IND AS 115 WORKED EXAMPLE

Accounting Treatment of a Repurchase Agreement

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Accounting Treatment of a Repurchase Agreement under Ind AS 115

SCENARIO

On 1 April 20x1, ABC Ltd. a pharmaceutical company sold a property it owned to a bank.

Additional information		
Reporting period		**31 March every year**
		On 1 April 20x1
Selling price of the property		**CU 6,000**
Market value of the property		**CU 8,000**
Net carrying amount of the property		**CU 2,400**
Remaining useful life of the property		**15 years (from 1 April 20x1)**
ABC Ltd.'s incremental borrowing rate	**10%**	
Applicable income tax rate	**40%**	

ABC Ltd. continued to occupy the property and was also responsible for its maintenance. ABC Ltd. has the option to repurchase the property on 31 March 20x3.

Reliability and faithful representation

For financial statements to be of value to their users they must possess certain qualitative characteristics; reliability is one such important characteristic. Accounting information should be reliable. Reliability gives the user confidence and trust that the financial statements are a reasonable explanation of the actual items or events that have occurred. In order for financial statements to be reliable, they must faithfully represent an entity's underlying transactions and other events. Faithful representation is the correspondence between accounting figures and descriptions and the resources or events that these figures and descriptions represent. It is necessary that they are accounted for and presented in accordance with their ***substance*** and ***economic reality*** and not merely their ***legal form***.

Substance over form

Substance is the reality of a transaction or situation as opposed to its form. ***Substance over form*** is an accounting concept whereby transactions and other events are accounted for and presented in accordance with their economic reality rather than their legal form. In accounting, substance should normally take precedence over form in deciding how a particular transaction should be recorded. For example, if an entity sells an asset without transferring the physical possession of that asset, and continues to enjoy the future economic benefits embodied in that asset, then the transaction is not represented faithfully by recording it as a sale. In fact, in all probability, the transaction is a financing arrangement.

WHAT THE STANDARD SAYS

Refer below paragraphs of Ind AS 115

- **66(b)**
- **B 64**
- **B 67 – B 69**

Definition of a Repurchase Agreement

According to Ind AS 115, one of the forms of a repurchase agreement is that it is a contract in which an entity sells an asset and also has the option (either in the same contract or in another contract) to repurchase the asset.

If an entity has an option to repurchase the asset, 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.

Financing arrangement

Consequently, the entity should account for the contract as a financing arrangement if the entity can repurchase the asset for an amount that is equal to or more than the original selling price of the asset. It should be noted that when comparing the repurchase price with the selling price, an entity shall consider the ***time value of money*****.**

POINT TO NOTE

In accordance with Ind AS 115, 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. If the option lapses unexercised, an entity shall derecognise the asset; and also shall derecognise the liability and recognise revenue.

Accounting treatment

From the above, it can be comprehended that the repurchase transaction is to be treated as a financing arrangement that does not give rise to revenue. Therefore, no revenue would be recognised and the 'sale proceeds' would be treated as borrowing. The borrowing is to be treated as a financial liability measured at amortised cost with an effective interest rate of 10%. The property would remain an asset of ABC Ltd. and depreciation under straight line method is to be charged. Since there will be a deductible temporary difference, a deferred tax asset is to be created through Profit and Loss.

For the reporting period ended on 31 March 20x2

Accounting Treatment	Journal No.	Heads of Account	Debit (CU)	Credit (CU)
Recognition of Sale Proceeds as a Financial Liability	1	Cash	6,000	
		Financial liability		6,000
Recognition of Interest Expense	2	Interest expense	600 [1]	
		Financial liability		600
Depreciation of the Property	3	Depreciation	160 [2]	
		Property		160
Creation of Deferred Tax Asset	4	Deferred tax asset	240 [3]	
		Deferred tax income		240

[1] (CU 6,000 x 10%)

[2] (CU 2,400 ÷ 15)

[3] (CU 600 x 40%)

For the reporting period ended on 31 March 20x3

If the Option is Exercised				
Accounting Treatment	**Journal No.**	**Heads of Account**	**Debit (CU)**	**Credit (CU)**
Recognition of Interest Expense	5	Interest expense	660 [4]	
		Financial liability		660
Depreciation of the Property	6	Depreciation	160 [5]	
		Property		160
Derecognition of Financial Liability	7	Financial liability	7,260 [6]	
		Cash		7,260
Derecognition of Deferred Tax Asset	8	Tax expense	240	
		Deferred tax asset		240

[4] (CU 6,600 x 10%)
[5] (CU 2,400 ÷ 15)
[6] (CU 6,000 + CU 600 + CU 660)

If the Option Lapses Unexercised				
Accounting Treatment	**Journal No.**	**Heads of Account**	**Debit (CU)**	**Credit (CU)**
Recognition of Interest Expense	5	Interest expense	660 [4]	
		Financial liability		660
Depreciation of the Property	6	Depreciation	160 [5]	
		Property		160
Derecognition of the Property	7	Cost of sales	2,080 [6]	
		Property		2,080
Derecognition of Financial Liability and recognition of Revenue	8	Financial liability	7,260	
		Revenue		7,260
Creation of Deferred Tax Asset	9	Deferred tax asset	264 [7]	
		Deferred tax income		264
Derecognition of Deferred Tax Asset	10	Tax expense	504 [8]	
		Deferred tax asset		504

[4] (CU 6,600 x 10%)
[5] (CU 2,400 ÷ 15)
[6] (CU 2,400 – CU 160 – CU 160)
[7] (CU 660 x 40%)
[8] (CU 240 + CU 264)