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group (paragraph 13);**
    - (ii) **the nature of, and changes in, the risks associated with its interests in consolidated structured entities (paragraphs 14–17);**
    - (iii) **the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control (paragraph 18); and**

**(iv) the consequences of losing control of a subsidiary during the reporting period (paragraph 19).**

- 11 When the financial statements of a subsidiary used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements (see paragraphs B92 and B93 of Ind AS 110), an entity shall disclose:
- (a) the date of the end of the reporting period of the financial statements of that subsidiary; and
  - (b) the reason for using a different date or period.

**The interest that non-controlling interests have in the group's activities and cash flows**

- 12 An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:
- (a) the name of the subsidiary.
  - (b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.
  - (c) the proportion of ownership interests held by non-controlling interests.
  - (d) the proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held.
  - (e) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.
  - (f) accumulated non-controlling interests of the subsidiary at the end of the reporting period.
  - (g) summarised financial information about the subsidiary (see paragraph B10).

**The nature and extent of significant restrictions**

- 13 An entity shall disclose:

### *Disclosure of Interests in Other Entities*

- (a) significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:
  - (i) those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group.
  - (ii) guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group.
- (b) the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a subsidiary).
- (c) the carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

### **Nature of the risks associated with an entity's interests in consolidated structured entities**

- 14 An entity shall disclose the terms of any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support).
- 15 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to a consolidated structured entity (eg purchasing assets of or instruments issued by the structured entity), the entity shall disclose:

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- (a) the type and amount of support provided, including situations in which the parent or its subsidiaries assisted the structured entity in obtaining financial support; and
- (b) the reasons for providing the support.

16 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to a previously unconsolidated structured entity and that provision of support resulted in the entity controlling the structured entity, the entity shall disclose an explanation of the relevant factors in reaching that decision.

17 An entity shall disclose any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

**Consequences of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control**

18 An entity shall present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control.

**Consequences of losing control of a subsidiary during the reporting period**

19 An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 25 of Ind AS 110, and:

- (a) the portion of that gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date when control is lost; and
- (b) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

## **Interests in unconsolidated subsidiaries (investment entities)**

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- 19A An investment entity that, in accordance with Ind AS 110, is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss shall disclose that fact.
- 19B For each unconsolidated subsidiary, an investment entity shall disclose:
- (a) the subsidiary's name;
  - (b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and
  - (c) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.
- 19C If an investment entity is the parent of another investment entity, the parent shall also provide the disclosures in 19B(a)–(c) for investments that are controlled by its investment entity subsidiary. The disclosure may be provided by including, in the financial statements of the parent, the financial statements of the subsidiary (or subsidiaries) that contain the above information.
- 19D An investment entity shall disclose:
- (a) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends or to repay loans or advances made to the unconsolidated subsidiary by the investment entity; and
  - (b) any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary, including commitments or intentions to assist the subsidiary in obtaining financial support.

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- 19E If, during the reporting period, an investment entity or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated subsidiary (eg purchasing assets of, or instruments issued by, the subsidiary or assisting the subsidiary in obtaining financial support), the entity shall disclose:
- (a) the type and amount of support provided to each unconsolidated subsidiary; and
  - (b) the reasons for providing the support.
- 19F An investment entity shall disclose the terms of any contractual arrangements that could require the entity or its unconsolidated subsidiaries to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or to provide financial support).
- 19G If during the reporting period an investment entity or any of its unconsolidated subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.

## **Interests in joint arrangements and associates**

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- 20 An entity shall disclose information that enables users of its financial statements to evaluate:**
- (a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 21 and 22); and**

- (b) **the nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 23).**

**Nature, extent and financial effects of an entity's interests in joint arrangements and associates**

- 21 An entity shall disclose:
- (a) for each joint arrangement and associate that is material to the reporting entity:
    - (i) the name of the joint arrangement or associate.
    - (ii) the nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities).
    - (iii) the principal place of business (and country of incorporation, if applicable and different from the principal place of business) of the joint arrangement or associate.
    - (iv) the proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).
  - (b) for each joint venture and associate that is material to the reporting entity:
    - (i) whether the investment in the joint venture or associate is measured using the equity method or at fair value.
    - (ii) summarised financial information about the joint venture or associate as specified in paragraphs B12 and B13.
    - (iii) if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.
  - (c) financial information as specified in paragraph B16 about the entity's investments in joint ventures and associates that are not individually material:

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- (i) in aggregate for all individually immaterial joint ventures and, separately,
  - (ii) in aggregate for all individually immaterial associates.
- 21A An investment entity need not provide the disclosures required by paragraphs 21(b)–21(c).
- 22 An entity shall also disclose:
  - (a) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements between investors with joint control of or significant influence over a joint venture or an associate) on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity.
  - (b) when the financial statements of a joint venture or associate used in applying the equity method are as of a date or for a period that is different from that of the entity:
    - (i) the date of the end of the reporting period of the financial statements of that joint venture or associate; and
    - (ii) the reason for using a different date or period.
  - (c) the unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture or associate when applying the equity method.

**Risks associated with an entity's interests in joint ventures and associates**

- 23 An entity shall disclose:
  - (a) commitments that it has relating to its joint ventures separately from the amount of other commitments as specified in paragraphs B18–B20.
  - (b) in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, unless the probability of

loss is remote, contingent liabilities incurred relating to its interests in joint ventures or associates (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures or associates), separately from the amount of other contingent liabilities.

## **Interests in unconsolidated structured entities**

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- 24 An entity shall disclose information that enables users of its financial statements:**
- (a) to understand the nature and extent of its interests in unconsolidated structured entities (paragraphs 26–28); and**
  - (b) to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities (paragraphs 29–31).**
- 25 The information required by paragraph 24(b) includes information about an entity's exposure to risk from involvement that it had with unconsolidated structured entities in previous periods (eg sponsoring the structured entity), even if the entity no longer has any contractual involvement with the structured entity at the reporting date.
- 25A An investment entity need not provide the disclosures required by paragraph 24 for an unconsolidated structured entity that it controls and for which it presents the disclosures required by paragraphs 19A–19G.

### **Nature of interests**

- 26 An entity shall disclose qualitative and quantitative information about its interests in unconsolidated structured entities, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.
- 27 If an entity has sponsored an unconsolidated structured entity for which it does not provide information required by paragraph 29 (eg

because it does not have an interest in the entity at the reporting date), the entity shall disclose:

- (a) how it has determined which structured entities it has sponsored;
- (b) *income from those structured entities* during the reporting period, including a description of the types of income presented; and
- (c) the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.

- 28 An entity shall present the information in paragraph 27(b) and (c) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs B2–B6).

### **Nature of risks**

- 29 An entity shall disclose in tabular format, unless another format is more appropriate, a summary of:
- (a) the carrying amounts of the assets and liabilities recognised in its financial statements relating to its interests in unconsolidated structured entities.
  - (b) the line items in the balance sheet in which those assets and liabilities are recognised.
  - (c) the amount that best represents the entity's maximum exposure to loss from its interests in unconsolidated structured entities, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests in unconsolidated structured entities it shall disclose that fact and the reasons.
  - (d) a comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in unconsolidated structured entities and the entity's maximum exposure to loss from those entities.

*Disclosure of Interests in Other Entities*

- 30 If during the reporting period an entity has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated structured entity in which it previously had or currently has an interest (for example, purchasing assets of or instruments issued by the structured entity), the entity shall disclose:
- (a) the type and amount of support provided, including situations in which the entity assisted the structured entity in obtaining financial support; and
  - (b) the reasons for providing the support.
- 31 An entity shall disclose any current intentions to provide financial or other support to an unconsolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

**income from a structured entity** For the purpose of this Ind AS, income from a **structured entity** includes, but is not limited to, recurring and non-recurring fees, interest, dividends, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.

**interest in another entity** For the purpose of this Ind AS, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.

Paragraphs B7–B9 provide further information about interests in other entities.

Paragraphs B55–B57 of Ind AS 110 explain variability of returns.

**structured entity** An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

Paragraphs B22–B24 provide further information about structured entities.

*Disclosure of Interests in Other Entities*

The following terms are defined in Ind AS 27, Ind AS 28, Ind AS 110 and Ind AS 111, *Joint Arrangements*, and are used in this Ind AS with the meanings specified in those Ind ASs:

- associate
- consolidated financial statements
- control of an entity
- equity method
- group
- investment entity
- joint arrangement
- joint control
- joint operation
- joint venture
- non-controlling interest
- parent
- protective rights
- relevant activities
- separate financial statements
- separate vehicle
- significant influence
- subsidiary.

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS. It describes the application of paragraphs 1–31 and has the same authority as the other parts of the Ind AS.*

- B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying Ind AS 112.

### **Aggregation (paragraph 4)**

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- B2 An entity shall decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.
- B3 An entity may aggregate the disclosures required by this Ind AS for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement in paragraph B4, and does not obscure the information provided. An entity shall disclose how it has aggregated its interests in similar entities.
- B4 An entity shall present information separately for interests in:
- (a) subsidiaries;
  - (b) joint ventures;
  - (c) joint operations;
  - (d) associates; and
  - (e) unconsolidated structured entities.
- B5 In determining whether to aggregate information, an entity shall consider quantitative and qualitative information about the different risk and return characteristics of each entity it is considering for

### *Disclosure of Interests in Other Entities*

aggregation and the significance of each such entity to the reporting entity. The entity shall present the disclosures in a manner that clearly explains to users of financial statements the nature and extent of its interests in those other entities.

- B6 Examples of aggregation levels within the classes of entities set out in paragraph B4 that might be appropriate are:
- (a) nature of activities (eg a research and development entity, a revolving credit card securitisation entity).
  - (b) industry classification.
  - (c) geography (eg country or region)

### **Interests in other entities**

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- B7 An interest in another entity refers to contractual and non-contractual involvement that exposes the reporting entity to variability of returns from the performance of the other entity. Consideration of the purpose and design of the other entity may help the reporting entity when assessing whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in this Ind AS. That assessment shall include consideration of the risks that the other entity was designed to create and the risks the other entity was designed to pass on to the reporting entity and other parties.
- B8 A reporting entity is typically exposed to variability of returns from the performance of another entity by holding instruments (such as equity or debt instruments issued by the other entity) or having another involvement that absorbs variability. For example, assume a structured entity holds a loan portfolio. The structured entity obtains a credit default swap from another entity (the reporting entity) to protect itself from the default of interest and principal payments on the loans. The reporting entity has involvement that exposes it to variability of returns from the performance of the structured entity because the credit default swap absorbs variability of returns of the structured entity.
- B9 Some instruments are designed to transfer risk from a reporting entity to another entity. Such instruments create variability of returns

for the other entity but do not typically expose the reporting entity to variability of returns from the performance of the other entity. For example, assume a structured entity is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any party involved in the arrangement). The structured entity obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of risk-free financial assets. The structured entity obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to the structured entity in return for a fee paid by the swap counterparty. The investors in the structured entity receive a higher return that reflects both the structured entity's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with the structured entity that exposes it to variability of returns from the performance of the structured entity because the CDS transfers variability to the structured entity, rather than absorbing variability of returns of the structured entity.

## **Summarised financial information for subsidiaries, joint ventures and associates (paragraphs 12 and 21)**

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- B10 For each subsidiary that has non-controlling interests that are material to the reporting entity, an entity shall disclose:
- (a) dividends paid to non-controlling interests.
  - (b) summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income.
- B11 The summarised financial information required by paragraph B10(b) shall be the amounts before inter-company eliminations.

*Disclosure of Interests in Other Entities*

- B12 For each joint venture and associate that is material to the reporting entity, an entity shall disclose:
- (a) dividends received from the joint venture or associate.
  - (b) summarised financial information for the joint venture or associate (see paragraphs B14 and B15) including, but not necessarily limited to:
    - (i) current assets.
    - (ii) non-current assets.
    - (iii) current liabilities.
    - (iv) non-current liabilities.
    - (v) revenue.
    - (vi) profit or loss from continuing operations.
    - (vii) post-tax profit or loss from discontinued operations.
    - (viii) other comprehensive income.
    - (ix) total comprehensive income.
- B13 In addition to the summarised financial information required by paragraph B12, an entity shall disclose for each joint venture that is material to the reporting entity the amount of:
- (a) cash and cash equivalents included in paragraph B12(b)(i).
  - (b) current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iii).
  - (c) non-current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iv).
  - (d) depreciation and amortisation.
  - (e) interest income.
  - (f) interest expense.
  - (g) income tax expense or income.
- B14 The summarised financial information presented in accordance with paragraphs B12 and B13 shall be the amounts included in the Ind AS financial statements of the joint venture or associate (and not the

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entity's share of those amounts). If the entity accounts for its interest in the joint venture or associate using the equity method:

- (a) the amounts included in the Ind AS financial statements of the joint venture or associate shall be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies.
- (b) the entity shall provide a reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture or associate.

B15 An entity may present the summarised financial information required by paragraphs B12 and B13 on the basis of the joint venture's or associate's financial statements if:

- (a) the entity measures its interest in the joint venture or associate at fair value in accordance with Ind AS 28 ; and
- (b) the joint venture or associate does not prepare Ind AS financial statements and preparation on that basis would be impracticable or cause undue cost.

In that case, the entity shall disclose the basis on which the summarised financial information has been prepared.

B16 An entity shall disclose, in aggregate, the carrying amount of its interests in all individually immaterial joint ventures or associates that are accounted for using the equity method. An entity shall also disclose separately the aggregate amount of its share of those joint ventures' or associates':

- (a) profit or loss from continuing operations.
- (b) post-tax profit or loss from discontinued operations.
- (c) other comprehensive income.
- (d) total comprehensive income.

An entity provides the disclosures separately for joint ventures and associates.

- B17 <sup>3</sup>When an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) is classified (or included in a disposal group that is classified) as held for sale in accordance with Ind AS 105, the entity is not required to disclose summarised financial information for that subsidiary, joint venture or associate in accordance with paragraphs B10–B16.

### **Commitments for joint ventures (paragraph 23(a))**

- B18 An entity shall disclose total commitments it has made but not recognised at the reporting date (including its share of commitments made jointly with other investors with joint control of a joint venture) relating to its interests in joint ventures. Commitments are those that may give rise to a future outflow of cash or other resources.
- B19 Unrecognised commitments that may give rise to a future outflow of cash or other resources include:
- (a) unrecognised commitments to contribute funding or resources as a result of, for example:
    - (i) the constitution or acquisition agreements of a joint venture (that, for example, require an entity to contribute funds over a specific period).
    - (ii) capital-intensive projects undertaken by a joint venture.
    - (iii) unconditional purchase obligations, comprising procurement of equipment, inventory or services that an entity is committed to purchasing from, or on behalf of, a joint venture.
    - (iv) unrecognised commitments to provide loans or other financial support to a joint venture.
    - (v) unrecognised commitments to contribute resources to a joint venture, such as assets or services.
    - (vi) other non-cancellable unrecognised commitments relating to a joint venture.

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<sup>3</sup> Substituted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

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- (b) unrecognised commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if a particular event occurs or does not occur in the future.

B20 The requirements and examples in paragraphs B18 and B19 illustrate some of the types of disclosure required by paragraph 18 of Ind AS 24, *Related Party Disclosures*.

## **Interests in unconsolidated structured entities (paragraphs 24–31)**

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### **Structured entities**

- B21 A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.
- B22 A structured entity often has some or all of the following features or attributes:
- (a) restricted activities.
  - (b) a narrow and well-defined objective, such as to effect a tax-efficient lease, carry out research and development activities, provide a source of capital or funding to an entity or provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.
  - (c) insufficient equity to permit the structured entity to finance its activities without subordinated financial support.
  - (d) financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches).
- B23 Examples of entities that are regarded as structured entities include, but are not limited to:
- (a) securitisation vehicles.

- (b) asset-backed financings.
- (c) some investment funds.

B24 An entity that is controlled by voting rights is not a structured entity simply because, for example, it receives funding from third parties following a restructuring.

**Nature of risks from interests in unconsolidated structured entities (paragraphs 29–31)**

B25 In addition to the information required by paragraphs 29–31, an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 24(b).

B26 Examples of additional information that, depending on the circumstances, might be relevant to an assessment of the risks to which an entity is exposed when it has an interest in an unconsolidated structured entity are:

- (a) the terms of an arrangement that could require the entity to provide financial support to an unconsolidated structured entity (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support), including:
  - (i) a description of events or circumstances that could expose the reporting entity to a loss.
  - (ii) whether there are any terms that would limit the obligation.
  - (iii) whether there are any other parties that provide financial support and, if so, how the reporting entity's obligation ranks with those of other parties.
- (b) losses incurred by the entity during the reporting period relating to its interests in unconsolidated structured entities.
- (c) the types of income the entity received during the reporting period from its interests in unconsolidated structured entities.
- (d) whether the entity is required to absorb losses of an unconsolidated structured entity before other parties, the

maximum limit of such losses for the entity, and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the unconsolidated structured entity.

- (e) information about any liquidity arrangements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in unconsolidated structured entities.
- (f) any difficulties an unconsolidated structured entity has experienced in financing its activities during the reporting period.
- (g) in relation to the funding of an unconsolidated structured entity, the forms of funding (eg commercial paper or medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of an unconsolidated structured entity if the structured entity has longer-term assets funded by shorter-term funding.

## **<sup>4</sup>Appendix C**

### **Effective date and transition**

*This appendix is an integral part of the Ind AS and has the same authority as the other parts of the Ind AS*

### **Effective date and transition**

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C1	*
C1A	*
C1B	*
C1C	*
C1D	Annual improvements to Ind AS - Amendments in Ind AS 112 and 28, added paragraph 5A and amended paragraph B17. An entity shall apply those amendments retrospectively in accordance with Ind AS 8, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> , for annual periods beginning on or after 1 <sup>st</sup> April, 2018.

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<sup>4</sup> Appendix inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

\* Refer Appendix 1

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 112 and the corresponding International Financial Reporting Standard (IFRS) 12, Disclosure of Interests in Other Entities, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 12, *Disclosure of Interests in Other Entities***

1. Different terminology is used, as used in existing laws eg, the term 'balance sheet' is used instead of 'Statement of financial position'.
2. <sup>5</sup>Paragraphs C1 to C1C of Appendix C, have not been included as these paragraphs relate to effective date and transition that are not relevant in Indian context. However, in order to maintain consistency with paragraph numbers of IFRS 12, the paragraph numbers are retained in Ind AS 112.

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<sup>5</sup> Inserted vide Notification No. G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

# Indian Accounting Standard (Ind AS) 113

## Fair Value Measurement<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

### Objective

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- 1 **This Ind AS:**
  - (a) **defines *fair value*;**
  - (b) **sets out in a single Ind AS a framework for measuring fair value; and**
  - (c) **requires disclosures about fair value measurements.**
- 2 Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions (ie an *exit price* at the measurement date from the perspective of a market participant that holds the asset or owes the liability).
- 3 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant *observable inputs* and minimises the use of *unobservable inputs*. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015.

## Ind AS 113

- 4 The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Ind AS shall be applied to an entity's own equity instruments measured at fair value.

## Scope

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- 5 **This Ind AS applies when another Ind AS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except as specified in paragraphs 6 and 7.**
- 6 The measurement and disclosure requirements of this Ind AS do not apply to the following:
- (a) share-based payment transactions within the scope of Ind AS 102, *Share-based Payment*;
  - (b) leasing transactions within the scope of Ind AS 17, *Leases*; and
  - (c) measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2, *Inventories*, or value in use in Ind AS 36, *Impairment of Assets*.
- 7 The disclosures required by this Ind AS are not required for the following:
- (a) plan assets measured at fair value in accordance with Ind AS 19, *Employee Benefits*;
  - (b) [Refer Appendix 1]; and
  - (c) assets for which recoverable amount is fair value less costs of disposal in accordance with Ind AS 36.
- 8 The fair value measurement framework described in this Ind AS applies to both initial and subsequent measurement if fair value is required or permitted by other Ind ASs.

## Measurement

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### Definition of fair value

- 9 This Ind AS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- 10 Paragraph B2 describes the overall fair value measurement approach.

### The asset or liability

- 11 A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:
- (a) the condition and location of the asset; and
  - (b) restrictions, if any, on the sale or use of the asset.
- 12 The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.
- 13 The asset or liability measured at fair value might be either of the following:
- (a) a stand-alone asset or liability (eg a financial instrument or a non-financial asset); or
  - (b) a group of assets, a group of liabilities or a group of assets and liabilities (eg a cash-generating unit or a business).
- 14 Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset or liability shall be determined in accordance with the Ind AS that requires or permits the fair value measurement, except as provided in this Ind AS.

### **The transaction**

- 15 **A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.**
- 16 **A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:**
- (a) **in the *principal market* for the asset or liability; or**
  - (b) **in the absence of a principal market, in the *most advantageous market* for the asset or liability.**
- 17 An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.
- 18 If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.
- 19 The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and businesses within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and businesses within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.
- 20 Although an entity must be able to access the market, the entity does not need to be able to sell the particular asset or transfer the

## *Fair Value Measurement*

particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.

- 21 Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

### **Market participants**

- 22 **An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.**
- 23 In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:
- (a) the asset or liability;
  - (b) the principal (or most advantageous) market for the asset or liability; and
  - (c) market participants with whom the entity would enter into a transaction in that market.

### **The price**

- 24 **Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.**
- 25 The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in

accordance with other Ind ASs. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the asset or liability.

- 26 Transaction costs do not include *transport costs*. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

## **Application to non-financial assets**

### **Highest and best use for non-financial assets**

- 27 **A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its *highest and best use* or by selling it to another market participant that would use the asset in its highest and best use.**
- 28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:
- (a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).
  - (b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).
  - (c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

## *Fair Value Measurement*

- 29 Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.
- 30 To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. For example, that might be the case for an acquired intangible asset that the entity plans to use defensively by preventing others from using it. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

### **Valuation premise for non-financial assets**

- 31 The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, as follows:
- (a) The highest and best use of a non-financial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business).
    - (i) If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (ie its complementary assets and the associated liabilities) would be available to market participants.
    - (ii) Liabilities associated with the asset and with the complementary assets include liabilities that fund working capital, but do not include liabilities used to fund assets other than those within the group of assets.

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- (iii) Assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.
  - (b) The highest and best use of a non-financial asset might provide maximum value to market participants on a stand-alone basis. If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.
- 32 The fair value measurement of a non-financial asset assumes that the asset is sold consistently with the unit of account specified in other Ind ASs (which may be an individual asset). That is the case even when that fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities because a fair value measurement assumes that the market participant already holds the complementary assets and the associated liabilities.
- 33 Paragraph B3 describes the application of the valuation premise concept for non-financial assets.

## **Application to liabilities and an entity's own equity instruments**

### **General principles**

- 34 **A fair value measurement assumes that a financial or non-financial liability or an entity's own equity instrument (eg equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date. The transfer of a liability or an entity's own equity instrument assumes the following:**
- (a) **A liability would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the**

**counterparty or otherwise extinguished on the measurement date.**

- (b) An entity's own equity instrument would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.**

35 Even when there is no observable market to provide pricing information about the transfer of a liability or an entity's own equity instrument (eg because contractual or other legal restrictions prevent the transfer of such items), there might be an observable market for such items if they are held by other parties as assets (eg a corporate bond or a call option on an entity's shares).

36 In all cases, an entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs to meet the objective of a fair value measurement, which is to estimate the price at which an orderly transaction to transfer the liability or equity instrument would take place between market participants at the measurement date under current market conditions.

*Liabilities and equity instruments held by other parties as assets*

37 **When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.**

38 In such cases, an entity shall measure the fair value of the liability or equity instrument as follows:

- (a) using the quoted price in an *active market* for the identical item held by another party as an asset, if that price is available.
- (b) if that price is not available, using other observable inputs, such as the quoted price in a market that is not active for the identical item held by another party as an asset.

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- (c) if the observable prices in (a) and (b) are not available, using another valuation technique, such as:
  - (i) an *income approach* (eg a present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the liability or equity instrument as an asset; see paragraphs B10 and B11).
  - (ii) a *market approach* (eg using quoted prices for similar liabilities or equity instruments held by other parties as assets; see paragraphs B5-B7).

39 An entity shall adjust the quoted price of a liability or an entity's own equity instrument held by another party as an asset only if there are factors specific to the asset that are not applicable to the fair value measurement of the liability or equity instrument. An entity shall ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset. Some factors that may indicate that the quoted price of the asset should be adjusted include the following:

- (a) The quoted price for the asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset. For example, the liability or equity instrument may have a particular characteristic (eg the credit quality of the issuer) that is different from that reflected in the fair value of the similar liability or equity instrument held as an asset.
- (b) The unit of account for the asset is not the same as for the liability or equity instrument. For example, for liabilities, in some cases the price for an asset reflects a combined price for a package comprising both the amounts due from the issuer and a third-party credit enhancement. If the unit of account for the liability is not for the combined package, the objective is to measure the fair value of the issuer's liability, not the fair value of the combined package. Thus, in such cases, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement.

*Liabilities and equity instruments not held by other parties as assets*

- 40 **When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is not held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.**
- 41 For example, when applying a present value technique an entity might take into account either of the following:
- (a) the future cash outflows that a market participant would expect to incur in fulfilling the obligation, including the compensation that a market participant would require for taking on the obligation (see paragraphs B31-B33).
  - (b) the amount that a market participant would receive to enter into or issue an identical liability or equity instrument, using the assumptions that market participants would use when pricing the identical item (eg having the same credit characteristics) in the principal (or most advantageous) market for issuing a liability or an equity instrument with the same contractual terms.

**Non-performance risk**

- 42 **The fair value of a liability reflects the effect of *non-performance risk*. Non-performance risk includes, but may not be limited to, an entity's own credit risk (as defined in Ind AS 107, *Financial Instruments: Disclosures*). Non-performance risk is assumed to be the same before and after the transfer of the liability.**
- 43 When measuring the fair value of a liability, an entity shall take into account the effect of its credit risk (credit standing) and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:

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- (a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability).
- (b) the terms of credit enhancements related to the liability, if any.

44 The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account. The issuer of a liability issued with an inseparable third-party credit enhancement that is accounted for separately from the liability shall not include the effect of the credit enhancement (eg a third-party guarantee of debt) in the fair value measurement of the liability. If the credit enhancement is accounted for separately from the liability, the issuer would take into account its own credit standing and not that of the third party guarantor when measuring the fair value of the liability.

**Restriction preventing the transfer of a liability or an entity's own equity instrument**

45 When measuring the fair value of a liability or an entity's own equity instrument, an entity shall not include a separate input or an adjustment to other *inputs* relating to the existence of a restriction that prevents the transfer of the item. The effect of a restriction that prevents the transfer of a liability or an entity's own equity instrument is either implicitly or explicitly included in the other inputs to the fair value measurement.

46 For example, at the transaction date, both the creditor and the obligor accepted the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer. As a result of the restriction being included in the transaction price, a separate input or an adjustment to an existing input is not required at the transaction date to reflect the effect of the restriction on transfer. Similarly, a separate input or an adjustment to an existing input is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.

**Financial liability with a demand feature**

47 The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand,

discounted from the first date that the amount could be required to be paid.

**Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk**

- 48 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (as defined in Ind AS 107) and to the credit risk (as defined in Ind AS 107) of each of the counterparties. If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this Ind AS for measuring fair value. That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.
- 49 An entity is permitted to use the exception in paragraph 48 only if the entity does all the following:
- (a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy;
  - (b) provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as defined in Ind AS 24, *Related Party Disclosures*; and

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- (c) is required or has elected to measure those financial assets and financial liabilities at fair value in the balance sheet at the end of each reporting period.

50 The exception in paragraph 48 does not pertain to financial statement presentation. In some cases the basis for the presentation of financial instruments in the balance sheet differs from the basis for the measurement of financial instruments, for example, if an Ind AS does not require or permit financial instruments to be presented on a net basis. In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53-56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure. An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

51 An entity shall make an accounting policy decision in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, to use the exception in paragraph 48. An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs 53-55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio.

52 The exception in paragraph 48 applies only to financial assets, financial liabilities and other contracts within the scope of Ind AS 109, *Financial Instruments*. The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, Ind AS 109, regardless of whether they meet the definitions of financial assets or financial liabilities in Ind AS 32, *Financial Instruments: Presentation*.

**Exposure to market risks**

53 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities managed on the basis of the entity's net exposure to a particular market risk (or risks), the entity shall apply the price within the bid-ask spread that

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is most representative of fair value in the circumstances to the entity's net exposure to those market risks (see paragraphs 70 and 71).

- 54 When using the exception in paragraph 48, an entity shall ensure that the market risk (or risks) to which the entity is exposed within that group of financial assets and financial liabilities is substantially the same. For example, an entity would not combine the interest rate risk associated with a financial asset with the commodity price risk associated with a financial liability because doing so would not mitigate the entity's exposure to interest rate risk or commodity price risk. When using the exception in paragraph 48, any basis risk resulting from the market risk parameters not being identical shall be taken into account in the fair value measurement of the financial assets and financial liabilities within the group.
- 55 Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities shall be substantially the same. For example, an entity that uses a 12-month futures contract against the cash flows associated with 12 months' worth of interest rate risk exposure on a five-year financial instrument within a group made up of only those financial assets and financial liabilities measures the fair value of the exposure to 12-month interest rate risk on a net basis and the remaining interest rate risk exposure (ie years 2-5) on a gross basis.

### **Exposure to the credit risk of a particular counterparty**

- 56 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities entered into with a particular counterparty, the entity shall include the effect of the entity's net exposure to the credit risk of that counterparty or the counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default (eg a master netting agreement with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party). The fair value measurement shall reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

### **Fair value at initial recognition**

- 57 When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an *exit price*). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.
- 58 In many cases the transaction price will equal the fair value (eg that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).
- 59 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph B4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.
- 60 If another Ind AS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that Ind AS specifies otherwise.

### **Valuation techniques**

- 61 **An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.**
- 62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the *cost approach* and the income approach. The main aspects of those approaches are summarised in paragraphs B5-B11. An entity shall

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use valuation techniques consistent with one or more of those approaches to measure fair value.

- 63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.
- 64 If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset or liability) at the measurement date.
- 65 Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (eg a change in its weightage when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:
- (a) new markets develop;
  - (b) new information becomes available;

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- (c) information previously used is no longer available;
- (d) valuation techniques improve; or
- (e) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with Ind AS 8. However, the disclosures in Ind AS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

### **Inputs to valuation techniques**

#### **General principles**

**67 Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.**

68 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include exchange markets, dealer markets, brokered markets and principal-to-principal markets (see paragraph B34).

69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs 11 and 12). In some cases those characteristics result in the application of an adjustment, such as a premium or discount (eg a control premium or non-controlling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the Ind AS that requires or permits the fair value measurement (see paragraphs 13 and 14). Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 80) rather than as a characteristic of the asset or liability (eg a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in

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an active market (ie a *Level 1 input*) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph 79.

### **Inputs based on bid and ask prices**

70 If an asset or a liability measured at fair value has a bid price and an ask price (eg an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (ie Level 1, 2 or 3; see paragraphs 72-90). The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required.

71 This Ind AS does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

### **Fair value hierarchy**

72 To increase consistency and comparability in fair value measurements and related disclosures, this Ind AS establishes a fair value hierarchy that categorises into three levels (see paragraphs 76-90), the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (*Level 3 inputs*).

73 In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value, such as costs to sell when measuring fair value less costs to sell, shall not be taken into

account when determining the level of the fair value hierarchy within which a fair value measurement is categorised.

- 74 The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph 61). However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorised within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorised.
- 75 If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorised within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a *Level 2 input* and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorised within Level 3 of the fair value hierarchy.

#### **Level 1 inputs**

- 76 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- 77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.
- 78 A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (eg on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

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- (a) the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and
- (b) whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

79 An entity shall not make an adjustment to a Level 1 input except in the following circumstances:

- (a) when an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (ie given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorised within a lower level of the fair value hierarchy.
- (b) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.
- (c) when measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph 39). If no adjustment to the quoted price of the

asset is required, the result is a fair value measurement categorised within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorised within a lower level of the fair value hierarchy.

- 80 If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

**Level 2 inputs**

- 81 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- 82 If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:
- (a) quoted prices for similar assets or liabilities in active markets.
  - (b) quoted prices for identical or similar assets or liabilities in markets that are not active.
  - (c) inputs other than quoted prices that are observable for the asset or liability, for example:
    - (i) interest rates and yield curves observable at commonly quoted intervals;
    - (ii) implied volatilities; and
    - (iii) credit spreads.
  - (d) *market-corroborated inputs*.
- 83 Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

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- (a) the condition or location of the asset;
- (b) the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 39); and
- (c) the volume or level of activity in the markets within which the inputs are observed.

84 An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

85 Paragraph B35 describes the use of Level 2 inputs for particular assets and liabilities.

### **Level 3 inputs**

86 Level 3 inputs are unobservable inputs for the asset or liability.

87 Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

88 Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (eg when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or

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quoted price does not represent fair value, as described in paragraphs B37-B47).

- 89 An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.
- 90 Paragraph B36 describes the use of Level 3 inputs for particular assets and liabilities.

## **Disclosure**

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- 91 **An entity shall disclose information that helps users of its financial statements assess both of the following:**
- (a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.**
  - (b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.**
- 92 To meet the objectives in paragraph 91, an entity shall consider all the following:
- (a) the level of detail necessary to satisfy the disclosure requirements;

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- (b) how much emphasis to place on each of the various requirements;
- (c) how much aggregation or disaggregation to undertake; and
- (d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this Ind AS and other Ind ASs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Ind AS) in the balance sheet after initial recognition:

- (a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fair value measurements of assets or liabilities are those that other Ind ASs require or permit in the balance sheet at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other Ind ASs require or permit in the balance sheet in particular circumstances (eg when an entity measures an asset held for sale at fair value less costs to sell in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*, because the asset's fair value less costs to sell is lower than its carrying amount).
- (b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).
- (c) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the

entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

- (d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs (eg a market multiple or future cash flows) used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.
- (e) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
  - (i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.
  - (ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

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- (iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).
  - (iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.
- (f) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.
- (g) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).
- (h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:
- (i) for all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in

unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with 93(d).

- (ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.
- (i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

94 An entity shall determine appropriate classes of assets and liabilities on the basis of the following:

- (a) the nature, characteristics and risks of the asset or liability; and
- (b) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the balance sheet. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the balance sheet. If another Ind AS specifies the class

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for an asset or a liability, an entity may use that class in providing the disclosures required in this Ind AS if that class meets the requirements in this paragraph.

- 95 An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph 93(c) and (e)(iv). The policy about the timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:
- (a) the date of the event or change in circumstances that caused the transfer.
  - (b) the beginning of the reporting period.
  - (c) the end of the reporting period.
- 96 If an entity makes an accounting policy decision to use the exception in paragraph 48, it shall disclose that fact.
- 97 For each class of assets and liabilities not measured at fair value in the balance sheet but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this Ind AS.
- 98 For a liability measured at fair value and issued with an inseparable third-party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.
- 99 An entity shall present the quantitative disclosures required by this Ind AS in a tabular format unless another format is more appropriate.

## Appendix A

### Defined terms

*This appendix is an integral part of the Ind AS.*

<b>active market</b>	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
<b>cost approach</b>	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
<b>entry price</b>	The price paid to acquire an asset or received to assume a liability in an exchange transaction.
<b>exit price</b>	The price that would be received to sell an asset or paid to transfer a liability.
<b>expected cash flow</b>	The probability-weighted average (ie mean of the distribution) of possible future cash flows.
<b>fair value</b>	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
<b>highest and best use</b>	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.
<b>income approach</b>	Valuation techniques that convert future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
<b>inputs</b>	The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following: (a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and

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	(b) the risk inherent in the inputs to the valuation technique.
	Inputs may be observable or unobservable.
<b>Level 1 inputs</b>	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
<b>Level 2 inputs</b>	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
<b>Level 3 inputs</b>	Unobservable inputs for the asset or liability.
<b>market approach</b>	A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.
<b>market-corroborated inputs</b>	Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
<b>market participants</b>	Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics: <ul style="list-style-type: none"><li>(a) They are independent of each other, ie they are not related parties as defined in Ind AS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.</li><li>(b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.</li><li>(c) They are able to enter into a transaction for the asset or liability.</li><li>(d) They are willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.</li></ul>

The market that maximises the amount that would be

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<b>most advantageous market</b>	received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.
<b>non-performance risk</b>	The risk that an entity will not fulfill an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.
<b>observable inputs</b>	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
<b>orderly transaction</b>	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).
<b>principal market</b>	The market with the greatest volume and level of activity for the asset or liability.
<b>risk premium</b>	Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.
<b>transaction costs</b>	The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria: (a) They result directly from and are essential to that transaction. (b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made (similar to costs to sell, as defined in Ind AS 105).
<b>transport costs</b>	The costs that would be incurred to transport an asset from its current location to its principal (or most

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	advantageous) market.
<b>unit of account</b>	The level at which an asset or a liability is aggregated or disaggregated in an Ind AS for recognition purposes.
<b>unobservable inputs</b>	Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

## Appendix B

### Application guidance

*This appendix is an integral part of the Ind AS.*

- B1 The judgements applied in different valuation situations may be different. This appendix describes the judgements that might apply when an entity measures fair value in different valuation situations.

### The fair value measurement approach

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- B2 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:
- (a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).
  - (b) for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
  - (c) the principal (or most advantageous) market for the asset or liability.
  - (d) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

### Valuation premise for non-financial assets (paragraphs 31-33)

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- B3 When measuring the fair value of a non-financial asset used in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities

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(eg a business), the effect of the valuation premise depends on the circumstances. For example:

- (a) the fair value of the asset might be the same whether the asset is used on a stand-alone basis or in combination with other assets or with other assets and liabilities. That might be the case if the asset is a business that market participants would continue to operate. In that case, the transaction would involve valuing the business in its entirety. The use of the assets as a group in an ongoing business would generate synergies that would be available to market participants (ie market participant synergies that, therefore, should affect the fair value of the asset on either a stand-alone basis or in combination with other assets or with other assets and liabilities).
- (b) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through adjustments to the value of the asset used on a stand-alone basis. That might be the case if the asset is a machine and the fair value measurement is determined using an observed price for a similar machine (not installed or otherwise configured for use), adjusted for transport and installation costs so that the fair value measurement reflects the current condition and location of the machine (installed and configured for use).
- (c) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through the market participant assumptions used to measure the fair value of the asset. For example, if the asset is work in progress inventory that is unique and market participants would convert the inventory into finished goods, the fair value of the inventory would assume that market participants have acquired or would acquire any specialised machinery necessary to convert the inventory into finished goods.
- (d) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the valuation technique used to measure the fair value of the asset. That

might be the case when using the multi-period excess earnings method to measure the fair value of an intangible asset because that valuation technique specifically takes into account the contribution of any complementary assets and the associated liabilities in the group in which such an intangible asset would be used.

- (e) in more limited situations, when an entity uses an asset within a group of assets, the entity might measure the asset at an amount that approximates its fair value when allocating the fair value of the asset group to the individual assets of the group. That might be the case if the valuation involves real property and the fair value of improved property (ie an asset group) is allocated to its component assets (such as land and improvements).

### **Fair value at initial recognition (paragraphs 57-60)**

- B4 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:
- (a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
  - (b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
  - (c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges that are

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measured separately in accordance with another Ind AS, or the transaction price includes transaction costs.

- (d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

## **Valuation techniques (paragraphs 61-66)**

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### **Market approach**

- B5 The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.
- B6 For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.
- B7 Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

### **Cost approach**

- B8 The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
- B9 From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market

participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

### **Income approach**

- B10 The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.
- B11 Those valuation techniques include, for example, the following:
- (a) present value techniques (see paragraphs B12-B30);
  - (b) option pricing models, such as the Black-Scholes-Merton formula or a binomial model (ie a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and
  - (c) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

### **Present value techniques**

- B12 Paragraphs B13-B30 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an *expected cashflow* (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being

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measured (eg whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

### **The components of a present value measurement**

- B13 Present value (ie an application of the income approach) is a tool used to link future amounts (eg cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:
- (a) an estimate of future cash flows for the asset or liability being measured.
  - (b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.
  - (c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (ie a risk-free interest rate).
  - (d) the price for bearing the uncertainty inherent in the cash flows (ie a *risk premium*).
  - (e) other factors that market participants would take into account in the circumstances.
  - (f) for a liability, the non-performance risk relating to that liability, including the entity's (ie the obligor's) own credit risk.

### *General principles*

- B14 Present value techniques differ in how they capture the elements in paragraph B13. However, all the following general principles govern the application of any present value technique used to measure fair value:
- (a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.

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- (b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.
- (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (ie a discount rate adjustment technique). That same rate should not be used if using expected (ie probability-weighted) cash flows (ie an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.
- (d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.
- (e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

*Risk and uncertainty*

- B15 A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is risk of default.

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- B16 Market participants generally seek compensation (ie a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.
- B17 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:
- (a) The discount rate adjustment technique (see paragraphs B18-B22) uses a risk-adjusted discount rate and contractual, promised or most likely cash flows.
  - (b) Method 1 of the expected present value technique (see paragraph B25) uses risk-adjusted expected cash flows and a risk-free rate.
  - (c) Method 2 of the expected present value technique (see paragraph B26) uses expected cash flows that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. That rate is different from the rate used in the discount rate adjustment technique.

### *Discount rate adjustment technique*

- B18 The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (eg contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (ie a market rate of return).

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- B19 The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (eg whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (eg credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (ie using a 'build-up' approach).
- B20 To illustrate a build-up approach, assume that Asset A is a contractual right to receive Rs. 800 in one year (ie there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:
- (a) Asset B is a contractual right to receive Rs. 1,200 in one year and has a market price of Rs. 1,083. Thus, the implied annual rate of return (ie a one-year market rate of return) is 10.8 percent  $[(Rs. 1,200/Rs. 1,083) - 1]$ .
  - (b) Asset C is a contractual right to receive Rs. 700 in two years and has a market price of Rs. 566. Thus, the implied annual rate of return (ie a two-year market rate of return) is 11.2 per cent  $[(Rs. 700/Rs. 566)^{0.5} - 1]$ .
  - (c) All three assets are comparable with respect to risk (ie dispersion of possible pay-offs and credit).
- B21 On the basis of the timing of the contractual payments to be received for Asset A relative to the timing for Asset B and Asset C (ie one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (Rs. 800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is Rs. 722 (Rs. 800/1.108). Alternatively, in the absence of available market information for Asset B, the one-year market rate could be derived from Asset C using the build-up approach. In that

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case the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

- B22 When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

### *Expected present value technique*

- B23 The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (ie the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).
- B24 In making an investment decision, risk-averse market participants would take into account the risk that the actual cash flows may differ from the expected cash flows. Portfolio theory distinguishes between two types of risk:
- (a) unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.
  - (b) systematic (non-diversifiable) risk, which is the common risk shared by an asset or a liability with the other items in a diversified portfolio.

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Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

- B25 Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (ie market) risk by subtracting a cash risk premium (ie risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of Rs. 1,200 for a certain cash flow of Rs. 1,000, the Rs. 1,000 is the certainty equivalent of the Rs. 1,200 (ie the Rs. 200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.
- B26 In contrast, Method 2 of the expected present value technique adjusts for systematic (ie market) risk by applying a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows (ie an expected rate of return). Models used for pricing risky assets, such as the capital asset pricing model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.
- B27 To illustrate Methods 1 and 2, assume that an asset has expected cash flows of Rs. 780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

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<b>Possible cash flows</b>	<b>Probability</b>	<b>Probability-weighted cash flows</b>
Rs. 500	15%	Rs. 75
Rs. 800	60%	Rs. 480
Rs. 900	25%	Rs. 225
Expected cash flows		Rs. 780

B28 In this simple illustration, the expected cash flows (Rs. 780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realised cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (eg changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.

B29 In theory, the present value (ie the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:

- (a) Using Method 1, the expected cash flows are adjusted for systematic (ie market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (ie the cash risk premium of Rs. 22) could be determined using the systematic risk premium of 3 per cent ( $\text{Rs. } 780 - [\text{Rs. } 780 \times (1.05/1.08)]$ ), which results in risk-adjusted expected cash flows of Rs. 758 (Rs. 780 - Rs. 22). The Rs. 758 is the certainty equivalent of Rs. 780 and is discounted at the risk-free interest rate (5 per cent). The

present value (ie the fair value) of the asset is Rs. 722 (Rs. 758/1.05).

- (b) Using Method 2, the expected cash flows are not adjusted for systematic (ie market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (ie the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (ie the fair value) of the asset is Rs. 722 (Rs. 780/1.08).

B30 When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

### **Applying present value techniques to liabilities and an entity's own equity instruments not held by other parties as assets (paragraphs 40 and 41)**

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B31 When using a present value technique to measure the fair value of a liability that is not held by another party as an asset (eg a decommissioning liability), an entity shall, among other things, estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation. Those future cash outflows shall include market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation. Such compensation includes the return that a market participant would require for the following:

- (a) undertaking the activity (ie the value of fulfilling the obligation; eg by using resources that could be used for other activities); and
- (b) assuming the risk associated with the obligation (ie a risk premium that reflects the risk that the actual cash outflows might differ from the expected cash outflows; see paragraph B33).

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- B32 For example, a non-financial liability does not contain a contractual rate of return and there is no observable market yield for that liability. In some cases the components of the return that market participants would require will be indistinguishable from one another (eg when using the price a third party contractor would charge on a fixed fee basis). In other cases an entity needs to estimate those components separately (eg when using the price a third party contractor would charge on a cost plus basis because the contractor in that case would not bear the risk of future changes in costs).
- B33 An entity can include a risk premium in the fair value measurement of a liability or an entity's own equity instrument that is not held by another party as an asset in one of the following ways:
- (a) by adjusting the cash flows (ie as an increase in the amount of cash outflows); or
  - (b) by adjusting the rate used to discount the future cash flows to their present values (ie as a reduction in the discount rate).

An entity shall ensure that it does not double-count or omit adjustments for risk. For example, if the estimated cash flows are increased to take into account the compensation for assuming the risk associated with the obligation, the discount rate should not be adjusted to reflect that risk.

## **Inputs to valuation techniques (paragraphs 67-71)**

- B34 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include the following:
- (a) *Exchange markets.* In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the National Stock Exchange.
  - (b) *Dealer markets.* In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell,

respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (eg used equipment).

- (c) *Brokered markets.* In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.
- (d) *Principal-to-principal markets.* In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

## **Fair value hierarchy (paragraphs 72-90)**

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### **Level 2 inputs (paragraphs 81-85)**

- B35 Examples of Level 2 inputs for particular assets and liabilities include the following:
- (a) *Receive-fixed, pay-variable interest rate swap based on the Mumbai Interbank Offered Rate (MIBOR) swap rate.* A Level 2 input would be the MIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.
  - (b) *Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency.* A Level 2 input would be the swap rate based on a yield curve denominated

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in a foreign currency that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety.

- (c) *Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate.* A Level 2 input would be the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, for example, by correlation with an interest rate that is observable over substantially the full term of the swap.
- (d) *Three-year option on exchange-traded shares.* A Level 2 input would be the implied volatility for the shares derived through extrapolation to year 3 if both of the following conditions exist:
  - (i) Prices for one-year and two-year options on the shares are observable.
  - (ii) The extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option.

In that case the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.

- (e) *Licensing arrangement.* For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.
- (f) *Finished goods inventory at a retail outlet.* For finished goods inventory that is acquired in a business combination, a Level 2 input would be either a price to customers in a retail market

or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (ie similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.

- (g) *Building held and used.* A Level 2 input would be the price per square metre for the building (a valuation multiple) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) buildings in similar locations.
- (h) *Cash-generating unit.* A Level 2 input would be a valuation multiple (eg a multiple of earnings or revenue or a similar performance measure) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) businesses, taking into account operational, market, financial and non-financial factors.

### **Level 3 inputs (paragraphs 86-90)**

B36 Examples of Level 3 inputs for particular assets and liabilities include the following:

- (a) *Long-dated currency swap.* A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
- (b) *Three-year option on exchange-traded shares.* A Level 3 input would be historical volatility, ie the volatility for the shares

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derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.

- (c) *Interest rate swap.* A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.
- (d) *Decommissioning liability assumed in a business combination.* A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfill the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, eg a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.
- (e) *Cash-generating unit.* A Level 3 input would be a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

## Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

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- B37 The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine

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whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following:

- (a) There are few recent transactions.
- (b) Price quotations are not developed using current information.
- (c) Price quotations vary substantially either over time or among market-makers (eg some brokered markets).
- (d) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- (e) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.
- (f) There is a wide bid-ask spread or significant increase in the bid-ask spread.
- (g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (ie a primary market) for the asset or liability or similar assets or liabilities.
- (h) Little information is publicly available (eg for transactions that take place in a principal-to-principal market).

**B38** If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will

## *Fair Value Measurement*

be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

- B39 This Ind AS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs 61-66 and B5-B11 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.
- B40 If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.
- B41 Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (ie not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.

- B42 Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. An entity's intention to hold the asset or to settle or otherwise fulfill the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.

**Identifying transactions that are not orderly**

- B43 The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (ie forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

- (a) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- (b) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- (c) The seller is in or near bankruptcy or receivership (ie the seller is distressed).
- (d) The seller was required to sell to meet regulatory or legal requirements (ie the seller was forced).
- (e) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

- B44 An entity shall consider all the following when measuring fair value or estimating market risk premiums:

### *Fair Value Measurement*

- (a) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.
- (b) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:
  - (i) the volume of the transaction.
  - (ii) the comparability of the transaction to the asset or liability being measured.
  - (iii) the proximity of the transaction to the measurement date.
- (c) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (ie the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

#### **Using quoted prices provided by third parties**

- B45 This Ind AS does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this Ind AS.
- B46 If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the

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quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.

- B47 Furthermore, the nature of a quote (eg whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.

## **Appendix C**

### **References to matters contained in other Indian Accounting Standards**

*This appendix is an integral part of the Ind AS.*

This appendix lists the appendices which are part of other Indian Accounting Standards and make reference to Ind AS 113, *Fair Value Measurement*.

- 1 Appendix C, *Determining whether an Arrangement contains a Lease* contained in Ind AS 17, *Leases*.
- 2 Appendix A, *Distributions of Non-cash Assets to Owners* contained in Ind AS 10, *Events After the Reporting Period*.
- 3 Appendix D, *Extinguishing Financial Liabilities with Equity Instruments* contained in Ind AS 109, *Financial Instruments*.

## Appendix 1

*Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 113 and the corresponding International Financial Reporting Standard (IFRS) 13, Fair Value Measurement, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 13, Fair Value Measurement**

- 1 Different terminology is used in this standard, eg, the term 'balance sheet' is used instead of 'Statement of financial position'.
- 2 Paragraph 7(b) refers to IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, which is not relevant for the companies. Hence the paragraph is deleted. In order to maintain consistency with the paragraph numbers of IFRS 13, the paragraph number is retained in Ind AS 113.

## Indian Accounting Standard (Ind AS) 114

# Regulatory Deferral Accounts<sup>#</sup>

(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)

## Objective

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- 1 The objective of this Standard is to specify the financial reporting requirements for *regulatory deferral account balances* that arise when an entity provides goods or services to customers at a price or rate that is subject to *rate regulation*.
- 2 In meeting this objective, the Standard requires:
  - (a) limited changes to the accounting policies that were applied in accordance with previous generally accepted accounting principles (*previous GAAP*) for regulatory deferral account balances, which are primarily related to the presentation of these accounts; and
  - (b) disclosures that:
    - (i) identify and explain the amounts recognised in the entity's financial statements that arise from rate regulation; and
    - (ii) help users of the financial statements to understand the amount, timing and uncertainty of future cash flows from any regulatory deferral account balances that are recognised.
- 3 The requirements of this Standard permit an entity within its scope to continue to account for regulatory deferral account balances in its financial statements in accordance with its previous GAAP when it adopts Ind ASs, subject to the limited changes referred to in paragraph 2 above.
- 4 In addition, this Standard provides some exceptions to, or

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<sup>#</sup> This Ind AS was notified vide G.S.R. 111(E) dated 16<sup>th</sup> February, 2015.

exemptions from, the requirements of other Standards. All specified requirements for reporting regulatory deferral account balances, and any exceptions to, or exemptions from, the requirements of other Standards that are related to those balances, are contained within this Standard instead of within those other Standards.

## Scope

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- 5 **An entity is permitted to apply the requirements of this Standard in its *first Ind AS financial statements* if and only if it:**
- (a) **conducts *rate-regulated activities*; and**
  - (b) **recognised amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP.**
- 6 **An entity shall apply the requirements of this Standard in its financial statements for subsequent periods if and only if, in its first Ind AS financial statements<sup>1</sup>, it recognised regulatory deferral account balances by electing to apply the requirements of this Standard.**
- 7 This Standard does not address other aspects of accounting by entities that are engaged in rate-regulated activities. By applying the requirements in this Standard, any amounts that are permitted or required to be recognised as assets or liabilities in accordance with other Standards shall not be included within the amounts classified as regulatory deferral account balances.
- 8 **An entity that is within the scope of, and that elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances that arise from all of the entity's rate-regulated activities.**

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<sup>1</sup> An entity subject to rate regulation coming into existence after Ind AS coming into force or an entity whose activities become subject to rate regulation as defined in this Ind AS subsequent to preparation and presentation of its first Ind AS financial statements shall be entitled to apply the requirements of the previous GAAP in respect of its such rate regulated activities.

## **Recognition, measurement, impairment and derecognition**

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### **Temporary exemption from paragraph 11 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors**

- 9 **An entity that has rate-regulated activities and that is within the scope of, and elects to apply, this Standard shall apply paragraphs 10 and 12 of Ind AS 8 when developing its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.**
- 10 Paragraphs 11–12 of Ind AS 8 specify sources of requirements and guidance that management is required or permitted to consider in developing an accounting policy for an item, if no relevant Standard applies specifically to that item. This Standard exempts an entity from applying paragraph 11 of Ind AS 8 to its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. Consequently, entities that recognise regulatory deferral account balances, either as separate items or as part of the carrying value of other assets and liabilities, in accordance with previous GAAP, are permitted to continue to recognise those balances in accordance with this Standard through the exemption from paragraph 11 of Ind AS 8, subject to any presentation changes required by paragraphs 18–19 of this Standard.

### **Continuation of existing accounting policies**

- 11 **On initial application of this Standard, an entity shall continue to apply previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances, except for any changes permitted by paragraphs 13–15. However, the presentation of such amounts shall comply with the presentation requirements of this Standard, which may require changes to the entity’s previous GAAP presentation policies (see paragraphs 18–19).**

- 12 An entity shall apply the policies established in accordance with paragraph 11 consistently in subsequent periods, except for any changes permitted by paragraphs 13–15.

### **Changes in accounting policies**

- 13 **An entity shall not change its accounting policies in order to start to recognise regulatory deferral account balances. An entity may only change its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in paragraph 10 of Ind AS 8.**
- 14 This Standard does not exempt entities from applying paragraphs 10 or 14–15 of Ind AS 8 to changes in accounting policy. To justify changing its accounting policies for regulatory deferral account balances, an entity shall demonstrate that the change brings its financial statements closer to meeting the criteria in paragraph 10 of Ind AS 8. However, the change does not need to achieve full compliance with those criteria for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.
- 15 Paragraphs 13–14 apply both to changes made on initial application of this Standard and to changes made in subsequent reporting periods.

### **Interaction with other Standards**

- 16 **Any specific exception, exemption or additional requirements related to the interaction of this Standard with other Standards are contained within this Standard (see paragraphs B7–B28). In the absence of any such exception, exemption or additional requirements, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets, liabilities, income and expenses that are recognised in accordance with other Standards.**

- 17 In some situations, another Standard might need to be applied to a regulatory deferral account balance that has been measured in accordance with an entity's accounting policies that are established in accordance with paragraphs 11–12 in order to reflect that balance appropriately in the financial statements. For example, the entity might have rate-regulated activities in a foreign country for which the transactions and regulatory deferral account balances are denominated in a currency that is not the functional currency of the reporting entity. The regulatory deferral account balances and the movements in those balances are translated by applying Ind AS 21 *The Effects of Changes in Foreign Exchange Rates*.

## Presentation

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### Changes in presentation

- 18 This Standard introduces presentation requirements, outlined in paragraphs 20–26, for regulatory deferral account balances that are recognised in accordance with paragraphs 11–12. When this Standard is applied, the regulatory deferral account balances are recognised in the balance sheet in addition to the assets and liabilities that are recognised in accordance with other Standards. These presentation requirements separate the impact of recognising regulatory deferral account balances from the financial reporting requirements of other Standards.
- 19 In addition to the items that are required to be presented in the balance sheet and in the statement of profit and loss in accordance with Ind AS 1 *Presentation of Financial Statements*, an entity applying this Standard shall present all regulatory deferral account balances and the movements in those balances in accordance with paragraphs 20–26.

### Classification of regulatory deferral account balances

- 20 An entity shall present separate line items in the balance sheet for:
- (a) the total of all regulatory deferral account debit balances; and

(b) the total of all regulatory deferral account credit balances.

- 21 When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet, it shall not classify the totals of regulatory deferral account balances as current or non-current. Instead, the separate line items required by paragraph 20 shall be distinguished from the assets and liabilities that are presented in accordance with other Standards by the use of sub-totals, which are drawn before the regulatory deferral account balances are presented.

### **Classification of movements in regulatory deferral account balances**

- 22 An entity shall present, in the other comprehensive income section of the statement of profit and loss, the net movement in all regulatory deferral account balances for the reporting period that relate to items recognised in other comprehensive income. Separate line items shall be used for the net movement related to items that, in accordance with other Standards:
- (a) will not be reclassified subsequently to profit or loss; and
  - (b) will be reclassified subsequently to profit or loss when specific conditions are met.
- 23 An entity shall present a separate line item in the profit or loss section of the statement of profit and loss, for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total, which is drawn before the net movement in regulatory deferral account balances.
- 24 When an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall present the resulting deferred tax asset (liability) and the related movement in that deferred tax asset

(liability) with the related regulatory deferral account balances and movements in those balances, instead of within the total presented in accordance with Ind AS 12 *Income Taxes* for deferred tax assets (liabilities) and the tax expense (income) (see paragraphs B9–B12).

- 25 When an entity presents a discontinued operation or a disposal group in accordance with Ind AS 105 *Non-current Assets Held for Sale and Discontinued Operations*, the entity shall present any related regulatory deferral account balances and the net movement in those balances, as applicable, with the regulatory deferral account balances and movements in those balances, instead of within the disposal groups or discontinued operations (see paragraphs B19–B22).
- 26 When an entity presents earnings per share in accordance with Ind AS 33 *Earnings per Share*, the entity shall present additional basic and diluted earnings per share, which are calculated using the earnings amounts required by Ind AS 33 but excluding the movements in regulatory deferral account balances (see paragraphs B13–B14).

## Disclosure

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### Objective

- 27 **An entity that elects to apply this Standard shall disclose information that enables users to assess:**
- (a) the nature of, and the risks associated with, the rate regulation that establishes the price(s) that the entity can charge customers for the goods or services it provides; and**
  - (b) the effects of that rate regulation on its financial position, financial performance and cash flows.**
- 28 If any of the disclosures set out in paragraphs 30–36 are not considered relevant to meet the objective in paragraph 27, they may be omitted from the financial statements. If the disclosures provided in accordance with paragraphs 30–36 are insufficient to meet the objective in paragraph 27, an entity shall disclose additional information that is necessary to meet that objective.

- 29 To meet the disclosure objective in paragraph 27, an entity shall consider all of the following:
- (a) the level of detail that is necessary to satisfy the disclosure requirements;
  - (b) how much emphasis to place on each of the various requirements;
  - (c) how much aggregation or disaggregation to undertake; and
  - (d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

### **Explanation of activities subject to rate regulation**

- 30 To help a user of the financial statements assess the nature of, and the risks associated with, the entity's rate-regulated activities, an entity shall, for each type of rate-regulated activity, disclose:
- (a) a brief description of the nature and extent of the rate-regulated activity and the nature of the regulatory rate-setting process;
  - (b) the identity of the rate regulator(s). If the rate regulator is a related party (as defined in Ind AS 24 *Related Party Disclosures*), the entity shall disclose that fact, together with an explanation of how it is related;
  - (c) how the future recovery of each class (ie each type of cost or income) of regulatory deferral account debit balance or reversal of each class of regulatory deferral account credit balance is affected by risks and uncertainty, for example:
    - (i) demand risk (for example, changes in consumer attitudes, the availability of alternative sources of supply or the level of competition);
    - (ii) regulatory risk (for example, the submission or approval of a rate-setting application or the entity's assessment of the expected future regulatory actions); and
    - (iii) other risks (for example, currency or other market risks).
- 31 The disclosures required by paragraph 30 shall be given in the

financial statements either directly in the notes or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. If the information is not included in the financial statements directly or incorporated by cross-reference, the financial statements are incomplete.

### **Explanation of recognised amounts**

- 32 An entity shall disclose the basis on which regulatory deferral account balances are recognised and derecognised, and how they are measured initially and subsequently, including how regulatory deferral account balances are assessed for recoverability and how any impairment loss is allocated.
- 33 For each type of rate-regulated activity, an entity shall disclose the following information for each class of regulatory deferral account balance:
- (a) a reconciliation of the carrying amount at the beginning and the end of the period, in a table unless another format is more appropriate. The entity shall apply judgement in deciding the level of detail necessary (see paragraphs 28–29), but the following components would usually be relevant:
    - (i) the amounts that have been recognised in the current period in the balance sheet as regulatory deferral account balances;
    - (ii) the amounts that have been recognised in the statement of profit and loss relating to balances that have been recovered (sometimes described as amortised) or reversed in the current period; and
    - (iii) other amounts, separately identified, that affected the regulatory deferral account balances, such as impairments, items acquired or assumed in a business combination, items disposed of, or the effects of changes in foreign exchange rates or discount rates;
  - (b) the rate of return or discount rate (including a zero rate or a range of rates, when applicable) used to reflect the time value

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of money that is applicable to each class of regulatory deferral account balance; and

- (c) the remaining periods over which the entity expects to recover (or amortise) the carrying amount of each class of regulatory deferral account debit balance or to reverse each class of regulatory deferral account credit balance.

34 When rate regulation affects the amount and timing of an entity's income tax expense (income), the entity shall disclose the impact of the rate regulation on the amounts of current and deferred tax recognised. In addition, the entity shall separately disclose any regulatory deferral account balance that relates to taxation and the related movement in that balance.

35 When an entity provides disclosures in accordance with Ind AS 112 *Disclosure of Interests in Other Entities* for an interest in a subsidiary, associate or joint venture that has rate-regulated activities and for which regulatory deferral account balances are recognised in accordance with this Standard, the entity shall disclose the amounts that are included for the regulatory deferral account debit and credit balances and the net movement in those balances for the interests disclosed (see paragraphs B25–B28).

36 When an entity concludes that a regulatory deferral account balance is no longer fully recoverable or reversible, it shall disclose that fact, the reason why it is not recoverable or reversible and the amount by which the regulatory deferral account balance has been reduced.

## Appendix A

### Defined terms

*This appendix is an integral part of the Standard.*

**First Ind AS financial statements** The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS.

**First-time adopter** An entity that presents its **first Ind AS financial statements**.

**Previous GAAP** The basis of accounting that a **first-time adopter** used immediately before adopting Ind ASs for its reporting requirements in India. For instance, for companies preparing their financial statements in accordance with the existing Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 shall consider those financial statements as previous GAAP financial statements.

***Explanation:***

*Guidance Note on Accounting for the Rate Regulated Activities, issued by the Institute of Chartered Accountants of India (ICAI) shall be considered to be the previous GAAP.*

**Rate-regulated activities** An entity's activities that are subject to **rate regulation**.

**Rate regulation** '**Cost of Service Regulation**' as defined in the Guidance Note on *Accounting for Rate Regulated Activities*.

**Rate regulator** '**Regulator**' as defined in the Guidance Note on *Accounting for Rate Regulated Activities*.

**Regulatory deferral account balance** A '**Regulatory Asset**' or a '**Regulatory Liability**' as defined in the Guidance Note on *Accounting for Rate Regulated Activities*.

## Appendix B

### Application Guidance

*This appendix is an integral part of the Standard.*

#### Rate-regulated activities

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- B1 Historically, rate regulation applied to all activities of an entity. However, with acquisitions, diversification and deregulation, rate regulation may now apply to only a portion of an entity's activities, resulting in it having both regulated and non-regulated activities. This Standard applies only to the rate-regulated activities that are subject to statutory or regulatory restrictions through the actions of a rate regulator, regardless of the type of entity or the industry to which it belongs.
- B2 An entity shall not apply this Standard to activities that are self-regulated, ie activities that are not subject to a pricing framework that is overseen and/or approved by a rate regulator.

#### Continuation of existing accounting policies

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- B3 For the purposes of this Standard, a regulatory deferral account balance is defined as the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. Some items of expense (income) may be outside the regulated rate(s) because, for example, the amounts are not expected to be accepted by the rate regulator or because they are not within the scope of the rate regulation. Consequently, such an item is recognised as income or expense as incurred, unless another Standard permits or requires it to be included in the carrying amount of an asset or liability.
- B4 In some cases, other Standards explicitly prohibit an entity from recognising, in the balance sheet, regulatory deferral account balances that might be recognised, either separately or included

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within other line items such as property, plant and equipment in accordance with previous GAAP accounting policies. However, in accordance with paragraph 11 of this Standard, an entity that elects to apply this Standard in its first Ind AS financial statements applies the exemption from paragraph 11 of Ind AS 8 in order to continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment, and derecognition of regulatory deferral account balances. Such accounting policies may include, for example, the following practices:

- (a) recognising a regulatory deferral account debit balance when the entity has the right, as a result of the actual or expected actions of the rate regulator, to increase rates in future periods in order to recover its allowable costs (ie the costs for which the regulated rate(s) is intended to provide recovery);
- (b) recognising, as a regulatory deferral account debit or credit balance, an amount that is equivalent to any loss or gain on the disposal or retirement of both items of property, plant and equipment and of intangible assets, which is expected to be recovered or reversed through future rates;
- (c) recognising a regulatory deferral account credit balance when the entity is required, as a result of the actual or expected actions of the rate regulator, to decrease rates in future periods in order to reverse over-recoveries of allowable costs (ie amounts in excess of the recoverable amount specified by the rate regulator); and
- (d) measuring regulatory deferral account balances on an undiscounted basis or on a discounted basis that uses an interest or discount rate specified by the rate regulator.

B5 The following are examples of the types of costs that rate regulators might allow in rate-setting decisions and that an entity might, therefore, recognise in regulatory deferral account balances:

- (i) volume or purchase price variances;
- (ii) costs of approved 'green energy' initiatives (in excess of amounts that are capitalised as part of the cost of property, plant and equipment in accordance with Ind AS 16 *Property, Plant and Equipment*);

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- (iii) non-directly-attributable overhead costs that are treated as capital costs for rate regulation purposes (but are not permitted, in accordance with Ind AS 16, to be included in the cost of an item of property, plant and equipment);
- (iv) project cancellation costs;
- (v) storm damage costs; and
- (vi) deemed interest (including amounts allowed for funds that are used during construction that provide the entity with a return on the owner's equity capital as well as borrowings).

B6 Regulatory deferral account balances usually represent timing differences between the recognition of items of income or expenses for regulatory purposes and the recognition of those items for financial reporting purposes. When an entity changes an accounting policy on the first-time adoption of Ind AS or on the initial application of a new or revised Standard, new or revised timing differences may arise that create new or revised regulatory deferral account balances. The prohibition in paragraph 13 that prevents an entity from changing its accounting policy in order to start to recognise regulatory deferral account balances does not prohibit the recognition of the new or revised regulatory deferral account balances that are created because of other changes in accounting policies required by Ind AS. This is because the recognition of regulatory deferral account balances for such timing differences would be consistent with the existing recognition policy applied in accordance with paragraph 11 and would not represent the introduction of a new accounting policy. Similarly, paragraph 13 does not prohibit the recognition of regulatory deferral account balances arising from timing differences that did not exist immediately prior to the date of transition to Ind AS but are consistent with the entity's accounting policies established in accordance with paragraph 11 (for example, storm damage costs).

## **Applicability of other Standards**

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B7 An entity that is within the scope of, and that elects to apply, the requirements of this Standard shall continue to apply its previous GAAP accounting policies for the recognition, measurement,

impairment and derecognition of regulatory deferral account balances. However, paragraphs 16–17 state that, in some situations, other Standards might also need to be applied to regulatory deferral account balances in order to reflect them appropriately in the financial statements. The following paragraphs outline how some other Standards interact with the requirements of this Standard. In particular, the following paragraphs clarify specific exceptions to, and exemptions from, other Standards and additional presentation and disclosure requirements that are expected to be applicable.

### **Application of Ind AS 10 *Events after the Reporting Period***

- B8 An entity may need to use estimates and assumptions in the recognition and measurement of its regulatory deferral account balances. For events that occur between the end of the reporting period and the date when the financial statements are authorised for issue, the entity shall apply Ind AS 10 to identify whether those estimates and assumptions should be adjusted to reflect those events.

### **Application of Ind AS 12 *Income Taxes***

- B9 Ind AS 12 requires, with certain limited exceptions, an entity to recognise a deferred tax liability and (subject to certain conditions) a deferred tax asset for all temporary differences. A rate-regulated entity shall apply Ind AS 12 to all of its activities, including its rate-regulated activities, to identify the amount of income tax that is to be recognised.
- B10 In some rate-regulatory schemes, the rate regulator permits or requires an entity to increase its future rates in order to recover some or all of the entity's income tax expense. In such circumstances, this might result in the entity recognising a regulatory deferral account balance in the balance sheet related to income tax, in accordance with its accounting policies established in accordance with paragraphs 11–12. The recognition of this regulatory deferral account balance that relates to income tax might itself create an additional temporary difference for which a further deferred tax amount would be recognised.

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- B11 Notwithstanding the presentation and disclosure requirements of Ind AS 12, when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall not include that deferred tax amount within the total deferred tax asset (liability) balances. Instead, the entity shall present the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances either:
- (a) with the line items that are presented for the regulatory deferral account debit balances and credit balances; or
  - (b) as a separate line item alongside the related regulatory deferral account debit balances and credit balances.
- B12 Similarly, when an entity recognises the movement in a deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances, the entity shall not include the movement in that deferred tax amount within the tax expense (income) line item that is presented in the statement of profit and loss in accordance with Ind AS 12. Instead, the entity shall present the movement in the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances either:
- (a) with the line items that are presented in the statement of profit and loss for the movements in regulatory deferral account balances; or
  - (b) as a separate line item alongside the related line items that are presented in the statement of profit and loss for the movements in regulatory deferral account balances.

**Application of Ind AS 33 *Earnings per Share***

- B13 Paragraph 66 of Ind AS 33 requires some entities to present, in the statement of profit and loss, basic and diluted earnings per share both for profit or loss from continuing operations and profit or loss that is attributable to the ordinary equity holders of the parent entity. In addition, paragraph 68 of Ind AS 33 requires an entity that reports a discontinued operation to disclose the basic and diluted amounts per share for the discontinued operation, either in the statement of profit or loss and other comprehensive income or in the notes.
- B14 For each earnings per share amount presented in accordance with

Ind AS 33, an entity applying this Standard shall present additional basic and diluted earnings per share amounts that are calculated in the same way, except that those amounts shall exclude the net movement in the regulatory deferral account balances. Consistent with the requirement in paragraph 73 of Ind AS 33, an entity shall present the earnings per share required by paragraph 26 of this Standard with equal prominence to the earnings per share required by Ind AS 33 for all periods presented.

### **Application of Ind AS 36 *Impairment of Assets***

- B15 Paragraphs 11–12 require an entity to continue to apply its previous GAAP accounting policies for the identification, recognition, measurement and reversal of any impairment of its recognised regulatory deferral account balances. Consequently, Ind AS 36 does not apply to the separate regulatory deferral account balances recognised.
- B16 However, Ind AS 36 might require an entity to perform an impairment test on a cash-generating unit (CGU) that includes regulatory deferral account balances. This test might be required because the CGU contains goodwill, or because one or more of the impairment indicators described in Ind AS 36 have been identified relating to the CGU. In such situations, paragraphs 74–79 of Ind AS 36 contain requirements for identifying the recoverable amount and the carrying amount of a CGU. An entity shall apply those requirements to decide whether any of the regulatory deferral account balances recognised are included in the carrying amount of the CGU for the purpose of the impairment test. The remaining requirements of Ind AS 36 shall then be applied to any impairment loss that is recognised as a result of this test.

### **Application of Ind AS 103 *Business Combinations***

- B17 The core principle of Ind AS 103 is that an acquirer of a business recognises the assets acquired and the liabilities assumed at their acquisition-date fair values. Ind AS 103 provides limited exceptions to its recognition and measurement principles. Paragraph B18 of this Standard provides an additional exception.
- B18 Paragraphs 11–12 require an entity to continue to apply its previous

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GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. Consequently, if an entity acquires a business, it shall apply, in its consolidated financial statements, its accounting policies established in accordance with paragraphs 11–12 for the recognition and measurement of the acquiree's regulatory deferral account balances at the date of acquisition. The acquiree's regulatory deferral account balances shall be recognised in the consolidated financial statements of the acquirer in accordance with the acquirer's policies, irrespective of whether the acquiree recognises those balances in its own financial statements.

***Application of Ind AS 105 Non-current Assets Held for Sale and Discontinued Operations***

- B19 Paragraphs 11–12 require an entity to continue to apply its previous accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. Consequently, the measurement requirements of Ind AS 105 shall not apply to the regulatory deferral account balances recognised.
- B20 Paragraph 33 of Ind AS 105 requires a single amount to be presented for discontinued operations in the statement of profit and loss. Notwithstanding the requirements of that paragraph, when an entity that elects to apply this Standard presents a discontinued operation, it shall not include the movement in regulatory deferral account balances that arose from the rate-regulated activities of the discontinued operation within the line items that are required by paragraph 33 of Ind AS 105. Instead, the entity shall present the movement in regulatory deferral account balances that arose from the rate-regulated activities of the discontinued operation either:
- (a) within the line item that is presented for movements in the regulatory deferral account balances related to profit or loss;  
or
  - (b) as a separate line item alongside the related line item that is presented for movements in the regulatory deferral account balances related to profit or loss
- B21 Similarly, notwithstanding the requirements of paragraph 38 of Ind

AS 105, when an entity presents a disposal group, the entity shall not include the total of the regulatory deferral account debit balances and credit balances that are part of the disposal group within the line items that are required by paragraph 38 of Ind AS 105. Instead, the entity shall present the total of the regulatory deferral account debit balances and credit balances that are part of the disposal group either:

- (a) within the line items that are presented for the regulatory deferral account debit balances and credit balances; or
- (b) as separate line items alongside the other regulatory deferral account debit balances and credit balances.

B22 If the entity chooses to include the regulatory deferral account balances and movements in those balances that are related to the disposal group or discontinued operation within the related regulated deferral account line items, it may be necessary to disclose them separately as part of the analysis of the regulatory deferral account line items described by paragraph 33 of this Standard.

***Application of Ind AS 110 Consolidated Financial Statements and Ind AS 28 Investments in Associates and Joint Ventures***

B23 Paragraph 19 of Ind 110 requires that a “parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances”. Paragraph 8 of this Standard requires that an entity that is within the scope of, and elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances arising from all of the entity’s rate-regulated activities. Consequently, if a parent recognises regulatory deferral account balances in its consolidated financial statements in accordance with this Standard, it shall apply the same accounting policies to the regulatory deferral account balances arising in all of its subsidiaries. This shall apply irrespective of whether the subsidiaries recognise those balances in their own financial statements.

B24 Similarly, paragraphs 35–36 of Ind AS 28 require that, in applying the equity method, an “entity’s financial statements shall be

prepared using uniform accounting policies for like transactions and events in similar circumstances". Consequently, adjustments shall be made to make the associate's or joint venture's accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances conform to those of the investing entity in applying the equity method.

### **Application of Ind AS 112 *Disclosure of Interests in Other Entities***

- B25 Paragraph 12(e) of Ind AS 112 requires an entity to disclose, for each of its subsidiaries that have non-controlling interests that are material to the reporting entity, the profit or loss that was allocated to non-controlling interests of the subsidiary during the reporting period. An entity that recognises regulatory deferral account balances in accordance with this Standard shall disclose the net movement in regulatory deferral account balances that is included within the amounts that are required to be disclosed by paragraph 12(e) of Ind AS 112.
- B26 Paragraph 12(g) of Ind AS 112 requires an entity to disclose, for each of its subsidiaries that have non-controlling interests that are material to the reporting entity, summarised financial information about the subsidiary, as specified in paragraph B10 of Ind AS 112. Similarly, paragraph 21(b)(ii) of Ind AS 112 requires an entity to disclose, for each joint venture and associate that is material to the reporting entity, summarised financial information as specified in paragraphs B12–B13 of Ind AS 112. Paragraph B16 of Ind AS 112 specifies the summary financial information that an entity is required to disclose for all other associates and joint ventures that are not individually material in accordance with paragraph 21(c) of Ind AS 112.
- B27 In addition to the information specified in paragraphs 12, 21, B10, B12–B13 and B16 of Ind AS 112, an entity that recognises regulatory deferral account balances in accordance with this Standard shall also disclose the total regulatory deferral account debit balance, the total regulatory deferral account credit balance and the net movements in those balances, split between amounts recognised in profit or loss and amounts recognised as other

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comprehensive income, for each entity for which those Ind AS 112 disclosures are required.

- B28 Paragraph 19 of Ind AS 112 specifies the information that an entity is required to disclose when the entity recognises a gain or loss on losing control of a subsidiary, calculated in accordance with paragraph 25 of Ind AS 110. In addition to the information required by paragraph 19 of Ind AS 112, an entity that elects to apply this Standard shall disclose the portion of that gain or loss that is attributable to derecognising regulatory deferral account balances in the former subsidiary at the date when control is lost.

## Appendix 1

*Note: This Appendix is not a part of this Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences, if any, between Indian Accounting Standard (Ind AS) 114 and the corresponding International Financial Reporting Standard (IFRS) 14, Regulatory Deferral Accounts.*

### **Comparison with IFRS 14, Regulatory Deferral Accounts**

1. Appendix A, Defined terms have been modified to clarify that Guidance Note of Accounting for Rate Regulated Activities would be considered as the previous GAAP for the purpose of Ind AS 114.
2. Under paragraph 6 of Ind AS 114, a footnote has been added to clarify the application of requirements of previous GAAP in the case of an entity subject to rate regulation coming into existence after Ind AS coming into force or an entity whose activities become subject to rate regulation as defined in this Ind AS subsequent to preparation and presentation of its first Ind AS financial statements.
3. Different terminology is used in this standard, e.g., the term 'balance sheet' is used instead of 'Statement of financial position', and 'Statement of profit and loss' is used instead of 'Statement of Profit and Loss and comprehensive income'.

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*(The Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

### Objective

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- 1 The objective of this Standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.**

#### **Meeting the objective**

- 2 To meet the objective in paragraph 1, the core principle of this Standard is that an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.
- 3 An entity shall consider the terms of the contract and all relevant facts and circumstances when applying this Standard. An entity shall apply this Standard, including the use of any practical expedients, consistently to contracts with similar characteristics and in similar circumstances.
- 4 This Standard specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or *performance obligations*) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use

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<sup>#</sup> This Ind AS was notified vide G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

estimates and assumptions that reflect the size and composition of the portfolio.

## Scope

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- 5 An entity shall apply this Standard to all contracts with customers, except the following:
- (a) lease contracts within the scope of Ind AS 17, *Leases*;
  - (b) insurance contracts within the scope of Ind AS 104, *Insurance Contracts*;
  - (c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109, *Financial Instruments*, Ind AS 110, *Consolidated Financial Statements*, Ind AS 111, *Joint Arrangements*, Ind AS 27, *Separate Financial Statements* and Ind AS 28, *Investments in Associates and Joint Ventures*; and
  - (d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.
- 6 An entity shall apply this Standard to a contract (other than a contract listed in paragraph 5) only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.
- 7 A contract with a customer may be partially within the scope of this Standard and partially within the scope of other Standards listed in paragraph 5.

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- (a) If the other Standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement requirements in those Standards. An entity shall exclude from the *transaction price* the amount of the part (or parts) of the contract that are initially measured in accordance with other Standards and shall apply paragraphs 73–86 to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of this Standard and to any other parts of the contract identified by paragraph 7(b).
  - (b) If the other Standards do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply this Standard to separate and/or initially measure the part (or parts) of the contract.
- 8 This Standard specifies the accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfil a contract with a customer if those costs are not within the scope of another Standard (see paragraphs 91–104). An entity shall apply those paragraphs only to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of this Standard.

## Recognition

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### Identifying the contract

- 9 **An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:**
- (a) **the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;**
  - (b) **the entity can identify each party's rights regarding the goods or services to be transferred;**
  - (c) **the entity can identify the payment terms for the goods or services to be transferred;**

- (d) **the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and**
- (e) **it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).**

- 10 A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.
- 11 Some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply this Standard to the duration of the contract (ie the contractual period) in which the parties to the contract have present enforceable rights and obligations.
- 12 For the purpose of applying this Standard, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). A contract is wholly unperformed if both of the following criteria are met:

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- (a) the entity has not yet transferred any promised goods or services to the customer; and
  - (b) the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.
- 13 If a contract with a customer meets the criteria in paragraph 9 at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer.
- 14 If a contract with a customer does not meet the criteria in paragraph 9, an entity shall continue to assess the contract to determine whether the criteria in paragraph 9 are subsequently met.
- 15 When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:
- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
  - (b) the contract has been terminated and the consideration received from the customer is non-refundable.
- 16 An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14). Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

### **Combination of contracts**

- 17 An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:
- (a) the contracts are negotiated as a package with a single commercial objective;
  - (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
  - (c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30.

### **Contract modifications**

- 18 A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. In some industries and jurisdictions, a contract modification may be described as a change order, a variation or an amendment. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement or implied by customary business practices. If the parties to the contract have not approved a contract modification, an entity shall continue to apply this Standard to the existing contract until the contract modification is approved.
- 19 A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, an entity shall consider all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity shall

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estimate the change to the transaction price arising from the modification in accordance with paragraphs 50–54 on estimating variable consideration and paragraphs 56–58 on constraining estimates of variable consideration.

20 An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

- (a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and
- (b) the price of the contract increases by an amount of consideration that reflects the entity's *stand-alone selling prices* of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the stand-alone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.

21 If a contract modification is not accounted for as a separate contract in accordance with paragraph 20, an entity shall account for the promised goods or services not yet transferred at the date of the contract modification (ie the remaining promised goods or services) in whichever of the following ways is applicable:

- (a) An entity shall account for the contract modification as if it were a termination of the existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification. The amount of consideration to be allocated to the remaining performance obligations (or to the remaining distinct goods or services in a single performance obligation identified in accordance with paragraph 22(b)) is the sum of:
  - (i) the consideration promised by the customer (including amounts already received from the customer) that was

included in the estimate of the transaction price and that had not been recognised as revenue; and

- (ii) the consideration promised as part of the contract modification.
- (b) An entity shall account for the contract modification as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification. The effect that the contract modification has on the transaction price, and on the entity's measure of progress towards complete satisfaction of the performance obligation, is recognised as an adjustment to revenue (either as an increase in or a reduction of revenue) at the date of the contract modification (ie the adjustment to revenue is made on a cumulative catch-up basis).
- (c) If the remaining goods or services are a combination of items (a) and (b), then the entity shall account for the effects of the modification on the unsatisfied (including partially unsatisfied) performance obligations in the modified contract in a manner that is consistent with the objectives of this paragraph.

### **Identifying performance obligations**

- 22 **At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:**
  - (a) **a good or service (or a bundle of goods or services) that is distinct; or**
  - (b) **a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).**
- 23 A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:
  - (a) each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in

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paragraph 35 to be a performance obligation satisfied over time; and

- (b) in accordance with paragraphs 39–40, the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

### **Promises in contracts with customers**

- 24 A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.
- 25 Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

### **Distinct goods or services**

- 26 Depending on the contract, promised goods or services may include, but are not limited to, the following:
  - (a) sale of goods produced by an entity (for example, inventory of a manufacturer);
  - (b) resale of goods purchased by an entity (for example, merchandise of a retailer);
  - (c) resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs B34–B38);

- (d) performing a contractually agreed-upon task (or tasks) for a customer;
- (e) providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides;
- (f) providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs B34–B38);
- (g) granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer);
- (h) constructing, manufacturing or developing an asset on behalf of a customer;
- (i) granting licences (see paragraphs B52–B63B); and
- (j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43).

27 A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).

28 A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or

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services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

29 In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

- (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.
- (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
- (c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is

significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

- 30 If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

### **Satisfaction of performance obligations**

- 31 **An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**
- 32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.
- 33 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:
- (a) using the asset to produce goods or provide services (including public services);
  - (b) using the asset to enhance the value of other assets;
  - (c) using the asset to settle liabilities or reduce expenses;

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- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset.

34 When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset (see paragraphs B64–B76).

**Performance obligations satisfied over time**

35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);
- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

36 An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation. Paragraphs B6–B8 provide guidance for assessing whether an asset has an alternative use to an entity.

37 An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an

enforceable right to payment for performance completed to date in accordance with paragraph 35(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Paragraphs B9–B13 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.

**Performance obligations satisfied at a point in time**

38 If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- (a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
- (b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

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- (c) The entity has transferred physical possession of the asset—the customer’s physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.
- (d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
- (e) The customer has accepted the asset—the customer’s acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs B83–B86.

**Measuring progress towards complete satisfaction of a performance obligation**

- 39 For each performance obligation satisfied over time in accordance with paragraphs 35–37, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity’s performance in transferring control of goods or services promised to a customer (ie the satisfaction of an entity’s performance obligation).
- 40 An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

*Methods for measuring progress*

- 41 Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14–B19 provide guidance for using output methods and input methods to measure an entity’s progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.
- 42 When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.
- 43 As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity’s measure of progress shall be accounted for as a change in accounting estimate in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

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### *Reasonable measures of progress*

- 44 An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress towards complete satisfaction of a performance obligation if it lacks reliable information that would be required to apply an appropriate method of measuring progress.
- 45 In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

## **Measurement**

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- 46 **When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation.**

### **Determining the transaction price**

- 47 **An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.**
- 48 The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When

determining the transaction price, an entity shall consider the effects of all of the following:

- (a) variable consideration (see paragraphs 50–55 and 59);
- (b) constraining estimates of variable consideration (see paragraphs 56–58);
- (c) the existence of a significant financing component in the contract (see paragraphs 60–65);
- (d) non-cash consideration (see paragraphs 66–69); and
- (e) consideration payable to a customer (see paragraphs 70–72).

- 49 For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

#### **Variable consideration**

- 50 If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.
- 51 An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.
- 51AA In some contracts, penalties are specified. In such cases, penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration. For example, where an entity agrees to transfer control of a good or service in a contract with customer at the end of 30 days for Rs. 1,00,000 and if it exceeds 30 days, the entity is entitled to receive only Rs. 95,000, the reduction

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of Rs. 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

- 52 The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:
- (a) the customer has a valid expectation arising from an entity's customary business practices, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.
  - (b) other facts and circumstances indicate that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.
- 53 An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:
- (a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
  - (b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).
- 54 An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount

of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

*Refund liabilities*

- 55 An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (ie amounts not included in the transaction price). The refund liability (and corresponding change in the transaction price and, therefore, the *contract liability*) shall be updated at the end of each reporting period for changes in circumstances. To account for a refund liability relating to a sale with a right of return, an entity shall apply the guidance in paragraphs B20–B27.

*Constraining estimates of variable consideration*

- 56 An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.
- 57 In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:
- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include

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volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

- (b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- (c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) the contract has a large number and broad range of possible consideration amounts.

58 An entity shall apply paragraph B63 to account for consideration in the form of a sales-based or usage-based royalty that is promised in exchange for a licence of intellectual property.

*Reassessment of variable consideration*

59 At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with paragraphs 87–90.

**The existence of a significant financing component in the contract**

60 In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing

is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

- 61 The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:
- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and
  - (b) the combined effect of both of the following:
    - (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
    - (ii) the prevailing interest rates in the relevant market.
- 62 Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:
- (a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.
  - (b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).
  - (c) the difference between the promised consideration and the cash selling price of the good or service (as described in

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paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

- 63 As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.
- 64 To meet the objective in paragraph 61 when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).
- 65 An entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a *contract asset* (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

**Non-cash consideration**

- 66 To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.
- 67 If an entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.
- 68 The fair value of the non-cash consideration may vary because of the form of the consideration (for example, a change in the price of a share to which an entity is entitled to receive from a customer). If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), an entity shall apply the requirements in paragraphs 56–58.
- 69 If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

**Consideration payable to a customer**

- 70 Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the

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entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.

- 71 If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.
- 72 Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:
- (a) the entity recognises revenue for the transfer of the related goods or services to the customer; and
  - (b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

### **Allocating the transaction price to performance obligations**

- 73 **The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.**
- 74 To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis in accordance

with paragraphs 76–80, except as specified in paragraphs 81–83 (for allocating discounts) and paragraphs 84–86 (for allocating consideration that includes variable amounts).

- 75 Paragraphs 76–86 do not apply if a contract has only one performance obligation. However, paragraphs 84–86 may apply if an entity promises to transfer a series of distinct goods or services identified as a single performance obligation in accordance with paragraph 22(b) and the promised consideration includes variable amounts.

**Allocation based on stand-alone selling prices**

- 76 To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.
- 77 The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service.
- 78 If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.
- 79 Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

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- (a) Adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- (b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.
- (c) Residual approach—an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 78, the stand-alone selling price of a good or service only if one of the following criteria is met:
  - (i) the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or
  - (ii) the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

80 A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, an entity may use a residual approach to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices and then use another method to estimate the stand-alone selling prices of the individual

goods or services relative to that estimated aggregate stand-alone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the stand-alone selling price of each promised good or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective in paragraph 73 and the requirements for estimating stand-alone selling prices in paragraph 78.

**Allocation of a discount**

- 81 A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract. Except when an entity has observable evidence in accordance with paragraph 82 that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services.
- 82 An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:
- (a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;
  - (b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and
  - (c) the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the

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performance obligation (or performance obligations) to which the entire discount in the contract belongs.

- 83 If a discount is allocated entirely to one or more performance obligations in the contract in accordance with paragraph 82, an entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service in accordance with paragraph 79(c).

**Allocation of variable consideration**

- 84 Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract, such as either of the following:

- (a) one or more, but not all, performance obligations in the contract (for example, a bonus may be contingent on an entity transferring a promised good or service within a specified period of time); or
- (b) one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation in accordance with paragraph 22(b) (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index).

- 85 An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) if both of the following criteria are met:

- (a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and
- (b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when

considering all of the performance obligations and payment terms in the contract.

- 86 The allocation requirements in paragraphs 73–83 shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 85.

### **Changes in the transaction price**

- 87 After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.
- 88 An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.
- 89 An entity shall allocate a change in the transaction price entirely to one or more, but not all, performance obligations or distinct goods or services promised in a series that forms part of a single performance obligation in accordance with paragraph 22(b) only if the criteria in paragraph 85 on allocating variable consideration are met.
- 90 An entity shall account for a change in the transaction price that arises as a result of a contract modification in accordance with paragraphs 18–21. However, for a change in the transaction price that occurs after a contract modification, an entity shall apply paragraphs 87–89 to allocate the change in the transaction price in whichever of the following ways is applicable:
- (a) An entity shall allocate the change in the transaction price to the performance obligations identified in the contract before the modification if, and to the extent that, the change in the transaction price is attributable to an amount of variable consideration promised before the modification and the

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modification is accounted for in accordance with paragraph 21(a).

- (b) In all other cases in which the modification was not accounted for as a separate contract in accordance with paragraph 20, an entity shall allocate the change in the transaction price to the performance obligations in the modified contract (ie the performance obligations that were unsatisfied or partially unsatisfied immediately after the modification).

## Contract costs

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### Incremental costs of obtaining a contract

- 91 **An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.**
- 92 The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).
- 93 Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.
- 94 As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.

### Costs to fulfil a contract

- 95 **If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, *Inventories*, Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:**

- (a) **the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);**
  - (b) **the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and**
  - (c) **the costs are expected to be recovered.**
- 96 For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.
- 97 Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:
- (a) direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);
  - (b) direct materials (for example, supplies used in providing the promised services to a customer);
  - (c) allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);
  - (d) costs that are explicitly chargeable to the customer under the contract; and
  - (e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).
- 98 An entity shall recognise the following costs as expenses when incurred:
- (a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 97);

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- (b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;
- (c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance); and
- (d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

### **Amortisation and impairment**

- 99 An asset recognised in accordance with paragraph 91 or 95 shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under a specific anticipated contract (as described in paragraph 95(a)).
- 100 An entity shall update the amortisation to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change shall be accounted for as a change in accounting estimate in accordance with Ind AS 8.
- 101 An entity shall recognise an impairment loss in profit or loss to the extent that the carrying amount of an asset recognised in accordance with paragraph 91 or 95 exceeds:
- (a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less
  - (b) the costs that relate directly to providing those goods or services and that have not been recognised as expenses (see paragraph 97).
- 102 For the purposes of applying paragraph 101 to determine the amount of consideration that an entity expects to receive, an entity shall use the principles for determining the transaction price (except for the requirements in paragraphs 56–58 on constraining estimates

of variable consideration) and adjust that amount to reflect the effects of the customer's credit risk.

- 103 Before an entity recognises an impairment loss for an asset recognised in accordance with paragraph 91 or 95, the entity shall recognise any impairment loss for assets related to the contract that are recognised in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38). After applying the impairment test in paragraph 101, an entity shall include the resulting carrying amount of the asset recognised in accordance with paragraph 91 or 95 in the carrying amount of the cash-generating unit to which it belongs for the purpose of applying Ind AS 36, *Impairment of Assets*, to that cash-generating unit.
- 104 An entity shall recognise in profit or loss a reversal of some or all of an impairment loss previously recognised in accordance with paragraph 101 when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

## Presentation

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- 105 **When either party to a contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.**
- 106 If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (ie a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.
- 107 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due,

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the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with Ind AS 109. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of Ind AS 109 (see also paragraph 113(b)).

- 108 A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with Ind AS 109. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).
- 109 This Standard uses the terms 'contract asset' and 'contract liability' but does not prohibit an entity from using alternative descriptions in the balance sheet for those items. If an entity uses an alternative description for a contract asset, the entity shall provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets.
- 109AA An entity shall present separately the amount of excise duty included in the revenue recognised in the statement of profit and loss.

## **Disclosure**

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- 110 **The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall**

**disclose qualitative and quantitative information about all of the following:**

- (a) its contracts with customers (see paragraphs 113–122);**
- (b) the significant judgements, and changes in the judgements, made in applying this Standard to those contracts (see paragraphs 123–126); and**
- (c) any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with paragraph 91 or 95 (see paragraphs 127–128).**

111 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.

112 An entity need not disclose information in accordance with this Standard if it has provided the information in accordance with another Standard.

### **Contracts with customers**

113 An entity shall disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of profit and loss in accordance with other Standards:

- (a) revenue recognised from contracts with customers, which the entity shall disclose separately from its other sources of revenue; and**
- (b) any impairment losses recognised (in accordance with Ind AS 109) on any receivables or contract assets arising from an entity's contracts with customers, which the entity shall disclose separately from impairment losses from other contracts.**

### **Disaggregation of revenue**

114 An entity shall disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing

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and uncertainty of revenue and cash flows are affected by economic factors. An entity shall apply the guidance in paragraphs B87–B89 when selecting the categories to use to disaggregate revenue.

- 115 In addition, an entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 114) and revenue information that is disclosed for each reportable segment, if the entity applies Ind AS 108, *Operating Segments*.

### **Contract balances**

- 116 An entity shall disclose all of the following:
- (a) the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed;
  - (b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and
  - (c) revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price).
- 117 An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 119(a)) relates to the typical timing of payment (see paragraph 119(b)) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information.
- 118 An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information. Examples of changes in the entity's balances of contract assets and contract liabilities include any of the following:
- (a) changes due to business combinations;
  - (b) cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including

adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained) or a contract modification;

- (c) impairment of a contract asset;
- (d) a change in the time frame for a right to consideration to become unconditional (ie for a contract asset to be reclassified to a receivable); and
- (e) a change in the time frame for a performance obligation to be satisfied (ie for the recognition of revenue arising from a contract liability).

#### **Performance obligations**

119 An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:

- (a) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement;
- (b) the significant payment terms (for example, when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable and whether the estimate of variable consideration is typically constrained in accordance with paragraphs 56–58);
- (c) the nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (ie if the entity is acting as an agent);
- (d) obligations for returns, refunds and other similar obligations; and
- (e) types of warranties and related obligations.

**Transaction price allocated to the remaining performance obligations**

- 120 An entity shall disclose the following information about its remaining performance obligations:
- (a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and
  - (b) an explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with paragraph 120(a), which the entity shall disclose in either of the following ways:
    - (i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or
    - (ii) by using qualitative information.
- 121 As a practical expedient, an entity need not disclose the information in paragraph 120 for a performance obligation if either of the following conditions is met:
- (a) the performance obligation is part of a contract that has an original expected duration of one year or less; or
  - (b) the entity recognises revenue from the satisfaction of the performance obligation in accordance with paragraph B16.
- 122 An entity shall explain qualitatively whether it is applying the practical expedient in paragraph 121 and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with paragraph 120. For example, an estimate of the transaction price would not include any estimated amounts of variable consideration that are constrained (see paragraphs 56–58).

**Significant judgements in the application of this Standard**

- 123 An entity shall disclose the judgements, and changes in the judgements, made in applying this Standard that significantly affect

the determination of the amount and timing of revenue from contracts with customers. In particular, an entity shall explain the judgements, and changes in the judgements, used in determining both of the following:

- (a) the timing of satisfaction of performance obligations (see paragraphs 124–125); and
- (b) the transaction price and the amounts allocated to performance obligations (see paragraph 126).

**Determining the timing of satisfaction of performance obligations**

124 For performance obligations that an entity satisfies over time, an entity shall disclose both of the following:

- (a) the methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied); and
- (b) an explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

125 For performance obligations satisfied at a point in time, an entity shall disclose the significant judgements made in evaluating when a customer obtains control of promised goods or services.

**Determining the transaction price and the amounts allocated to performance obligations**

126 An entity shall disclose information about the methods, inputs and assumptions used for all of the following:

- (a) determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration;
- (b) assessing whether an estimate of variable consideration is constrained;
- (c) allocating the transaction price, including estimating stand-alone selling prices of promised goods or services and

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allocating discounts and variable consideration to a specific part of the contract (if applicable); and

- (d) measuring obligations for returns, refunds and other similar obligations.

126AA An entity shall reconcile the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price, for example, on account of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, etc., specifying the nature and amount of each such adjustment separately.

### **Assets recognised from the costs to obtain or fulfil a contract with a customer**

127 An entity shall describe both of the following:

- (a) the judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95); and
- (b) the method it uses to determine the amortisation for each reporting period.

128 An entity shall disclose all of the following:

- (a) the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95), by main category of asset (for example, costs to obtain contracts with customers, pre-contract costs and setup costs); and
- (b) the amount of amortisation and any impairment losses recognised in the reporting period.

### **Practical expedients**

129 If an entity elects to use the practical expedient in either paragraph 63 (about the existence of a significant financing component) or paragraph 94 (about the incremental costs of obtaining a contract), the entity shall disclose that fact.

## Appendix A

### Defined terms

*This appendix is an integral part of the Standard.*

<b>contract</b>	An agreement between two or more parties that creates enforceable rights and obligations.
<b>contract asset</b>	An entity's right to consideration in exchange for goods or services that the entity has transferred to a <b>customer</b> when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
<b>contract liability</b>	An entity's obligation to transfer goods or services to a <b>customer</b> for which the entity has received consideration (or the amount is due) from the customer.
<b>customer</b>	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.
<b>income</b>	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.
<b>Performance obligation</b>	A promise in a <b>contract</b> with a <b>customer</b> to transfer to the customer either: (a) a good or service (or a bundle of goods or services) that is distinct; or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
<b>revenue</b>	<b>Income</b> arising in the course of an entity's ordinary activities.

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**stand-alone selling price**  
(of a good or service)

The price at which an entity would sell a promised good or service separately to a **customer**.

**transaction price**  
(for a contract with a customer)

The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a **customer**, excluding amounts collected on behalf of third parties.

## Appendix B

### Application Guidance

*This appendix is an integral part of the Standard. It describes the application of paragraphs 1–129 and has the same authority as the other parts of the Standard.*

- B1 This application guidance is organised into the following categories:
- (a) performance obligations satisfied over time (paragraphs B2–B13);
  - (b) methods for measuring progress towards complete satisfaction of a performance obligation (paragraphs B14–B19);
  - (c) sale with a right of return (paragraphs B20–B27);
  - (d) warranties (paragraphs B28–B33);
  - (e) principal versus agent considerations (paragraphs B34–B38);
  - (f) customer options for additional goods or services (paragraphs B39–B43);
  - (g) customers' unexercised rights (paragraphs B44–B47);
  - (h) non-refundable upfront fees (and some related costs) (paragraphs B48–B51);
  - (i) licensing (paragraphs B52–B63B);
  - (j) repurchase agreements (paragraphs B64–B76);
  - (k) consignment arrangements (paragraphs B77–B78);
  - (l) bill-and-hold arrangements (paragraphs B79–B82);
  - (m) customer acceptance (paragraphs B83–B86); and
  - (n) disclosure of disaggregated revenue (paragraphs B87–B89).

#### **Performance obligations satisfied over time**

- B2 In accordance with paragraph 35, a performance obligation is satisfied over time if one of the following criteria is met:

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- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);
- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity's performance does not create an asset with an alternative use to the entity (see paragraphs B6–B8) and the entity has an enforceable right to payment for performance completed to date (see paragraphs B9–B13).

**Simultaneous receipt and consumption of the benefits of the entity's performance (paragraph 35(a))**

- B3 For some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.
- B4 For other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer. In determining whether another entity would not need to substantially re-perform the work the entity has completed to date, an entity shall make both of the following assumptions:
  - (a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

- (b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

**Customer controls the asset as it is created or enhanced (paragraph 35(b))**

- B5 In determining whether a customer controls an asset as it is created or enhanced in accordance with paragraph 35(b), an entity shall apply the requirements for control in paragraphs 31–34 and 38. The asset that is being created or enhanced (for example, a work-in-progress asset) could be either tangible or intangible.

**Entity's performance does not create an asset with an alternative use (paragraph 35(c))**

- B6 In assessing whether an asset has an alternative use to an entity in accordance with paragraph 36, an entity shall consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use, such as selling it to a different customer. The possibility of the contract with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use.
- B7 A contractual restriction on an entity's ability to direct an asset for another use must be substantive for the asset not to have an alternative use to the entity. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract.
- B8 A practical limitation on an entity's ability to direct an asset for another use exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic

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loss could arise because the entity either would incur significant costs to rework the asset or would only be able to sell the asset at a significant loss. For example, an entity may be practically limited from redirecting assets that either have design specifications that are unique to a customer or are located in remote areas.

**Right to payment for performance completed to date (paragraph 35(c))**

- B9 In accordance with paragraph 37, an entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity's failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:
- (a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or
  - (b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.
- B10 An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it

would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

- B11 In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer might not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration).
- B12 In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether:
- (a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;
  - (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or
  - (c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer,

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its right to payment for performance to date remains enforceable.

- B13 The payment schedule specified in a contract does not necessarily indicate whether an entity has an enforceable right to payment for performance completed to date. Although the payment schedule in a contract specifies the timing and amount of consideration that is payable by a customer, the payment schedule might not necessarily provide evidence of the entity's right to payment for performance completed to date. This is because, for example, the contract could specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the contract.

### **Methods for measuring progress towards complete satisfaction of a performance obligation**

- B14 Methods that can be used to measure an entity's progress towards complete satisfaction of a performance obligation satisfied over time in accordance with paragraphs 35–37 include the following:
- (a) output methods (see paragraphs B15–B17); and
  - (b) input methods (see paragraphs B18–B19).

#### **Output methods**

- B15 Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity's performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units

delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

- B16 As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.
- B17 The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

#### **Input methods**

- B18 Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.
- B19 A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a customer. Therefore, an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:
- (a) When a cost incurred does not contribute to an entity's progress in satisfying the performance obligation. For

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example, an entity would not recognise revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labour or other resources that were incurred to satisfy the performance obligation).

- (b) When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognise revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity's performance might be to recognise revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:
- (i) the good is not distinct;
  - (ii) the customer is expected to obtain control of the good significantly before receiving services related to the good;
  - (iii) the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and
  - (iv) the entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal in accordance with paragraphs B34–B38).

### **Sale with a right of return**

- B20 In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:
- (a) a full or partial refund of any consideration paid;

- (b) a credit that can be applied against amounts owed, or that will be owed, to the entity; and
  - (c) another product in exchange.
- B20AA In some contracts, an entity transfers control of a product to a customer with an unconditional right of return. In such cases, the recognition of revenue shall be as per the substance of the arrangement. Where the substance is that of a consignment sale, the entity shall account for such a contract as per the provisions of paragraph B77 of this Appendix. In other cases, the accounting for contracts with customers shall be as per paragraphs B21-B27.
- B21 To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:
  - (a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
  - (b) a refund liability; and
  - (c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.
- B22 An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a performance obligation in addition to the obligation to provide a refund.
- B23 An entity shall apply the requirements in paragraphs 47–72 (including the requirements for constraining estimates of variable consideration in paragraphs 56–58) to determine the amount of consideration to which the entity expects to be entitled (ie excluding the products expected to be returned). For any amounts received (or receivable) for which an entity does not expect to be entitled, the entity shall not recognise revenue when it transfers products to customers but shall recognise those amounts received (or receivable) as a refund liability. Subsequently, at the end of each reporting period, the entity shall update its assessment of amounts for which it expects to be entitled in exchange for the transferred

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products and make a corresponding change to the transaction price and, therefore, in the amount of revenue recognised.

- B24 An entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity shall recognise corresponding adjustments as revenue (or reductions of revenue).
- B25 An asset recognised for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity shall update the measurement of the asset arising from changes in expectations about products to be returned. An entity shall present the asset separately from the refund liability.
- B26 Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.
- B27 Contracts in which a customer may return a defective product in exchange for a functioning product shall be evaluated in accordance with the guidance on warranties in paragraphs B28–B33.

### **Warranties**

- B28 It is common for an entity to provide (in accordance with the contract, the law or the entity's customary business practices) a warranty in connection with the sale of a product (whether a good or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.
- B29 If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately),

the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In those circumstances, an entity shall account for the promised warranty as a performance obligation in accordance with paragraphs 22–30 and allocate a portion of the transaction price to that performance obligation in accordance with paragraphs 73–86.

- B30 If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.
- B31 In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:
- (a) Whether the warranty is required by law—if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.
  - (b) The length of the warranty coverage period—the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.
  - (c) The nature of the tasks that the entity promises to perform—if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.
- B32 If a warranty, or a part of a warranty, provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, the promised service is a performance

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obligation. Therefore, an entity shall allocate the transaction price to the product and the service. If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

- B33 A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

### **Principal versus agent considerations**

- B34 When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.
- B34A To determine the nature of its promise (as described in paragraph B34), the entity shall:
- (a) identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see paragraph 26)); and

- (b) assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.

B35 An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

B35A When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

- (a) a good or another asset from the other party that it then transfers to the customer.
- (b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.
- (c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

B35B When (or as) an entity that is a principal satisfies a performance obligation, the entity recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred.

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- B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.
- B37 Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:
- (a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.
  - (b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.
  - (c) the entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or

service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

- B37A The indicators in paragraph B37 may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.
- B38 If another entity assumes the entity's performance obligations and contractual rights in the contract so that the entity is no longer obliged to satisfy the performance obligation to transfer the specified good or service to the customer (ie the entity is no longer acting as the principal), the entity shall not recognise revenue for that performance obligation. Instead, the entity shall evaluate whether to recognise revenue for satisfying a performance obligation to obtain a contract for the other party (ie whether the entity is acting as an agent).

### **Customer options for additional goods or services**

- B39 Customer options to acquire additional goods or services for free or at a discount come in many forms, including sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.
- B40 If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

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- B41 If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.
- B42 Paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:
- (a) any discount that the customer could receive without exercising the option; and
  - (b) the likelihood that the option will be exercised.
- B43 If a customer has a material right to acquire future goods or services and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the terms of the original contract, then an entity may, as a practical alternative to estimating the stand-alone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. Typically, those types of options are for contract renewals.

### **Customers' unexercised rights**

- B44 In accordance with paragraph 106, upon receipt of a prepayment from a customer, an entity shall recognise a contract liability in the amount of the prepayment for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. An entity shall derecognise that contract liability (and recognise revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation.

- B45 A customer's non-refundable prepayment to an entity gives the customer a right to receive a good or service in the future (and obliges the entity to stand ready to transfer a good or service). However, customers may not exercise all of their contractual rights. Those unexercised rights are often referred to as breakage.
- B46 If an entity expects to be entitled to a breakage amount in a contract liability, the entity shall recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity shall recognise the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity expects to be entitled to a breakage amount, the entity shall consider the requirements in paragraphs 56–58 on constraining estimates of variable consideration.
- B47 An entity shall recognise a liability (and not revenue) for any consideration received that is attributable to a customer's unexercised rights for which the entity is required to remit to another party, for example, a government entity in accordance with applicable unclaimed property laws.

### **Non-refundable upfront fees (and some related costs)**

- B48 In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts.
- B49 To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided. The revenue recognition period would extend beyond the initial

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contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as described in paragraph B40.

- B50 If the non-refundable upfront fee relates to a good or service, the entity shall evaluate whether to account for the good or service as a separate performance obligation in accordance with paragraphs 22–30.
- B51 An entity may charge a non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks as described in paragraph 25). If those setup activities do not satisfy a performance obligation, the entity shall disregard those activities (and related costs) when measuring progress in accordance with paragraph B19. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity shall assess whether costs incurred in setting up a contract have resulted in an asset that shall be recognised in accordance with paragraph 95.

### **Licensing**

- B52 A licence establishes a customer's rights to the intellectual property of an entity. Licences of intellectual property may include, but are not limited to, licences of any of the following:
- (a) software and technology;
  - (b) motion pictures, music and other forms of media and entertainment;
  - (c) franchises; and
  - (d) patents, trademarks and copyrights.
- B53 In addition to a promise to grant a licence (or licences) to a customer, an entity may also promise to transfer other goods or services to the customer. Those promises may be explicitly stated in the contract or implied by an entity's customary business practices, published policies or specific statements (see paragraph 24). As with other types of contracts, when a contract with a customer includes a promise to grant a licence (or licences) in addition to

other promised goods or services, an entity applies paragraphs 22–30 to identify each of the performance obligations in the contract.

B54 If the promise to grant a licence is not distinct from other promised goods or services in the contract in accordance with paragraphs 26–30, an entity shall account for the promise to grant a licence and those other promised goods or services together as a single performance obligation. Examples of licences that are not distinct from other goods or services promised in the contract include the following:

- (a) a licence that forms a component of a tangible good and that is integral to the functionality of the good; and
- (b) a licence that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that enables, by granting a licence, the customer to access content).

B55 If the licence is not distinct, an entity shall apply paragraphs 31–38 to determine whether the performance obligation (which includes the promised licence) is a performance obligation that is satisfied over time or satisfied at a point in time.

B56 If the promise to grant the licence is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the licence is a separate performance obligation, an entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity's promise in granting the licence to a customer is to provide the customer with either:

- (a) a right to access the entity's intellectual property as it exists throughout the licence period; or
- (b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted.

#### **Determining the nature of the entity's promise**

B57 \*

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\* Refer Appendix 1

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- B58 The nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:
- (a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraph B59 and B59A);
  - (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph B58(a); and
  - (c) those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25).
- B59 Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.
- B59A An entity's activities significantly affect the intellectual property to which the customer has rights when either:
- (a) those activities are expected to significantly change the form (for example, the design or content) or the functionality (for example, the ability to perform a function or task) of the intellectual property; or
  - (b) the ability of the customer to obtain benefit from the intellectual property is substantially derived from, or dependent upon, those activities. For example, the benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of the intellectual property.

Accordingly, if the intellectual property to which the customer has rights has significant stand-alone functionality, a substantial portion of the benefit of that intellectual property is derived from that functionality. Consequently, the ability of the customer to obtain benefit from that intellectual property would not be significantly affected by the entity's activities unless those activities significantly change its form or functionality. Types of intellectual property that often have significant stand-alone functionality include software, biological compounds or drug formulas, and completed media content (for example, films, television shows and music recordings).

- B60 If the criteria in paragraph B58 are met, an entity shall account for the promise to grant a licence as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see paragraph 35(a)). An entity shall apply paragraphs 39–45 to select an appropriate method to measure its progress towards complete satisfaction of that performance obligation to provide access.
- B61 If the criteria in paragraph B58 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence transfers. An entity shall account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity shall apply paragraph 38 to determine the point in time at which the licence transfers to the customer. However, revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognise revenue before that code has been provided (or otherwise made available).

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- B62 An entity shall disregard the following factors when determining whether a licence provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:
- (a) Restrictions of time, geographical region or use—those restrictions define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time.
  - (b) Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorised use—a promise to defend a patent right is not a performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and provides assurance to the customer that the licence transferred meets the specifications of the licence promised in the contract.

**Sales-based or usage-based royalties**

- B63 Notwithstanding the requirements in paragraphs 56–59, an entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:
- (a) the subsequent sale or usage occurs; and
  - (b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).
- B63A The requirement for a sales-based or usage-based royalty in paragraph B63 applies when the royalty relates only to a licence of intellectual property or when a licence of intellectual property is the predominant item to which the royalty relates (for example, the licence of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates).
- B63B When the requirement in paragraph B63A is met, revenue from a sales-based or usage-based royalty shall be recognised wholly in accordance with paragraph B63. When the requirement in paragraph

B63A is not met, the requirements on variable consideration in paragraphs 50–59 apply to the sales-based or usage-based royalty.

### **Repurchase agreements**

- B64 A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.
- B65 Repurchase agreements generally come in three forms:
- (a) an entity's obligation to repurchase the asset (a forward);
  - (b) an entity's right to repurchase the asset (a call option); and
  - (c) an entity's obligation to repurchase the asset at the customer's request (a put option).

#### **A forward or a call option**

- B66 If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:
- (a) a lease in accordance with Ind AS 17, *Leases*, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset; or
  - (b) a financing arrangement in accordance with paragraph B68 if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.
- B67 When comparing the repurchase price with the selling price, an entity shall consider the time value of money.

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- B68 If the repurchase agreement is a financing arrangement, the entity shall continue to recognise the asset and also recognise a financial liability for any consideration received from the customer. The entity shall recognise the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, as processing or holding costs (for example, insurance).
- B69 If the option lapses unexercised, an entity shall derecognise the liability and recognise revenue.

**A put option**

- B70 If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right, the entity shall account for the agreement as a lease in accordance with Ind AS 17.
- B71 To determine whether a customer has a significant economic incentive to exercise its right, an entity shall consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the right expires. For example, if the repurchase price is expected to significantly exceed the market value of the asset, this may indicate that the customer has a significant economic incentive to exercise the put option.
- B72 If the customer does not have a significant economic incentive to exercise its right at a price that is lower than the original selling price of the asset, the entity shall account for the agreement as if it were the sale of a product with a right of return as described in paragraphs B20–B27.
- B73 If the repurchase price of the asset is equal to or greater than the original selling price and is more than the expected market value of

the asset, the contract is in effect a financing arrangement and, therefore, shall be accounted for as described in paragraph B68.

- B74 If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity shall account for the agreement as if it were the sale of a product with a right of return as described in paragraphs B20–B27.
- B75 When comparing the repurchase price with the selling price, an entity shall consider the time value of money.
- B76 If the option lapses unexercised, an entity shall derecognise the liability and recognise revenue.

### **Consignment arrangements**

- B77 When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment.
- B78 Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:
- (a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
  - (b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
  - (c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

## **Bill-and-hold arrangements**

- B79 A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.
- B80 An entity shall determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product (see paragraph 38). For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset.
- B81 In addition to applying the requirements in paragraph 38, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:
- (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
  - (b) the product must be identified separately as belonging to the customer;
  - (c) the product currently must be ready for physical transfer to the customer; and
  - (d) the entity cannot have the ability to use the product or to direct it to another customer.

- B82 If an entity recognises revenue for the sale of a product on a bill-and-hold basis, the entity shall consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 22–30 to which the entity shall allocate a portion of the transaction price in accordance with paragraphs 73–86.

### **Customer acceptance**

- B83 In accordance with paragraph 38(e), a customer's acceptance of an asset may indicate that the customer has obtained control of the asset. Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications. An entity shall consider such clauses when evaluating when a customer obtains control of a good or service.
- B84 If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving confirmation of the customer's acceptance. The entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed-upon specifications in the contract. If revenue is recognised before customer acceptance, the entity still must consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.
- B85 However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because in that circumstance the entity cannot determine that the customer has the

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ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service.

- B86 If an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

### **Disclosure of disaggregated revenue**

- B87 Paragraph 114 requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Consequently, the extent to which an entity's revenue is disaggregated for the purposes of this disclosure depends on the facts and circumstances that pertain to the entity's contracts with customers. Some entities may need to use more than one type of category to meet the objective in paragraph 114 for disaggregating revenue. Other entities may meet the objective by using only one type of category to disaggregate revenue.
- B88 When selecting the type of category (or categories) to use to disaggregate revenue, an entity shall consider how information about the entity's revenue has been presented for other purposes, including all of the following:
- (a) disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations);
  - (b) information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments; and
  - (c) other information that is similar to the types of information identified in paragraph B88(a) and (b) and that is used by the entity or users of the entity's financial statements to evaluate the entity's financial performance or make resource allocation decisions.

- B89 Examples of categories that might be appropriate include, but are not limited to, all of the following:
- (a) type of good or service (for example, major product lines);
  - (b) geographical region (for example, country or region);
  - (c) market or type of customer (for example, government and non-government customers);
  - (d) type of contract (for example, fixed-price and time-and-materials contracts);
  - (e) contract duration (for example, short-term and long-term contracts);
  - (f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and
  - (g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).

## Appendix C

### Effective date and transition

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- C1 An entity shall apply this Standard for accounting periods beginning on or after 1 April, 2018.
- C1A \*
- C1B \*

### Transition

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- C2 For the purposes of the transition requirements in paragraphs C3–C8A:
- (a) the date of initial application is the start of the reporting period in which an entity first applies this Standard; and
  - (b) a completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue*.
- C3 An entity shall apply this Standard using one of the following two methods:
- (a) retrospectively to each prior reporting period presented in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the expedients in paragraph C5; or
  - (b) retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application in accordance with paragraphs C7–C8.
- C4 Notwithstanding the requirements of paragraph 28 of Ind AS 8, when this Standard is first applied, an entity need only present the quantitative information required by paragraph 28(f) of Ind AS 8 for the accounting period immediately preceding the first annual period for which this Standard is applied (the ‘immediately preceding

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\* Refer Appendix 1

period') and only if the entity applies this Standard retrospectively in accordance with paragraph C3(a). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

- C5 An entity may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph C3(a):
- (a) for completed contracts, an entity need not restate contracts that:
    - (i) begin and end within the same accounting period; or
    - (ii) are completed contracts at the beginning of the earliest period presented.
  - (b) for completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
  - (c) for contracts that were modified before the beginning of the earliest period presented, an entity need not retrospectively restate the contract for those contract modifications in accordance with paragraphs 20–21. Instead, an entity shall reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when:
    - (i) identifying the satisfied and unsatisfied performance obligations;
    - (ii) determining the transaction price; and
    - (iii) allocating the transaction price to the satisfied and unsatisfied performance obligations.
  - (d) for all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue (see paragraph 120).

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- C6 For any of the practical expedients in paragraph C5 that an entity uses, the entity shall apply that expedient consistently to all contracts within all reporting periods presented. In addition, the entity shall disclose all of the following information:
- (a) the expedients that have been used; and
  - (b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.
- C7 If an entity elects to apply this Standard retrospectively in accordance with paragraph C3(b), the entity shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) of the accounting period that includes the date of initial application. Under this transition method, an entity may elect to apply this Standard retrospectively only to contracts that are not completed contracts at the date of initial application (for example, 1 April, 2018 for an entity with a 31 March year-end).
- C7A An entity applying this Standard retrospectively in accordance with paragraph C3(b) may also use the practical expedient described in paragraph C5(c), either:
- (a) for all contract modifications that occur before the beginning of the earliest period presented; or
  - (b) for all contract modifications that occur before the date of initial application.
- If an entity uses this practical expedient, the entity shall apply the expedient consistently to all contracts and disclose the information required by paragraph C6.
- C8 For reporting periods that include the date of initial application, an entity shall provide both of the following additional disclosures if this Standard is applied retrospectively in accordance with paragraph C3(b):
- (a) the amount by which each financial statement line item is affected in the current reporting period by the application of this Standard as compared to Ind AS 11 and Ind AS 18; and
  - (b) an explanation of the reasons for significant changes identified in C8(a).

*Ind AS 115*

C8A \*

C9 \*

## **Withdrawal of other Standards**

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C10 This Standard supersedes the following Standards:

- (a) Ind AS 11, *Construction Contracts*;
- (b) Ind AS 18, *Revenue*

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\* Refer Appendix 1

## Appendix D

### Service Concession Arrangements

*This appendix is an integral part of the Standard.*

#### Background

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- 1 Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.
- 2 In recent times, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Appendix typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.
- 3 A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

- (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
- (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
- (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.
- (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

## Scope

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- 4 This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements.
- 5 This Appendix applies to public-to-private service concession arrangements if:
  - (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.
- 6 Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this Appendix if the conditions in paragraph 5(a) of this Appendix are met. Paragraphs AG1–AG8 of the Application Guidance of this Appendix provide guidance on determining whether, and to what extent, public-to-private service concession arrangements are within the scope of this Appendix.
- 7 This Appendix applies to both:

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- (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and
  - (b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.
- 8 This Appendix does not specify the accounting for infrastructure that was held and recognised as property, plant and equipment by the operator before entering the service arrangement. The derecognition requirements of Ind ASs (as set out in Ind AS 16) apply to such infrastructure.
- 9 This Appendix does not specify the accounting by grantors.

## **Issues**

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- 10 This Appendix sets out general principles on recognising and measuring the obligations and related rights in service concession arrangements. Requirements for disclosing information about service concession arrangements are in Appendix E to this Indian Accounting Standard. The issues addressed in this Appendix are:
- (a) treatment of the operator's rights over the infrastructure;
  - (b) recognition and measurement of arrangement consideration;
  - (c) construction or upgrade services;
  - (d) operation services;
  - (e) borrowing costs;
  - (f) subsequent accounting treatment of a financial asset and an intangible asset; and
  - (g) items provided to the operator by the grantor.

## **Accounting Principles**

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### **Treatment of the operator's rights over the infrastructure**

- 11 Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the

right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

### **Recognition and measurement of arrangement consideration**

- 12 Under the terms of contractual arrangements within the scope of this Appendix, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.
- 13 The operator shall recognise and measure revenue in accordance with Ind AS 115 for the services it performs. The nature of the consideration determines its subsequent accounting treatment. The subsequent accounting for consideration received as a financial asset and as an intangible asset is detailed in paragraphs 23–26 of this Appendix.

### **Construction or upgrade services**

- 14 The operator shall account for construction or upgrade services in accordance with Ind AS 115.

### **Consideration given by the grantor to the operator**

- 15 If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised in accordance with Ind AS 115. The consideration may be rights to:
- (a) a financial asset, or
  - (b) an intangible asset.
- 16 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The

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operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

- 17 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.
- 18 If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognised initially in accordance with Ind AS 115.
- 19 The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law. The nature of the consideration determines the subsequent accounting as described in paragraphs 23–26 of this Appendix. However, both types of consideration are classified as a contract asset during the construction or upgrade period in accordance with Ind AS 115.

### **Operation services**

- 20 The operator shall account for operation services in accordance with Ind AS 115.

### **Contractual obligations to restore the infrastructure to a specified level of serviceability**

- 21 The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to

maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.

### **Borrowing costs incurred by the operator**

- 22 In accordance with Ind AS 23, borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement in accordance with that Standard.

### **Financial asset**

- 23 Ind ASs 32,107 and 109 apply to the financial asset recognised under paragraphs 16 and 18 of this Appendix.
- 24 The amount due from or at the direction of the grantor is accounted for in accordance with Ind AS 109 as measured at:
- (a) amortised cost;
  - (b) fair value through other comprehensive income; or
  - (c) fair value through profit or loss.
- 25 If the amount due from the grantor is measured at amortised cost or fair value through other comprehensive income, Ind AS 109 requires interest calculated using the effective interest method to be recognised in profit or loss.

### **Intangible asset**

- 26 Ind AS 38 applies to the intangible asset recognised in accordance with paragraphs 17 and 18 of this Appendix. Paragraphs 45–47 of Ind AS 38 provide guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.

**Items provided to the operator by the grantor**

- 27 In accordance with paragraph 11 of this Appendix, infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator. The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in Ind AS 20. Instead, they are accounted for as part of the transaction price as defined in Ind AS 115.

## **Application Guidance on Appendix D**

*This Application Guidance is an integral part of Appendix D*

### **Scope (paragraph 5 of Appendix D)**

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- AG1 Paragraph 5 of Appendix D specifies that infrastructure is within the scope of the Appendix when the following conditions apply:
- (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.
- AG2 The control or regulation referred to in condition (a) could be by contract or otherwise (such as through a regulator), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. In applying this condition, the grantor and any related parties shall be considered together. If the grantor is a public sector entity, the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Appendix D.
- AG3 For the purpose of condition (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, the condition shall be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, if for example, a contract purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.
- AG4 For the purpose of condition (b), 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

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arrangement. The residual interest in the infrastructure is the estimated current value of the infrastructure as if it were already of the age and in the condition expected at the end of the period of the arrangement.

- AG5 Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 5(a) of Appendix D and any significant residual interest in the infrastructure, the operator is only managing the infrastructure on the grantor's behalf—even though, in many cases, it may have wide managerial discretion.
- AG6 Conditions (a) and (b) together identify when the infrastructure, including any replacements required (see paragraph 21 of Appendix D), is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an item of infrastructure during the period of the arrangement (eg the top layer of a road or the roof of a building), the item of infrastructure shall be considered as a whole. Thus condition (b) is met for the whole of the infrastructure, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.
- AG7 Sometimes the use of infrastructure is partly regulated in the manner described in paragraph 5(a) of Appendix D and partly unregulated. However, these arrangements take a variety of forms:
- (a) any infrastructure that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in Ind AS 36 shall be analysed separately if it is used wholly for unregulated purposes. For example, this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients.
  - (b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests shall be applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 5 of Appendix D, the existence of ancillary activities does not detract from the grantor's control of the infrastructure.

*Ind AS 115*

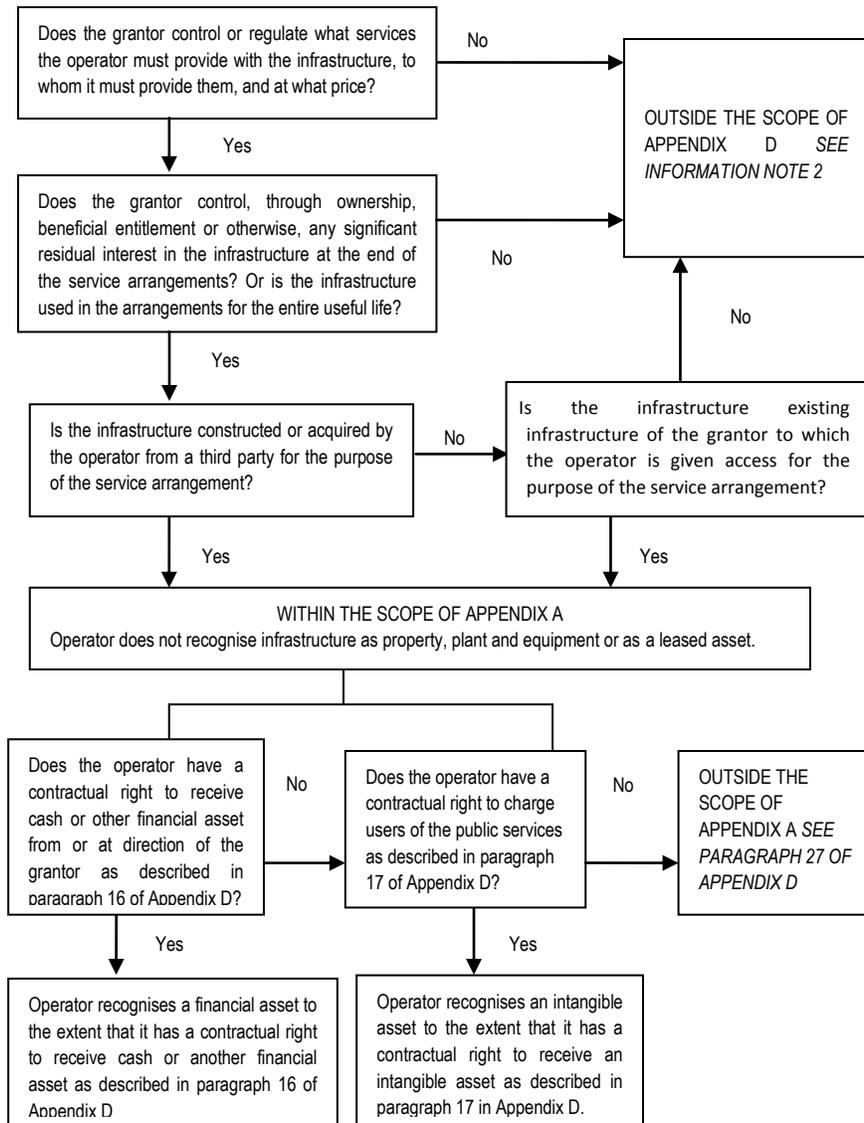
AG8 The operator may have a right to use the separable infrastructure described in paragraph AG7(a), or the facilities used to provide ancillary unregulated services described in paragraph AG7(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with Ind AS 17.

## Information note 1

### Accounting framework for public-to-private service arrangements

*This note accompanies, but is not part of, Appendix D*

The diagram below summarises the accounting for service arrangements established by Appendix A



## Information note 2

### References to Indian Accounting Standards that apply to typical types of public-to-private arrangements

*This note accompanies, but is not part of, Appendix D.*

The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to Indian Accounting Standards that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not Appendix D's intention to convey the impression that bright lines exist between the accounting requirements for public-to-private arrangements

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (eg Operator leases asset from grantor)	Service and/or maintenance contract (specific tasks eg debt collection)	Rehabilitate – operate - transfer	Build - operate - transfer	Build - own - operate	100% Divestment/ Privatisation/ Corporation
Asset ownership	Grantor				Operator	
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Operator and/or Grantor		Operator	
Typical duration	8–20 years	1–5 years	25–30 years			Indefinite (or may be limited by licence)
Residual interest	Grantor				Operator	
Relevant Indian Accounting Standards	Ind AS 17	Ind AS 18	This Appendix A		Ind AS 16	

## Appendix E

### Service Concession Arrangements: Disclosures

*This Appendix is an integral part of the Standard.*

#### Issue

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- 1 An entity (the operator) may enter into an arrangement with another entity (the grantor) to provide services that give the public access to major economic and social facilities. The grantor may be a public or private sector entity, including a governmental body. Examples of service concession arrangements involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. Examples of arrangements that are not service concession arrangements include an entity outsourcing the operation of its internal services (eg employee cafeteria, building maintenance, and accounting or information technology functions).
- 2 A service concession arrangement generally involves the grantor conveying for the period of the concession to the operator:
  - (a) the right to provide services that give the public access to major economic and social facilities, and
  - (b) in some cases, the right to use specified tangible assets, intangible assets, or financial assets,in exchange for the operator:
  - (c) committing to provide the services according to certain terms and conditions during the concession period, and
  - (d) when applicable, committing to return at the end of the concession period the rights received at the beginning of the concession period and/or acquired during the concession period.
- 3 The common characteristic of all service concession arrangements is that the operator both receives a right and incurs an obligation to provide public services.

- 4 The issue is what information should be disclosed in the notes in the financial statements of an operator and a grantor.
- 5 Certain aspects and disclosures relating to some service concession arrangements are addressed by Indian Accounting Standards (eg Ind AS 16 applies to acquisitions of items of property, plant and equipment, Ind AS 17 applies to leases of assets, and Ind AS 38 applies to acquisitions of intangible assets). However, a service concession arrangement may involve executory contracts that are not addressed in Indian Accounting Standards, unless the contracts are onerous, in which case Ind AS 37 applies. Therefore, this Appendix addresses additional disclosures of service concession arrangements.

## **Accounting Principles**

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- 6 All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator and a grantor shall disclose the following in each period:
  - (a) a description of the arrangement;
  - (b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
  - (c) the nature and extent (eg quantity, time period or amount as appropriate) of:
    - (i) rights to use specified assets;
    - (ii) obligations to provide or rights to expect provision of services;
    - (iii) obligations to acquire or build items of property, plant and equipment;
    - (iv) obligations to deliver or rights to receive specified assets at the end of the concession period;
    - (v) renewal and termination options; and
    - (vi) other rights and obligations (eg major overhauls);

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- (d) changes in the arrangement occurring during the period; and
- (e) how the service arrangement has been classified.

6A An operator shall disclose the amount of revenue and profits or losses recognized in the period on exchanging construction services for a financial asset or an intangible asset.

7 The disclosures required in accordance with paragraph 6 of this Appendix shall be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg toll collections, telecommunications and water treatment services).

## **Appendix F**

### **References to matters contained in other Indian Accounting Standards**

*This appendix is an integral part of the Ind AS.*

This appendix lists the appendices which are part of other Indian Accounting Standards and make reference to Ind AS 115, *Revenue from Contracts with Customers*.

- 1 Appendix B, *Evaluating the Substance of Transactions involving the Legal Form of a Lease* contained in Ind AS 17, *Leases*.
- 2 Appendix A, *Intangible Assets—Web Site Costs* contained in Ind AS 38, *Intangible Assets*.

## Appendix 1

*Note: This appendix is not a part of the Indian Accounting Standard. The purpose of this appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 115 and the corresponding International Financial Reporting Standard (IFRS) 15, Revenue from Contracts with Customers, IFRIC 12, Service Concession Arrangements and SIC 29 Service Concession Arrangements: Disclosures, issued by the International Accounting Standards Board.*

### **Comparison with IFRS 15, Revenue from Contracts with Customers, IFRIC 12 and SIC 29**

1. Different terminology is used in Ind AS 115 eg the term 'balance sheet' is used instead of 'statement of financial position' and 'statement of profit and loss' is used instead of 'statement of comprehensive income'.
2. As per paragraph 15 of IFRS 15, an amount of consideration, among other things, can vary because of penalties. However, paragraph 51 of Ind AS 115 has been amended to exclude 'penalties' from the list of examples given in the paragraph 51 due to which an amount of consideration can vary. However, paragraph 51AA has been inserted to explain the accounting treatment of 'penalties'.
3. Paragraph 109AA has been inserted to require an entity to present separately the amount of excise duty included in the revenue recognised in the statement of profit and loss.
4. Paragraph 126AA has been inserted to present reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price specifying the nature and amount of each such adjustment separately.
5. In Appendix D – Application Guidance, paragraph B20AA has been inserted to explain the accounting treatment in case of transfers of control of a product to a customer with an unconditional right of return.

*Ind AS 115*

6. Paragraphs C1A, C1B, C8A and C9 related to effective date and transition have been deleted due to following reasons:
  - (a) Paragraph C1A refers to amendments in paragraphs 5, 97, B66 and B70 due to issuance of IFRS 16, *Leases* for which corresponding Ind AS is under formulation.
  - (b) Paragraphs C1B and C8A are not relevant in Indian context as the same refer to application of these amendments in case where IFRS 15 was initially applied before issuance of amendments to the standard.
  - (c) Paragraph C9 refers to application of IAS 39, *Financial Instruments*, which is not relevant in Indian context.
7. Paragraphs B57 of Appendix B of IFRS 15 appears as 'Deleted'. However, in order to maintain consistency with paragraph numbers of IFRS 15, the paragraph number is retained in Ind AS 115.