Test Series: April 2021

MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – II

PAPER 6E –GLOBAL FINANCIAL REPORTING STANDARDS

Candidates are required to answer any four case study out of five case studies.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Time Allowed – 4 Hours **Maximum Marks – 100**

ANSWER TO CASE STUDY 1

I. Answer to Multiple Choice Question

1.1 Option (a) : Rs. 115.8 Million

Reason

Goodwill- ABC Ltd

	Rs. million	Rs. million
Consideration transferred		480
Non-controlling interests		95.4
FV of identifiable assets acquired and liabilities assumed		
Share capital	180	
Retained earnings	270	(450)
		125.4
Less: Impairment loss		(9.6)
Goodwill		**115.8**

1.2 Option (b) : Rs. 6 Million

Reason

Development inventories

The development costs do not meet the recognition criteria set out in IAS 38 '*Intangible Assets'* and, therefore, they cannot be treated as inventory because they were previously written off as incurred. They were reinstated after acquisition, so must be written off ABC Ltd.'s post-acquisition reserves.

		Rs. million	Rs. million
Retained earnings (ABC Ltd)	Dr.	6	
To Inventories (Consolidated Statement of financial position)			6

1.3 Option (c) : Rs. 97.2 Million

Reason

Investment in associate

	Rs. million
Cost	432
Share of post-acquisition profits [(540- 468) x 30%]	21.6
Unrealised profit on inventories (Refer Note below)	(3.6)
Impairment loss (SPLOCI/retained earnings) (balancing figure)	(97.2)
Recoverable amount – 30% x Rs. 1,176 million (per question)	352.8

Note:

Unrealised profit on intra-group trading with associate (PQR Ltd)

	Rs. million
Inventories selling price	42
Cost	(30)
Profit	12

IAS 28 requires that XYZ Ltd.'s share of this profit must be eliminated.

XYZ Ltd.'s share is 30% x Rs. 12 million = Rs. 3.6 million

		Rs. million	**Rs. million**
SPLOCI (retained earnings) XYZ Ltd	Dr.	3.6	
To Investment in associate			3.6

The unrealised profit is eliminated from retained earnings in books of seller (XYZ Ltd) and from inventories in the books of the holder (PQR Ltd) – i.e. investment in associate.

1.4 Option (b) : Nil

Reason

Foreign currency contract

The payment to the supplier is a non-refundable advance and thus, does not meet the requirement of foreign currency monetary item. Hence, no exchange gain/ loss is required to be recognised on 31 March 20X4.

1.5 Option (a) : Rs. 0.32 Million

Reason

4% Debentures

	Rs.
Initial cost	12,00,000
Finance income @ 10%	1,20,000
Cash inflow @ 4%	(48,000)
At 31 March 20X3	12,72,000
Finance income @ 10%	1,27,200

Cash inflow @ 4%	(48,000)
At 31 March 20X4	13,51,200

After the impairment, the debentures are stated at their recoverable amount (using the original effective interest rate of 10%):

80% x Rs. 1.56 million x 0.826 = Rs. 1,030,848

An impairment loss of Rs. 320,352 (Rs. 1,351,200 – Rs. 1,030,848) should be recorded as follows:

		Rs. million	Rs. million
SPLOCI (retained earnings)	Dr.	0.32	
To Financial asset			0.32

II. Answer to Descriptive Question

1.6 Working Notes

1. **Debt Factoring**

Under IFRS 9 'Financial Instruments', a financial asset must be derecognised if:

(i) The contractual rights to the cash flows have expired

(ii) The financial asset has been transferred, together with the risks and rewards.

Condition (ii) has clearly not been met. XYZ Ltd still bears the risks and rewards of ownership. Accordingly, the receivable must be reinstated.

	Rs. million	Rs. million
Trade Receivables (SFP)	108	
To Retained earnings		10.8
To Loan (current liabilities)		97.2

2. **Non- controlling interest: ABC Ltd**

	Rs. million
NCI at acquisition	95.4
NCI share of post-acquisition profits [84 (W.N.3) x 20%]	16.8
Less: NCI share of impairment loss (9.6 x 20%)	(1.92)
	110.28

3. **Retained earnings**

Retained earnings	XYZ Ltd	ABC Ltd	PQR Ltd
	Rs. million	Rs. million	Rs. million
As given in the case study (appendix)	**961.2**	**360**	**540**
Foreign currency (Answer to MCQ 4)	Nil		
Debt factoring reversal	10.8		
Unrealised profit- trade with PQR Ltd	(3.6)		

Financial asset	(0.32)		
Development inventories		(6)	
Pre-acquisition		(270)	(468)
Post-acquisition		84	72
Group share			
ABC Ltd: (84 x 80%)	67.2		
PQR Ltd: (72 x 30%)	21.6		
Less: Group impairment losses:			
ABC Ltd: [80% x 9.6]	(7.68)		
PQR Ltd (see answer to MCQ 3)	(97.2)		
	952.00		

XYZ Ltd Group

Consolidated Statement of Financial Position as at 31 March 20X4

Non-current assets	**Workings**	**Rs. million**
Property, plant and equipment	(4080 + 360)	4,440
Goodwill	(MCQ 1)	115.8
Other intangible assets		720
Investment in associate	(MCQ 3)	352.8
Financial assets	(1.2 - 0.32 (MCQ 5))	0.88
		5,629.48
Current assets		
Inventories	(1,920 + 180 - 6)	2,094
Trade receivables	(1,440 + 108 – Nil (MCQ 4) + 108 (W.N.1)	1,656
Cash	(1,200 + 72)	1,272.00
Total assets		**10,651.48**
Equity and liabilities		
Share capital		3,600
Retained profits	(W.N.3)	952
Other reserves		720
Non-controlling interests	(W.N.2)	110.28
Non-current liabilities		1,680
Current liabilities	(3,312 + 180 + 97.2 (WN 1))	3589.20
Total Equity and liabilities		**10,651.48**

ANSWER TO CASE STUDY 2

I. Answers to Multiple Choice Questions

2.1. Option (d) 20 April 20X3 –

Reason:

As per definition of ‘grant date’ given in Appendix A of IFRS 2, the grant date is:

The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, 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 equity instruments of the entity, provided the specified vesting conditions, 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.

The grant date is when both parties agree to a share-based payment arrangement. The word 'agree' is used in its usual sense, which means that there must be both an offer and acceptance of that offer. Hence, the date at which one party makes an offer to another party is not grant date. The date of grant is when that other party accepts the offer. Here acceptance by the party is later to approval by the shareholders resolution. Hence grant date will be the later date.

2.2 Option (a) Nil

Reason:

As per para 37 of IFRS 2, 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 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.

2.3 Option (a) Equity-settled share-based payment

Reason:

As per para 43B of IFRS 2, 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 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.

2.4 Option (d) Recognized as revenue as and when the performance obligation is satisfied

Reason:

As per para B4.5.3 of IFRS 9, fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with IFRS 15 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) of IFRS 9 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). (IFRS 9.B5.4.3)

2.5 Option (c) Goodwill

Reason:

As per para 66 of IAS 12, temporary differences may arise in a business combination. In accordance with IFRS 3, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

II. Answer to Descriptive Question

2.6 Accounting for ESOP and ESPP scheme

Accounting for the arrangement with each employee is as described below:

Employee	Accounting
A	⇒ This is an equity settled share-based arrangement, with a grant date being 20 April 20X3 i.e. the date when both BC Ltd and the employee (viz. A) have shared understanding of the terms and conditions of the agreement (Refer Appendix A to IFRS 2 - definition of grant date) ⇒ Fair value of equity instruments to be issued on the grant date should therefore, be valued on 20 April 20X3 with reference to the quoted price of the shares in the relevant stock market. This value should however be valued after adjustments for the terms and conditions in the agreement. (Refer para B2 of IFRS 2) ⇒ The entity's accounting of the arrangement with A is, therefore, incorrect because of wrong determination of grant date and date of measurement of fair value which is relevant for determination of the share-based payment expense for the period; ⇒ Achievement of cost savings is a performance condition and is a vesting condition, which is to be considered in determining the number of equity instruments that will ultimately vest in the employee. ⇒ In this case, only 50,000 shares vest as at 31 March 20X4.
B	⇒ This is an equity settled share-based arrangement with a grant date being 20 April 20X3 i.e. the date when both BC Ltd and the employee have shared understanding of the terms and conditions of the agreement (Refer Appendix A to IFRS 2 - definition of grant date) ⇒ Fair value of equity instruments to be issued on the grant date should, therefore, be valued on 20 April 20X3 with reference to the quoted price of the shares in the relevant stock market. This value should however be valued after

	adjustments for the terms and conditions in the agreement. (Refer para B2 of IFRS 2) ⇒ The agreement has been varied such that the fair value of the option is reduced (as a result of increase in the exercise price). ⇒ As per para B44a of IFRS 2, 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. ⇒ An entity should *inter alia* recognize at 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. ⇒ Hence, irrespective of the modification, the share based payment expense is to be recorded for the grant date fair value @ Rs. 345 for the entire 10,000 shares that have vested, due to satisfaction of the vesting condition which is a performance condition.
C	⇒ The agreement provides for a choice of settlement to the counterparty (i.e. employee) and hence is required to be accounted for as a compound financial instrument as per para 37 of IFRS 2. ⇒ The vesting condition is a *market condition* and accordingly is to be considered in determining the fair value of the options in addition to the terms and conditions of the contract as per para 21 of IFRS 2. ⇒ 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. 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. ⇒ Since the equity instruments to be issued is equal to the fair value of the cash alternative i.e. Rs. 12.50 lacs (2.50 x 5), the fair value of equity component is zero. ⇒ 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. ⇒ 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.

D	⇒ In this case, the vesting term has been modified on the acquisition date of the business combination. As required by para B58 of IFRS 3, the pre-combination service costs must be determined by apportioning the total fair value of the acquisition date of the acquiree to the *pre-combination vesting term*. ⇒ The post combination expense is recognized as the difference between (a) the fair value of the replacement award and (b) the pre-combination cost. ⇒ The total vesting term is the greater of (a) the total vesting term [i.e. 6 years] and (b) the original vesting period [i.e. 5 years]. ⇒ Thus, the total fair value on 31 March 20X3 of the options issued by BC Ltd (4000 x 275 = Rs. 11 lacs) relating to pre-combination period is Rs. 3 lacs and the post combination cost is Rs. 8 lacs. *(Refer Working Note)* ⇒ The pre-combination cost is included as part of the consideration for the business combination, while the post combination cost will be expensed in the post combination financial statements of BC Ltd.
E	⇒ In this case, the vesting term has been modified on the acquisition date of the business combination. As required by para B58 of IFRS 3, the pre-combination service costs must be determined by apportioning the total fair value of the acquisition date of the acquiree to the pre-combination vesting term. ⇒ The post combination expense is recognized as the difference between (a) the fair value of the replacement award and (b) the pre-combination cost. ⇒ The total vesting term is the greater of (a) the total vesting term [i.e. 4 years] and (b) original vesting period [i.e. 5 years]. ⇒ Thus, the total fair value on 31 March 20X3 of the options issued by BC Ltd (4000 x 275 = Rs. 11 lacs) relating to pre-combination period is Rs. 3 lacs and the post combination cost is Rs. 8 lacs. *(Refer Working Note)* ⇒ The pre-combination cost is included as part of the consideration for the business combination, while the post combination cost will be expensed in the post combination financial statements of BC Ltd.
T	⇒ The agreement with T is one of a *limited recourse loan*, where effectively BC Ltd is issuing an option to purchase shares at below fair value. ⇒ No loan is to be recognized as a financial asset. ⇒ This is an equity settled share-based payment, for which expense has to be recognized in Profit or Loss as per the fair value of the options on 1 June 20X3. ⇒ When the shares are issued, the credit is given to share capital - with cash being debited.
V	⇒ The agreement with V is a *full recourse loan,* requiring full repayment of the amount outstanding as loan, which is disbursed in cash upfront. ⇒ The interest is assumed to be in line with the market interest rates and hence does not as such create any additional remuneration to be accounted as an employee benefit as per IAS 19. ⇒ The loan has to be recognized as a financial asset and measured at amortised cost as per para 4.1.2 of IFRS 9.
M	⇒ The loan is yet to be disbursed and is not expected to be released in future, on account of resignation expected by M.

	⇒ The amount of Rs. 1.65 lacs is to be accounted as per para 4.2.1(d) of IFRS 9 and para B5.4.3 of IFRS 9 ie as per IFRS 15 which states that such commitment fee is recognised as and when the performance obligation is satisfied.

Working Note

Statement of computation w.r.t Pre combination and Post combination cost

	Employees	
	D	E
Fair value of the option issued by BC	Rs. 275	Rs. 275
Number of options issued	4,000 Units	4,000 Units
Total fair value of the replacement awards (A)	**Rs. 11 lacs**	**Rs. 11 lacs**
Vesting term as per original award	5 years	5 years
Vesting term as per replacement award	6 years	4 years
Vesting term (as per IFRS 3.B58) - Greater of original vesting term and the new total vesting period (B)	**6 years**	**5 years**
Remaining vesting term as at 31st March 20X3	4 years	3 years
Pre-combination term (C)	**2 years**	**2 years**
Fair value of the option issued by acquiree	Rs. 60	Rs. 60
Number of options issued by acquiree	15,000	12,500
Total fair value of the acquiree award (D)	**Rs. 9 lacs**	**Rs. 7.5 lacs**
Fair value allocation to pre-combination term - forming part of consideration [(D/ B) x C] (E)	**Rs. 3 lacs**	**Rs. 3 lacs**
Post combination fair value (A) – (E) = (F)	**Rs. 8 lacs**	**Rs. 8 lacs**

ANSWER TO CASE STUDY 3

I Answers to Multiple Choice Questions

3.1 Option (c) - Statement I & III

Reason:

Para 13 of IFRS 8 specifies the thresholds for considering a particular segment as an operating segment that needs to be reported.

Based on the numbers given in the case study, both the revenue and profit thresholds fail for F&B segment. So it means that either the assets threshold must be true or that the management belief holds good to consider it an operating segment.

3.2 Option (b) : Yes. Rs. 305,000

Reason:

Para 23 of IFRS 8 clearly mentions that 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.

By adding the amount of interest income, the figure comes to Rs. 305,000.

3.3 Option (b) - Statement II only

Reason:

Para 20 of IAS 28 states that an entity shall apply IFRS 5 to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. Any retained portion of an investment in an associate or a JV that has not been classified as held for sale shall be accounted for using the equity method until the disposal of the portion that is held for sale takes place. Even after the partial disposal, if the remaining portion of investment qualifies as a significant influence, the equity method of accounting shall be continued.

3.4 Option (c) - Statement III & II

Reason:

Para 3 of IAS 28 defines associate as an entity over which the investor has significant influence. And significant influence means the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Further, para 5 says:

If an entity holds, directly or indirectly, 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case.

Para 6 goes on to explain significant influence in more details like:

a) Representation on the board of directors of the investee;

b) Participation in policy-making processes, including participation in decisions about dividends;

c) Material transactions between the entity and the investee;

d) Interchange of managerial personnel; or

e) Provision of essential technical information

Based on the facts of the case, it appears that the VC firm is purely an investment partner of Anvitas Technologies Pvt. Ltd and has no influence on operational or strategic decisions of the investee company.

3.5 Option (b) - Reported Segment – Reportable Segment – Associate & Reportable Segment

Reason:

In the beginning of the case F&B was reported as an operating segment since management wanted to know about this segment even though it did not meet the threshold criteria and hence was a reported segment.

Then it went on to become a reportable segment by virtue of threshold criteria for revenue and profit.

Since a new company was floated from within the segment (with segment employee) and investment from the segment, it also became an associate.

Even after dilution of investment, it remained an associate and also the business is going as per the agreement with Anvitas Technologies Pvt. Ltd. So it has remained a reportable segment.

II Answers to Descriptive Questions

3.6. As per para 10 of IAS 28:

Under the equity method, on initial recognition the investment in an associate or JV is recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss.

Further any changes in the proportionate interest of the investor company in the investee company arising from the investee's other comprehensive income shall be recognised to the extent of investor's share, in the investor's other comprehensive income.

As on 31st March 20X3 – the accounting treatment of shares held by Srikrishna Chemical Industries Ltd. in Anvitas Technologies Pvt. Ltd. would be as follows –

Extracted income statement:

- Income from associate company – Rs. 147,000 (49% of 3 lacs profit)

Extracted statement of financial position:

- Investment in an associate – Rs. 637,000 [49,000 equity shares of Rs.10 each + (3,00,000 x 49%)]

As on 30th April 20X3 in the books of Srikrishna Chemical Industries Ltd.

Extracted statement of financial position:

- Investment in an associate – Rs. 377,000 (29,000 equity shares of Rs.10 each)

Extracted income statement:

Extraordinary item –

- Income from sale of investment – Rs. 194.9 Lacs

Notes/brief explanations:

1. Portion of investment which is decided to be sold has to be classified as "held for sale" in accordance with IFRS 5.
2. However, as per IAS 28, for the portion of investment that still qualifies as a "significant influence" on the investee, the equity method of accounting will continue.
3. Income from sale of investment – Gross amount received – Rs. 200,00,000 - Rs. 260,000 (637,000 x 20%/49%)-towards cost of acquisition - Rs. 250,000 towards cost of sale.

3.7 Depreciable amount = cost of the asset less its residual value.

Cost:

USD 36,00,000 x Rs. 68.55 =	Rs. 24,67,80,000
Add: Insurance and installation cost –	Rs. 5,00,00,000
Less: Net residual value -	(Rs. 2,00,00,000)
Depreciable amount =	**Rs. 27,67,80,000**

Per unit rate of depreciation = Depreciable amount/ No. of units of expected production

= Rs. 27,67,80,000/50,00,000 = Rs. 55.356

Depreciation for the year ended 31st March 20X3 (actual):

Actual units x per unit rate = 6 lac units x Rs. 55.356 = Rs. 332,13,600

Similarly for the next four years the projected deprecation amount would be as follows –

FY20X3-X4 = 9 lac units x Rs. 55.356 = Rs. 498,20,400

FY20X4-X5 = 10 lac units x Rs. 55.356 = Rs. 553,56,000

FY20X5-X6 = 12 lac units x Rs. 55.356 = Rs. 664,27,200

FY20X6-X7 = 13 lac units x Rs. 55.356 = Rs. 719,62,800

3.8 Para 6 of IAS 36 defines impairment loss as

"The amount by which the carrying amount of an asset exceeds its recoverable amount."

It also defines "carrying amount" as the amount at which as asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

Further it says, "Recoverable amount" of an asset is the higher of its fair value less costs of disposal and its value in use.

Value in use is the present value of the future cash flows expected to be derived from an asset.

In the instant case, information is given about fair values less costs of disposal but information about value in use is not available. However, it is said that the machines are being used only occasionally to keep them in working condition. This implies that the value in use is not greater than the fair value less costs of disposal.

Hence, we can assume that the recoverable amount of the machines is same as the fair value less costs of disposal which is Rs. 500 crore.

The impairment loss as on 31stMarch, 20X3 would be as follows:

Carrying amount as on 1st April 20X2	Rs. 631.34 crore
Less: Normal depreciation from 1.4.20X2 to 30.9.20X2	(Rs. 40.63 crore)
Carrying amount as on 1st October, 20X2	Rs. **590.71 crore**

Since the management has decided to continue the use of old machines in FY 20X3-X4 till 30th September, 20X3 (though occasionally), and no decision has been taken about its sale or disposal as at 31st March 20X3, the same can't be classified under "Non-current assets held for sale", rather it will continue to be an item of **Property, Plant and Equipment**. Hence, the old machine should continue to be depreciated for the full Financial Year 20X2-20X3 and should additionally be subjected to impairment testing.

Accordingly, the impairment loss as on 31stMarch, 20X3 would be as follows:

Carrying amount as on 1st October, 20X2	Rs. **590.71 crore**
Less: Depreciation from 1.10.20X2 to 31.3.20X3	(Rs. 49.14 crore*)
Carrying amount as on 31st March, 20X3	**Rs. 541.57 crore**

*[{(590.71 crore– 1 crore) / 6 years} x 0.5 years}

Based on the impairment testing, the recoverable amount of the assets is Rs. 500 crores and hence, as on 31st March 20X3, the carrying amount of the old machines would be Rs. 500 crores and an impairment loss of Rs. 41.57 crore shall be debited to P&L account.

So, the journal entries would be:

1. For depreciation of old machines:

Depreciation a/c (40.63 crore + 49.14 crore)	Dr.	Rs. 89.77 crore	
To Old Machines a/c			Rs. 89.77 crore

(Being provision made for depreciation of old machines.)

2. For impairment loss:

Impairment loss a/c	Dr.	Rs. 41.57 crore	
To Old Machines a/c			Rs. 41.57 crore

(Being impairment loss on old machines recognized)

3. Posting to P&L account:

Profit & Loss a/c	Dr	Rs. 131.34 crore	
To Depreciation a/c			Rs. 89.77 crore
To Impairment loss a/c			Rs. 41.57 crore

(Being depreciation and impairment loss on old machines transferred to P&L)

ANSWER TO CASE STUDY 4

I. Answers to Multiple Choice Questions

4.1 Option (b) Deduct the grant received from the cost of the asset and depreciate the net carrying value over its useful economic life

Reason:

The grant of Rs. 15 million in respect of the plant and equipment should be recognized over the 40 year life of the factory. IAS 20 allows this to be done in two ways:

The first way is to deduct the grant amount in calculating the carrying amount of the asset and depreciate the net figure over its useful economic life. In the instant case only four months of depreciation would be charged because the factory was not brought into use until 1 December 20X3.

Therefore, the depreciation worked out would be Rs. 0.375 million [(60-15) x 1/40 x 4/12)] for 20X3-20X4.

Accordingly, the Property, Plant and Equipment would be shown under Statement of Financial Position as Rs. 44.625 million (45 – 0.375).

The second way is to show the grant as a deferred credit and leave the initial carrying value of the property at Rs. 60 million. Therefore, the depreciation in the current year would be Rs. 0.5 million (60 million x 1/40 x 4/12).

Property, Plant and Equipment of Rs. 59.50million (60 million – 0.50 million) would be shown in the Statement of Financial Position.

The deferred credit would be released to the income statement over the same 40 year period as the asset is depreciated so the amount included in the Statement of Profit or Loss for the current year 20X3-20X4 would be Rs. 0.125 million (15 million x 1/40 x 4/12).

The remaining deferred credit of Rs. 14.875 million (Rs. 15 million – Rs. 0.125 million) would be shown in the Statement of Financial Position as deferred income under liabilities. Rs. 0.375 million (Rs. 15

million x 1/40) would be in current liabilities and the balance of Rs. 14.50 million (Rs. 14.875 million – Rs. 0.375 million) would be in non-current liabilities.

4.2 Option (a) Grant relating to an inducement to begin developing the factory can be recognized immediately in the Statement of Profit or Loss

Reason:

Accounting for government grants is dealt with by IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance'. The basic principle of IAS 20 is that grants should be recognized as income over the periods necessary to match them with the related costs for which they are intended to compensate, on a systematic basis. That part of the grant relating to an inducement to begin developing the factory (Rs. 6 million) was received without any conditions and so can be recognized immediately in the Statement of Profit or Loss.

4.3 Option (a) Rs. 0.6 million would be recognized in the income statement for the current period ending 31 March, 20X4

Reason

The basic recognition principle for the Rs. 9 million employment grant would be similar to grant for building. This means that Rs. 0.60 million (Rs. 9 million x 1/5 x 4/12) would be recognized in the income statement for the current period, with the balance of Rs. 8.40 million (Rs. 9 million – Rs. 0.60 million) shown as deferred income. Rs. 1.80 million (Rs. 9 million x 1/5) would be shown under current liabilities, with the balance of Rs. 6.60 million (Rs. 8.40 million – Rs. 1.80 million) under non-current liabilities.

The issue of possible repayment depends on how likely, or otherwise, it is that repayment will occur. If, as seems to be the case here, repayment is possible, but unlikely, then the possibility of repayment would be disclosed as a contingent liability. If repayment were considered probable, then a liability would need to be recognized. Any amount repayable would create a separate liability, with an equal and opposite transfer from deferred income. If the deferred income balance is insufficient then any excess would be charged from in the Statement of Profit or Loss.

4.5 Option (c) Rs. 0.03 million

Reason:

As per para 37 of IAS 7, when accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

Accordingly,

Dividend paid by Associate Tintin Ltd = Rs. 0.10 million

Jackson's share of dividend 30% x Rs. 0.10 million = Rs. 0.030 million

This is the amount that should appear in the statement of cash flows of Jackson Ltd. as this is the share of Jackson Ltd.'s dividend from the Associate Tintin Ltd.

II. Answers to Descriptive Questions

4.6 The treatment related to the transactions of Jackson Ltd, under relevant IFRS is explained as under:

In accordance with the principles of *IAS 16 'Property, Plant and Equipment',* costs of Rs. 13.5 million (Rs. 10 million + Rs. 3.5 million) will be debited to property, plant and equipment as cost of Plant.

From 1 October 20X3, an obligation exists to rectify the damage caused by the Plant and this obligation should be provided for.

The amount provided is the present value of the expected future payment, which is Rs. 0.966 million (Rs. 3 million x 0.322).

The amount provided is debited to property, plant and equipment and credited to provisions at 1st October 20X3.

The costs of Plant (excluding the land) will be Rs. 4.466 million (Rs. 3.5 million + Rs. 0.966 million).

This cost will be depreciated over a 10-year period, giving a charge in the current period of Rs. 0.223 million in the current year (Rs. 4.466 million x 1/10 x 6/12).

The closing balance in property, plant and equipment is Rs. 14.243 million (Rs. 13.5 million + Rs. 0.966 million – Rs. 0.223 million).

As the date of settlement of the liability draws closer the discount unwinds.

The unwinding of the discount in the current year is Rs. 0.058 million (Rs. 0.966 million x 12% x 6/12).

The land rectification process itself creates an additional liability based on the damage caused by the reporting date.

The additional amount provided is Rs. 0.034 million (Rs. 0.20 million x 6/12 x 0.341).

This additional provision causes an extra charge to the statement of comprehensive income.

The carrying amount of the provision at the year-end is Rs. 1.058 million (Rs. 0.966 million + Rs. 0.058 million + Rs. 0.034 million).

4.7 The goodwill on consolidation of Kaplan Ltd that is recognized in the consolidated statement of financial position of Jackson Ltd is Rs. 30 million (Rs. 190 million – 80% x Rs. 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets unit B are impaired by Rs. 24 million (Rs. 90 million – Rs. 66 million). This impairment loss will be charged to the income statement.

Assets will be written down on a pro-rata basis as shown in the table below: **Rs. in million**

Asset	**Impact on carrying value**		
	Existing	**Impairment**	**Revised**
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

*The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is Rs. 350 million.

Rs. in million

Component	Impact of impairment review on carrying value		
	Existing	**Impairment**	**Revised**
Goodwill (see below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B	66.00	Nil	66.00
Unit C (revised)	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

As per Appendix C of IAS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to Rs. 37.50 million (Rs. 30 million x 100/80). The impairment loss of Rs. 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by Rs. 23.50 million to Rs. 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is Rs. 18.80 million (Rs. 23.50 million x 80%) and the closing consolidated goodwill figure is Rs. 11.20 million (Rs. 14.00 million x 80%) or (Rs. 30 million – Rs. 18.80 million).

4.8 According to para 8 of IAS 23 "Borrowing Costs", an entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

Other borrowing costs should be recognized as an expense in the period in which they are incurred.

A ***qualifying asset*** is an asset that takes substantial period of time to get ready for its intended use or sale. (para 5)

Based on above the treatment is as under:

Calculation of total interest payable during the year

11% of Rs. 6.00 million + 9% of Rs. 9.00 million +10% of Rs. 3.00 million) = Rs. 1.77 million

Capitalized interest cost to be recorded as an asset in the Statement of Financial Position:

Effective interest rate on debentures and subordinated debentures:

[{(Rs. 9 million/ Rs. 12 million) x 9%} + {(Rs. 3 million / Rs. 12 million) x 10%}] = 9.25%

Effective interest rate on construction loan = 9.25%

Capitalized interest rate would be

= [(Rs. 6 million/ 0.11) + (Rs. 2 million / 0.925)]

= Rs. 6.60 million + Rs. 0.185 million

= Rs. 0.845 million

Amount of interest expense to be reported in Income Statement:

= Rs. 1.77 million – Rs. 0.845 million

= Rs. 0.925 million

4.9. The decision to offer the division for sale on 1 January 20X4 means that from that date the division is classified as held for sale. The division is available for immediate sale, is being actively marketed at a reasonable price, and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division will be measured at the lower of their existing carrying amounts and their fair value less costs to sell. In this case, this means measuring the assets of the division at Rs. 3·2 million on 1 January 20X4.

The reduction in carrying value of the assets of Rs. 0.40 million (Rs. 2 million + Rs. 1 million + Rs. 0.60 million – Rs. 3.2 million) will be treated as an impairment loss and allocated to goodwill, leaving a carrying amount for goodwill of Rs. 0.20 million (Rs. 0.60 million – Rs. 0.40 million).

The increased expectation of the selling price of Rs. 0.10 million (Rs. 3.3 million – Rs. 3.2 million) will be treated as a reversal of an impairment loss. However, since this reversal relates to goodwill, it cannot be recognised.

The assets of the division need to be presented separately from other assets in the statement of financial position. Their major classes of assets classifies as held for sale should be separately disclosed, either in the statement of financial position or in the notes.

The property, plant and equipment should not be depreciated after 1 January 20X4, so it's carrying value at 31 March 20X4 will be Rs. 2 million. The inventories of the division will be shown at their year-end cost of Rs. 0.90 million.

The division will be regarded as a discontinued operation in the year ended 31 March 20X4. It represents a separate line of business and is held for sale at the year end.

The statement of comprehensive income should disclose, as a single amount, the post-tax profit or loss of the division and the impairment loss arising on the re-measurement of the division on classification as held for sale. Further analysis of this single amount may be presented in the notes or in the statement of comprehensive income. If it is presented in the statement of comprehensive income it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations.

ANSWER TO CASE STUDY 5

I. Answers to Multiple Choice Questions

5.1 Option (b): Machinery of Rs. 13,00,000 should be depreciated over a period of 10 years; major overhaul cost of Rs. 2,00,000 should be depreciated over a period of 3 years.

Reason

Cost of each significant item of property, plant and equipment having different useful life should be recognised and depreciated separately.

5.2 Option (c): Subsidy received should be recognised over the period of 5 years, i.e., Rs. 3,00,000 per annum.

Reason

The income related grant should be matched with the costs of meeting the grants over the balance period of employing the locals. So each year a portion of the grant received should be deferred over the balance portion of the 10 year condition attached to the grant.

5.3 Option (c): Expense in year 1 = Rs. 50,00,000; expense in year 2 = Rs. 46,00,000 and expense in year 3 = Rs. 92,00,000

Reason

Fair value on grant date = 400 x 1,000 x 50 = Rs. 2,00,00,000

Cumulative charge

- Year 1- Rs. 2,00,00,000 x 75% x (1/3) = Rs. 50,00,000
- Year 2- Rs. 2,00,00,000 x 72% x (2/3) = Rs. 96,00,000
- Year 3- 940 x 50 x 400 = Rs. 1,88,00,000

Expense for the period

- Year 1 = Rs. 50,00,000
- Year 2 = Rs. 46,00,000 (Rs. 96,00,000 – Rs. 50,00,000)
- Year 3 = Rs. 92,00,000 (Rs. 1,88,00,000 – Rs. 96,00,000)

5.4 Option (b): 15,76,389

Reason

1 April- 31 May	10,00,000 x 2/12 x 4/3	2,22,222
1 June- 30 November	12,00,000 x 6/12 x 4/3	8,00,000
1 December- 28 February	16,00,000 x 3/12	4,00,000
1 March – 31 March	18,50,000 x 1/12	1,54,167
		15,76,389

5.5 Option (a): Property, plant and equipment

Reason

The building will not be classified as held-for-sale as it is not available for immediate sale because, until new premises have been found, the office staff will remain in the existing building. Also, the directors have only tentatively started looking for a buyer which may indicate that the entity is not committed to the sale. Additionally, the price being asked for the building is above the market price, and is not reasonable compared to that price. It is unlikely that the entity will sell the building for that price.

II. Answers to Descriptive Questions

5.6 IAS 32 states that an issuer of a financial instrument must determine the classification of the financial instrument as either a financial asset/ financial liability or an equity. The classification should be determined as per the substance of the contractual arrangement and based on the definition of financial liability, financial asset and equity.

In accordance with IAS 32, the following criteria constitute a financial liability-

(a) It should contain a contractual obligation-

- to deliver cash or another financial asset to another entity; or
- to exchange financial assets/liabilities with another entity under potentially unfavourable conditions.

or

(b) A contract that will or maybe settled in the entity's own equity instruments and is-

- a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments or;
- a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

In accordance with IAS 32, any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities can be termed as equity. An instrument is an equity instrument if, and only if, both the conditions below are met:

(a) The instrument includes no contractual obligation to-

- to deliver cash or another financial asset to another entity; or
- to exchange financial assets/liabilities with another entity under potentially unfavourable conditions.

(b) If the instrument will or maybe settled in the issuer's own equity instrument, it is-

- a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments or;
- a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of their own equity shares.

The first step is to evaluate whether the OCCPS issued meets the criteria for equity-

Technical guidance	Analysis	Conclusion
No contractual obligation to deliver cash or another financial asset to another entity.	The company as per the terms of the OCCPS issued, has to provide cumulative dividend at the rate of 10%, both in case of redemption and conversion as well. Hence, the company has an obligation to provide either cash or another financial asset, and the company does not have the right to indefinitely defer such payments.	Condition not met
No contractual obligation to exchange financial assets / liabilities with another entity under potentially unfavourable conditions.	There is no such clause in the terms of the OCCPS which would trigger such condition.	Not applicable

Since the first condition itself for classification for equity is not met, the same should not be classified as equity.

Analysis for classification as a financial liability-

Technical guidance	Analysis	Conclusion
There exists a contractual obligation to deliver cash or another financial asset to another entity.	The company as per the terms of the OCCPS issued, has to provide cumulative dividend at the rate of 10%, both in case of redemption and conversion as well. The company cannot defer the payment indefinitely as they have to pay either in cash on redemption or convert the	Condition met

	obligation into equity shares after a period of 10 years.	
To exchange financial assets / liabilities with another entity under potentially unfavourable conditions.	There is no such clause in the terms of the OCCPS which would trigger such condition.	Not applicable

Hence since the basic condition is met, the same can be classified as a financial liability.

The shareholders have the option that, in case, the company is unable to redeem the preference shares in cash, they can exercise their right to get the preference shares converted into equity shares at a conversion ratio which shall be agreed at the time of conversion. In the current case, the company has the first right to redeem the preference shares. In case the company is unable to redeem the same in accordance with the conditions of the term sheet, the preference shareholders may then exercise their option to have their preference shares converted into equity shares.

Hence, effectively the option is with the company to determine the outcome.

Analysis for whether the embedded option in the instrument qualifies for accounting as a derivative-

Technical guidance	Analysis	Conclusion
No or little initial investment	There has been no investment made in order to gain such option.	Condition met
Settled at a future date	The settlement of the same shall take place when the preference should mature at the end of the 10 year period.	Condition met
Fair value changes in response to changes in one or more underlying variables	The value of the option is completely dependent on the OCCPS. If the OCCPS are redeemed, the value of the option becomes 0 and vice versa.	Condition met

Hence the option does satisfy the criteria for derivatives. However, as per IFRS 9, instruments with a non-financial underlying variable that is specific to a party to the contract are not derivatives. In the current case, the option in the current case is completely dependent on the ability of A Ltd. to redeem the preference shares. Hence, the same should not be accounted for separately as the same is closely linked to the contract.

5.7 <u>Assessment of whether an item is a financial liability</u>

1. Tax liability of Rs. 12,00,000
   - No, tax liability arises as per the requirements of law and not because of contractual arrangement.
2. Non-refundable revenue received in advance amounting to Rs. 1,57,000
   - No, there is no contractual obligation to pay cash/other financial assets
3. Non-refundable advance received against sale of government securities
   - Yes, instrument contains contractual obligation to deliver other financial asset, viz., government securities
4. Liability for damages under a lawsuit amounting to Rs. 50,00,000
   - No, not arising because of contractual arrangement

5. Financial guarantees given of Rs. 6,50,000

    - Yes, A Ltd. has contractual right to pay cash if the original debtor fails to pay. For an instrument to be classified as financial liability, it is not necessary that the entity should have an unconditional obligation to pay. Contractual obligation to pay which are contingent upon future events is also a financial liability.

<u>Assessment of whether an item is a qualifying hedged item</u>

1. A probable forecast transaction
    - Not allowed, because only highly probable forecast transactions are eligible hedged items.
2. An issued loan with a fixed coupon
    - Allowed as a hedged item.
3. USD 100 of a net investment which amounts to USD 150 in total (functional currency is Rs.)
    - Allowed since IFRS 9 allows designating portions of net investments as hedged items.
4. 50% of an interest rate swap
    - Not allowed since IFRS 9 generally precludes derivatives from being the hedged item.
5. A net position of USD 150 consisting of assets amounting to USD 250 and liabilities amounting to USD 100 (functional currency is Rs.)
    - Allowed, because hedge accounting is now allowed for hedges of net positions.

5.8 Principal market: Market which is normally the place in which the assets / liabilities are being transacted with highest volume with high level of activities comparing with any other market available for similar transactions.

Most advantageous market: This is the market which either maximizes the amount that would be received when an entity sells an asset or minimize the amount that is to be paid while transferring the liability.

Accordingly, Market A is the principal market and market C is the most advantageous market.

While identifying the fair value in principal and advantageous market following are considered:

	Transaction costs	**Transportation costs**
Identifying the principal market	×	×
Identifying the most advantageous market	✓	✓
Measuring fair value	×	✓

Accordingly, fair value in principal market is Rs. 47 and fair value in most advantageous market is Rs.20 49.