

MOCK TEST PAPER

FINAL COURSE

PAPER 6E: GLOBAL FINANCIAL REPORTING STANDARDS

ANSWER TO CASE STUDY 1

I. Answers to Multiple Choice Questions

1.1 Option (d) : (i), (ii) and (iii)

Refer to definition of provision under IAS 37

1.2 Option (b): ₹170 million

Reason

Cash flow from operating activities

Particulars	Amount (₹ in million)
Net Income	120
Depreciation	25
Profit from sale of land	<u>(2)</u>
Cash generation	143
Decrease in accounts receivables	20
Increase in inventory	(10)
Increase in deferred tax liabilities	15
Increase in accounts payable	7
Decrease in wages payable	<u>(5)</u>
Cash flow from operations	<u>170</u>

1.3 Option (a) : ₹ 1.35 per share

Reason

Diluted earnings per share:

$$= \frac{\text{Net Income} - \text{Preference dividends} + \text{Dividendson Covered Securities}}{(\text{Share outstanding} + \text{additional shares if securities were converted})}$$

$$= \frac{₹25,000 - ₹6,000 + 6,000}{[12,500 + (3,000 \times 2)]} = \frac{₹25,000}{18,500} = ₹ 1.35 \text{ per share}$$

1.4 Option (c) : ₹ 38.25 million

Reason

In accordance with the provisions laid down in IFRS 11 “Joint Arrangements”, this is a joint arrangement because two or more parties have joint control of the pipeline under a contractual arrangement.

The arrangement will be regarded as a joint operation because Jefferson Ltd and the other investor have rights to the assets and obligations for the liabilities of this joint arrangement.

This signifies that Jefferson Ltd and the other investor will each recognize 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the pipeline should, under the principles of IAS 23 be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is ₹ 1.5 million ($₹ 30 \text{ million} \times 10\% \times 6/12$).

The total cost of the asset is ₹ 76.5 million ($₹ 75 \text{ million} + ₹ 1.5 \text{ million}$). ₹ 38.25 million is included in the property, plant and equipment of Jefferson Ltd and the same amount in the property, plant and equipment of the other investor.

1.5 Option (b) : ₹ 1.95625 million

Reason

		Total	50% share
The depreciation charge for the year ended 31 st March, 20X2 on pipeline	$(₹ 76.5 \text{ million} \times 1/20 \times 6/12) \times 1/2$	₹ 1,912,500	₹ 956,250
The other costs relating to the arrangement in the current year			
Finance cost for the second half year	₹ 1,500,000		
Add: Maintenance costs	₹ 500,000	₹ 2,000,000	<u>1,000,000</u>
			<u>1,956,250</u>

II. Answers to Descriptive Questions

- 1.6 IFRS 105 – Non-current assets held for sale and discontinued operations – stipulates that business operations are classified as discontinued in the period they are classified as held for sale (in the case of sold operations) or in the period of abandonment

(in the case of abandoned operations). These subsidiaries are not to be sold, but effectively closed down, or abandoned. Therefore, separate presentation of the results as discontinued operations is not appropriate for the year ended 31st March, 20X2.

However, the results will be separately presented as discontinued operations in the financial statements of the following accounting period.

Also, it could be argued that the properties of the subsidiaries to be abandoned are held for sale, since this is how their value will be principally recovered. Therefore, the properties (as distinct from the other assets) could be moved to the 'held for sale' classification in the statement of financial position. The properties would be measured at the lower of their current carrying value and their fair value less costs to sell. Therefore, in this case no re-measurement would take place.

(i) Future operating losses:

As per the question, latest estimates are that the operating losses of the affected subsidiaries for the six months to 30th September, 20X2 will total ₹ 15 million. In accordance with the provisions of *IAS 37- Provisions, Contingent Liabilities and Contingent Assets*, future operating losses, should not be recognized as part of a provision because IAS 37 requires that entities provide for the consequences of past events, rather than for the potential consequences of future events.

(ii) Onerous contracts

The obligation to close the subsidiaries that are part of the restructuring program makes the leases onerous contracts. IAS 37 states that a provision is required because of the existing obligation to make lease payments until the end of the lease, without any expected future economic benefit.

The provision under onerous contracts should therefore be for the *lower* of the cost of immediate termination of the leases (₹ 5 million in this case) and the present value of the cost of fulfilling the leases (₹ 6 million in this case). Therefore, the provision should be increased by ₹ 5 million.

(iii) Provision for restructuring expenses

IAS 37 does not allow restructuring provisions to be reduced by the anticipated profits on the sale of non-current assets, even if they arise as part of the restructuring. Therefore, it would be inappropriate to recognize the potential profits on the sale of the properties of the subsidiaries at this stage.

(iv) Impairment of assets

Where a business is expected to make operating losses in the future, then IAS 37 reminds us that it is necessary to review its assets for evidence of impairment, using the rules outlined in IAS 36 “*Impairment of Assets*”.

The recoverable amount of the plant and equipment is the higher of its value in use is ₹ 1.8 million and its fair value less costs to sell is ₹ 2 million. Their carrying amount is ₹ 18 million. The plant should be written down to its recoverable amount of ₹ 2 million and an impairment loss will be charged in the statement of comprehensive income.

1.7 (i) Treatment of brand and future services of employees

IAS 38 “*Intangible Assets*” stipulates that most intangibles that satisfy the definition of assets will be regarded as identifiable when acquired as part of the acquisition of a business. This would certainly apply to brands which, from the perspective of Jefferson Ltd., have been acquired as part of the acquisition of Abbott Ltd.

However, the estimated value of future services of employees could not be regarded as an identifiable asset because enterprises do not normally have sufficient control over the potential benefits derivable from those services – the employees can normally leave.

- (ii) Goodwill on consolidation is the difference between the fair value of the consideration given and the fair value of the identifiable net assets acquired.

The treatment is as under:

Particulars	(₹ Million)
The fair value of the consideration given is ₹ 270 m (50 m x ₹ 5.40).	270.00
The fair value of the identifiable net assets acquired is ₹ 190 m (₹ 180m + ₹ 10m)	190.00
Goodwill on consolidation	80.00

Therefore, the goodwill on consolidation is ₹ 80 m (₹ 270 m – ₹ 190 m). Under the provisions of IFRS 3 “*Business Combinations*”, the goodwill is not amortized but reviewed annually for impairment. Thus, on 31st March, 20X2, goodwill will be measured at its cost of ₹ 80 m less any necessary impairment. It can never be revalued.

1.8 Provision of mining operations

With respect to the mining operations the treatment under IAS 37 "*Provisions, Contingent Liabilities and Contingent Assets*" would be as under:

Liabilities from environment and similar provisions fulfill all three recognition criteria, as soon as an entity performs any operation affected by these laws. The three recognition criteria mentioned in the IAS is as under:

- (i) an entity has a present obligation (legal or constructive) as a result of a past event
- (ii) it is probable that an outflow of economic benefits will be required to settle the obligation, and
- (iii) a reliable estimate can be made of the obligation

Hence the treatment is as follows:

At the time of making the provision, on 31st March, 20X2:

Particulars	₹	₹
Mine Account (reflected in Balance Sheet) Dr. To Provision for landscape work (Being provision made for the cost of landscape work)	20,00,000	20,00,000

The mine account will be amortized over a period of five years. As the benefits to be received from the mine will flow to the entity over a period of more than one financial year, it is reflected as an asset in the balance sheet.

The journal entry made at the end of every year for amortization of mine account is:

Particulars	₹	₹
Mine Amortization expense (reflected in IS) Dr. To Accumulated Mine Amortization Account (Being amortization for the year (₹ 20,00,000/5 years))	₹ 4,00,000	₹ 4,00,000

At the end of 5th year, when the actual landscape work is done:

Particulars	₹	₹
Provision for landscape work Dr. To Bank A/c (Being amount paid for landscaping work)	₹ 20,00,000	₹ 20,00,000

ANSWER TO CASE STUDY 2

I. Answers to Multiple Choice Questions

2.1 Option (d) : ₹ 2,280 thousand

Reason

IAS 38 'Intangible Assets', requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 2X17 was the last criterion to be met, the other criteria have been met as follows:

- ◆ Intention to complete the asset is apparent as it is a major project with full support from the board
- ◆ Finance is available as resources are focused on project
- ◆ Costs can be reliably measured
- ◆ Benefits expected to exceed costs

An amount of ₹ 3,000 thousand (₹ 3,600 thousand x 10/12) should be capitalised in the Statement of Financial Position representing the expenditure since 1 June 2X17. The expenditure prior to 1 June of ₹ 600 thousand (2/12 x ₹ 3,600 thousand) should be recognised as an expense, retrospective recognition as an asset is not allowed.

IAS 36 'Impairment of Assets', requires an intangible asset not yet available for use to be tested for impairment annually. A cash flow of ₹ 2,400 thousand in perpetuity would clearly have a present value in excess of ₹ 1,200 thousand and hence there would be no impairment. However, the research director is technically qualified so impairment tests should be based on her estimate of a five-year remaining life and a present value of the future cost savings of ₹ 2,280 thousand. This is greater than the offer received (fair value less costs to sell) of ₹ 1,680 thousand and should be used as the recoverable amount. The carrying amount should be reduced to this amount and an impairment loss of ₹ 720 thousand recognised in the profit and loss for the year.

		₹ '000	₹ '000
Operating expenses- development expenditure	Dr.	600	
Operating expenses – impairment of intangible	Dr.	720	
To Intangible assets-development expenditure			1320

2.2 Option (c) : ₹ 60.856 thousand; ₹ 873.256 thousand

Reason

IFRS 9 'Financial Instruments', financial assets can be measured at fair value through profit and loss or at amortised cost. Amortised cost is the cost of an asset or liability

adjusted to give a constant effective interest rate over the life of the asset or liability. Financial assets not carried at FVTPL are subject to an impairment test. A financial asset measured at amortised cost applies only to debt instruments and must be designated upon initial recognition. Here, the financial assets initially measured at fair value less transaction costs. IFRS 9 requires debt instruments to meet two tests (business model test and cash flow test) to be measured at amortised cost.

Amount that loan notes should be measured on 1 April 2X17:

Proceeds ₹ 900 thousand x 95% = ₹ 855 thousand
Issue costs ₹ (15.60 thousand)
₹ 839.40 thousand

Calculation of IRR

Year	Cash Outflow ₹ '000	Present value of cash outflow @ 7% ₹ '000	Present value of cash outflow @ 9% ₹ '000
1	27	₹ 25.233	₹ 24.770
2	27	₹ 23.582	₹ 22.725
3	27	₹ 22.040	₹ 20.848
4	1,017	<u>₹ 775.864</u>	<u>₹ 720.468</u>
		<u>₹ 846.719</u>	<u>₹ 788.811</u>

IRR = 7% + [(846.719 - 839.40) / (846.719 - 788.811)] x (9 - 7) = 7.25% (approx.)

Year ₹ '000	Balance on 1 April ₹ '000	Interest @ 7.25% ₹ '000	Paid ₹ '000	Balance on 31 March ₹ '000
2X17-2X18	839.4	60.86	(27)	873.26
2X18-2X19	873.26	63.31	(27)	909.57
2X19-2X20	909.57	65.94	(27)	948.51
2X20-2X21	948.51	68.77	(1017)	0.278*

* Difference is due to rounding off.

Statement of Profit or Loss and Other Comprehensive Income– for year-ended 31 March 2X18 – finance costs ₹ 60.856; Statement of Financial Position – 31 March 2X18 ₹ 873,260

2.3 Option (a) : ₹ 240 thousand

Reason

There should be a provision made for the personal injury claims amounting to 8 x ₹ 30 thousand = ₹ 240 thousand

Legal claim

During the year an accident at one of the company's manufacturing plants caused a number of employees to suffer injury. This provision is to cover personal injury claims made by individuals concerned. This provision is based on lawyers' best estimate of the likely amount at which the claims can reasonably be settled. It is hoped that the claims will be settled in the next financial year. It is expected that the full amount of these claims will be reimbursed by the insurance company following their payment.

Contingent liability

Following the accident a number of employees have made claims for undue stress. Based on lawyers' advice the company does not believe these claims will be successful. If such case was to be successful, the estimated pay-out would be ₹ 36 thousand.

2.4 Option (b) : ₹ 4,513 thousand

Reason

When an extended period of credit is offered to customer (a retail bank), there are two performance elements i.e. first, the goods on the date of sale, and second, financing income. Future receipts from the bank should be discounted to their present value at the imputed interest rate, in this case 8%.

The customer paid ₹ 960 thousand on 1 April 2X17 (₹ 4,800 thousand x 20%). At that date the present value of the amount receivable on 1 April 2X19 was (₹ 4,800 thousand x 80%) x 0.857 = ₹ 3,290 thousand.

Revenue to be recognised in respect of this transaction in the year ended 31 March 2X18:

	₹ '000	
Sale of goods (₹ 960 thousand + ₹ 3.29 m)	4,250	
Financing income (₹ 3,290 thousand x 8%)	<u>263</u>	4,513
Carrying amount of receivable (₹ 3,290 thousand x 1.08)		3,553

2.5 Option (a) : ₹ 1,224 thousand ; ₹ 406 thousand

Reason						
			Asset ₹'000	Obligation ₹'000	P&L ₹'000	OCI ₹'000
At 1 April 2X17	Opening Balances		5,400	6,660		
	Debit	Credit				
Current service cost	SPLOCI	obligation		864	(864)	

Past service costs	SPLOCI	obligation		630	(630)	
Benefits paid	Obligation	Asset	(1036)	(1036)		
Contributions paid	Asset	Bank	738			
Yield	Asset	P & L finance	<u>270</u>		270	
Total			5,372	7,118		
Re-measurement - fair value gain on asset re - measurement	Asset	OCI	2,512			2,512
Actuarial loss on obligation	OCI	Obligation		<u>2918</u>		<u>(2918)</u>
At 31 March 2X18	closing balances – A&O		<u>7,884</u>	<u>10,036</u>	<u>(1,224)</u>	<u>(406)</u>
The net obligation in the Statement of Financial Position at 31 March is ₹ 2,152 thousand (10,036 thousand – 7,884 thousand).						

II. Answers to Descriptive Questions

2.6 Acquisition of ABC Ltd

The acquisition of 7,200 thousand out of 9,600 thousand shares currently in issue does appear to confer control upon XYZ Ltd, because 75% of the ordinary shares were acquired and there is no indication to the contrary. From 31 March 2X17, therefore, ABC Ltd should be consolidated as a subsidiary, with 100% of revenue, assets, expenses and liabilities recognised in the consolidated financial statements, along with the non-controlling interest of 25%. Assets and liabilities should be recognised at fair value of acquisition. The domain name in ABC Ltd appears to meet the criteria for recognition as an intangible asset under IAS 38 'Intangible Assets'. It is clearly separable (can be sold and purchased separately) and it arises from contractual rights. The recent bid for it suggests that its fair value is ₹ 4,800 thousand, and this should be added to the existing total of net assets to give a revised figure of ₹ 1,72,800 thousand.

An intangible asset with an indefinite life should be tested annually for impairment. No amortisation adjustment is required.

An adjusting accounting entry is required in respect of the initial issue of shares by XYZ Ltd. It was correct to recognise ₹ 28,800 thousand ordinary share capital but an adjustment is also required to share premium, 28,800 thousand shares at the then current market price of ₹ 5.4 results in a purchase consideration of ₹ 1,55,520 thousand. A credit to the share premium (155,520 thousand – 28,800 thousand) of ₹ 126,720 thousand is required. The investment (intangible) should be reversed and replaced with goodwill on consolidation.

Purchase consideration also comprises deferred consideration which will be payable in cash on 1 July 2X20. This should be recognised on acquisition at a discounted value, calculated as follows:

$\text{₹ } 12,000 \text{ thousand} \times 1 / (1.08)^3 = \text{₹ } 9,525.987 \text{ thousand}$. This discount should be unwound until the date of payment on 1 July 2X20. Each year the amount unwound should be recognised as a finance cost in profit or loss. For the nine months ended 31 March 2X18 the finance cost should be: $\text{₹ } 9,525.987 \text{ thousand} \times 8\% \times 9/12 = \text{₹ } 571.559 \text{ thousand}$.

This amount should be added to the deferred consideration liability:

$\text{₹ } 9,525.987 \text{ thousand} + \text{₹ } 571.559 \text{ thousand} = \text{₹ } 10,097.546 \text{ thousand}$.

Goodwill should be calculated as follows:

	₹ '000
28,800 thousand New shares at ₹ 5.4	155,520.000
Deferred consideration	<u>9,525.987</u>
	165,045.987
Non-controlling interest (NCI) (₹ 172,800 thousand x 25%)	<u>43,200.000</u>
	208,245.987
Less: Fair value of net assets on the date of acquisition	<u>(172,800.000)</u>
Goodwill	<u>35,445.987</u>

Journal Entries

		₹ '000	₹ '000
Consolidated assets and liabilities (SOFPI)	Dr.	172,800	
Goodwill (SOFPI)	Dr.	35,445.987	
To Investment in bright (intangibles)			28,800
To Share premium			126,720
To Non-controlling interest (SOFPI)			43,200
To Deferred consideration (SOFPI)			9,525.987
Finance cost (SPLOCI)	Dr.	571.559	
To Deferred consideration (SOFPI)			571.559

Profit of the year in the consolidated financial statements should be increased by ABC Ltd.'s profits for the period since acquisition (i.e. post-acquisition profits): $\text{₹ } 9,600 \text{ thousand} \times 9/12 = \text{₹ } 7,200 \text{ thousand}$. Out of this, ₹ 5,400 thousand is attributable to XYZ Ltd, and ₹ 1,800 thousand to NCI.

2.7 Accounting for damaged machine

Impairment of the machine would be governed by IAS 36 'Impairment of Assets'. The aim of IAS 36 is to ensure that non-current assets or cash generating units are carried at value no more than their recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and its value in use.

In the present case, there is no method of assessing the fair value less costs of disposal of the machine (since there is no active market for the machine), we should therefore use

the value in use. Also, the machine does not generate cash inflows that are independent of cash inflows from other assets or groups of assets. We should, therefore, consider the value in use for the cash generating unit to which the machine belongs. While the crushing machines capacity has been reduced by 20%, it can still operate at faster speeds than the attached conveyor belt. The production line has therefore not been impaired and no impairment loss should be recognised for the machine.

The relevant adjustments to the financial statements should be made:

		₹ '000	₹ '000
Property, plant and equipment	Dr.	1,000	
To Administrative expenses			1,000
(Being adjustment made for reversal of impairment loss)			

Accounting for freehold manufacturing building

Land is not depreciated as it has an indefinite life. Land should be shown in the statement of financial position at its original cost of ₹ 5,600 thousand. The building element was recognised at cost of ₹ 20,000 thousand.

Carrying amount before the revaluation on 31 March 2X15 would have been ₹ 18,000 thousand (₹ 20,000 thousand – two years depreciation ₹ 2,000 thousand). The buildings element should then be revalued upwards to ₹ 22,500 thousand and the surplus over carrying amount of ₹ 4,500 thousand recognised in other comprehensive income and credited to revaluation surplus.

Depreciation would now be ₹ 1,250 thousand (₹ 22,500 thousand / 18 years). Management could elect to make an annual transfer of ₹ 250 thousand from revaluation surplus to retained earnings through the statement of changes in equity.

On 31 March 2X18, the following balances should be included in the statement of financial position:

Land ₹ 5,600 thousand

Building ₹ 18,750 thousand (i.e., ₹ 22,500 thousand – three year depreciation at ₹ 1,250 thousand p.a.)

The open market value of buildings element is now only ₹ 16,500 thousand and an impairment loss of ₹ 2,250 thousand should be recognised. As the loss is less than the revaluation surplus on the related asset, the entire loss should be recognised in other comprehensive income and set off against the revaluation surplus.

		₹ '000	₹ '000
Depreciation (statement of comprehensive income)	Dr.	1,250	
To Accumulated depreciation (statement of financial position)			1,250
Impairment (other comprehensive income)	Dr.	2,250	
To Non-current assets (statement of financial position)			2,250

Revised Draft Consolidated Statement of Profit or Loss and Other Comprehensive Income
for the year end 31 March 2X18

		Adjustment								
	₹'000	₹'000	₹'000	₹'000	₹'000	₹'000	₹'000	₹'000	₹'000	₹'000
	Draft	1	2	3	4	5	6	7	8	Final
Revenue	15,888	7,200	(287)							22,801
Cost of Sales	<u>(10,590)</u>									<u>(10,590)</u>
Gross Profit	5,298									12,211
Distributive expenses	(3,084)									(3,084)
Administrative expenses	<u>(960)</u>			(1,494)	(1,320)		(240)	1,000	(1,250)	<u>(4,264)</u>
Profits from operation	1,254									4,863
Finance costs	<u>(120)</u>	(571.559)		270		(60.856)				<u>(482.415)</u>
Profit before taxation	1,134									4,380.585
Income tax	<u>(255.6)</u>									<u>(255.6)</u>
Profit for the year	878.4									4,124.985
Other Comprehensive income	—			(406)					(2,250)	<u>(2,656.00)</u>
Total Comprehensive income for the period	<u>878.4</u>									<u>1,468.985</u>
Profit (loss) attributable to the group										(331.015)
Profit attributable to NCI		1,800								1,800

Working Note:

Adjustment entry needed to be passed to correct the revenue recognized by XYZ Ltd in respect of transaction with Bank.

XYZ Ltd has recognised ₹ 4,800 thousand in revenue in respect of this transaction and therefore an adjustment of ₹ 287 thousand (4,800 - 4,513) is required.

		₹ '000	₹ '000
Revenue (SPLOCI)	Dr.	287	
To Trade receivables			287

ANSWER TO CASE STUDY 3
I. Answers to Multiple Choice Questions

3.1 Option (c) : Change the subsequent depreciation per annum to ₹ 40,000 per annum.

Reason

This is a change in accounting estimate and will be treated prospectively since there is change in estimated useful life in future years.

3.2 Option (b) : 20th June, 20X2

Reason

The date would be 20th June 20X2, i.e. the date, the Board of Directors reviews the financial statements and approves them will be construed as date of authorisation under IAS 10.

3.3 Option (c) Increase provision to ₹ 6,50,000 treating it as adjusting event based

Reason

Increase provision to ₹ 6,50,000 treating it as adjusting event based on court verdict as all tenets of provisions have been fulfilled under IAS 37.

3.4 Option (b) : Change in accounting estimates

Reason

Pursuant to IAS 8, this will be treated as change in accounting estimates.

3.5 Option (a) ₹ 10.15

Reason

Particulars	Amount ₹
Conversion cost of finished goods	2,00,00,000
Raw materials	1,50,00,000
Freight inward	8,00,000
Fixed Overhead (40,00,000 / 50,00,000 x ₹ 60,00,000)	48,00,000
Total capitalized cost of inventories (A)	4,06,00,000

Units produced	(B)	40,00,000
Capitalized cost per unit	(A/B = C)	₹ 10.15

Note: Storage cost of finished goods, abnormal wastage and the remaining unallocated fixed overhead are expensed off in the period it is incurred.

II. Answers to Descriptive Questions

3.6 The treatment of biological assets:

Extracts from the Statement of Profit & Loss	₹'000	₹'000
Income		
Change in fair value of purchased herd (W2)	(30)	
Government grant (W3)	400	
Change in fair value of newly born calves (W4)	125	
Fair value of milk (W5)	<u>5.5</u>	
Total income		500.5
Expense		
Maintenance costs (W2)	500	
Breeding fees (W2)	<u>300</u>	
Total expense		<u>(800)</u>
Net income		<u>(299.5)</u>
Extracts from Statement of Financial Position		
Property, plant and equipment:		
Land (W1)		20,000
Mature herd (W2)		970
Calves (W4)		<u>125</u>
		<u>21,095</u>
Inventory		
Milk (W5)		5.5

Working Notes:

1. Land

The purchase of the land is not covered by IAS 41. The relevant standard to apply to this transaction is IAS 16 "Property, Plant and Equipment". Under this standard the land would initially be recorded at cost. Land is considered to have infinite life, hence, no depreciation is charged on it. However, the allowed alternative treatment would permit the land to be revalued to market value, with the surplus taken to equity.

2. Cows

Under the 'fair value model' laid down in IAS 41 the mature cows would be recognised in the Statement of Financial Position at 31st March, 20X2 at their fair value of $10,000 \times ₹ 97 = ₹ 9,70,000$. The difference between the fair value of the mature herd and its cost ($₹ 9,70,000 - ₹ 1 \text{ million} = \text{a loss of } ₹ 30,000$) would be charged in the income statement, along with the maintenance costs of ₹ 5,00,000.

3. Grant

Grants relating to agricultural activity are not subject to the normal requirement of IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance". Under IAS 41 such grants are credited to income as soon as they are unconditionally receivable rather than being recognised over the useful economic life of the herd. Therefore, ₹ 4,00,000 would be credited to income by Robsons Ltd.

4. Calves

They are biological assets and the fair value model is applied. The breeding fees are charged to income and an asset of $5,000 \times ₹ 25 = ₹ 1,25,000$ recognised in the Statement of Financial Position and credited to income.

5. Milk

This is agricultural produce and is initially recognised on the same basis as biological assets. Thus, the milk would be valued at $10,000 \times ₹ 0.55 = ₹ 5,500$. This is regarded as 'cost' for the future application of IAS 2 "*Inventories*" to the unsold milk.

- 3.7 As per IAS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with IFRS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under IAS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts for the year ended 31st March, 20X1 would be restated to reflect the correct classification. IAS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1st April, 20X0). Therefore, the entity is not required to present a third balance sheet.

3.8 The treatment is in accordance with IAS 19 “Employees Benefits”

Statement of Financial Position – extracts

	31.3.20X1 ₹ Million	31.3.20X2 ₹ Million
Present value of obligation	24,000	27,000
Fair value of plan assets (25,360-60)	(23,200)	(25,300)
Net defined benefit obligation	800	1,700

Statement of Comprehensive Income – extracts

	₹ Million
Current service cost	320
Net interest cost – W1	80
Past service cost – W3	1,000
Net expense in profit & loss	1,400
Re-measurement costs – W2	500
Net expenses recognized in total comprehensive income	1,900

Working Notes:

1 Net interest cost:

10% of opening net liability or asset = 10% of (24,000 – 23,200) = ₹ 80 m

2 Re-measurement cost:

Plan assets	₹ Million
Fair value of plan assets – 1.4.20X1	23,200
Return on plan assets (10% of 23,200)	2320
Contributions for the period	220
Benefits paid during the year	(330)
Expected fair value of plan assets – 31.3.20X2	25,410
Fair value of plan assets – 31.3.20X2 (25,360-60)	25,300
Re-measurements recognized in OCI in respect of plan assets	110
Defined benefit obligation	₹ Million
Defined benefit obligation – 1.4.20X1 (based on actuarial valuation)	24,000
Interest cost (10% of 24,000)	2400
Current service costs	320
Benefits paid during the year	(330)
Expected obligations on 31.3.20X2	26,390
Defined benefit obligation – 31.3.20X2 (based on actuarial valuation)	27,000
Re-measurements recognized in OCI in respect of defined benefit obligation	610

Net re-measurement loss during the year ₹ 610 m – ₹ 110 m = ₹ 500 m

3 Past service cost

In accordance with IAS 19, ₹ 1000 million will be recognized immediately as past service costs in the income statement irrespective of whether benefits are vested or non-vested.

ANSWER TO CASE STUDY 4

I. Answers to Multiple Choice Questions

4.1. Option (d) ₹ 27,00,000

Reason:	
Basic price (as per supplier's invoice plus taxes)	₹ 20,00,000
Initial delivery and handling costs	₹ 4,00,000
Cost of site preparation	₹ 2,00,000
Interest charges paid to supplier of plant for deferred credit (since there is no qualifying asset)	-
Present value of estimated dismantling costs to be incurred after 10 years	₹ 1,00,000
Operating losses before commercial production	-
Cost of machinery	<u>₹ 27,00,000</u>

4.2. Option (a) Deferred tax asset of ₹ 9,000

Reason:			
Particulars	Carrying amount	Tax base	Temporary difference
At acquisition	₹ 1,50,000	₹ 1,50,000	Nil
Accumulated depreciation	(₹ 50,000)	(₹ 50,000)	Nil
Impairment loss	(₹ 30,000)	Nil	(₹ 30,000)
Tax rate			
	30%		
Deferred tax asset			
	₹ 9,000		

4.3. Option (d) 20 months

Reason:
Capitalisation under IAS 23 will commence from the date when the expenditure is incurred (1 May 2X12) and must cease when the asset is ready for its intended use (28 February 2X14); in this case a 22-month period. However, interest cannot be capitalised during a period where development activity is suspended ie for the period of two months from July, 2X13 to August, 2X13.

4.4. Option (c) Intangible asset of ₹ 2,00,000; expense of ₹ 8,00,000

Reason:	
Research expenditure	Expense as incurred
Development expenditure	Expense if the recognition criteria for intangible assets are not met

	• Capitalise once the recognition criteria are met • Past expense cannot be capitalised
--	--

- 4.5. Option (c) : A Ltd. should recognise an expense of ₹ 1,50,000 immediately and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

Reason:

The 'non-compete' clause is a non-vesting condition, because A Ltd. does not receive any services. On the grant date, A Ltd. should immediately recognise a cost of ₹ 1,50,000, as the director is not providing any future services. A Ltd. cannot reverse the expense recognised, even if the director goes to work for a competitor and loses the share options, because the condition is a non-vesting condition.

II. Answers to the Descriptive Questions

- 4.6. (a) In the present case, majority consent is required to conduct the relevant activities of C Ltd. A Ltd. has majority voting rights and decisions will be taken by the majority shareholders and A Ltd. also controls the relevant activities of C Ltd. by having control over costing, budgeting, pricing and marketing of the project. A Ltd. exercises control over this entity, it is exposed to variable returns from its involvement with C Ltd. and has the ability to affect those returns through its power over C Ltd. Therefore, considering the guidance under IFRS 10, A Ltd. might have to consolidate C Ltd. as its subsidiary.
- (b) Since only three trustees out of ten, are closely related to A Ltd. who actively participate, and all trustees participate in their own capacity. Hence, A Ltd. doesn't have power over the trust. Further, donation given by A Ltd. to trust will never flow back to A Ltd. even in case of dissolution and discount allowed on tuition fee is also not material and not being borne by ABC Foundation. Hence, A Ltd. doesn't have any direct exposure, or rights, to variable returns of the trust. On analysis of the above facts and guidance available under IFRS 10, A Ltd. neither has power nor has exposure to variable returns. Thus, considering the requirement under IFRS 10, control could not be established. Thus, A Ltd. cannot consolidate ABC Foundation as its subsidiary under IFRS.
- 4.7. According to IFRS 9 criteria, A Ltd. and D Ltd. will classify the loan asset and liability, respectively, at amortised cost.

Scenario (a)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. A Ltd. and D Ltd. should recognize financial asset and liability, respectively, at the amount of loan given. Upon, repayment, both the entities should reverse the entries that were made at the origination. It may be noted that this accounting outcome will not apply when there is evidence that the loan is repayable after a period of time, but is disguised as being repayable on demand. Consideration should be given to the substance of the arrangement.

Journal entries in the books of A Ltd.

<i>At origination</i>			
Loan to D Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000

<i>On repayment</i>			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to D Ltd. A/c			₹ 10,00,000

Journal entries in the books of D Ltd.

<i>At origination</i>			
Bank A/c	Dr.	₹ 10,00,000	
To Loan from A Ltd. A/c			₹ 10,00,000

<i>On repayment</i>			
Loan from A Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000

Scenario (b)

Both A Ltd. and D Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of ₹ 10,00,000 payable at the end of 3 years using discounting factor of 10%, i.e., ₹ 7,51,000. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of A Ltd.

<i>At origination</i>			
Loan to D Ltd. A/c	Dr.	₹ 7,51,000	
Investment in D Ltd. A/c	Dr.	₹ 2,49,000	
To Bank A/c			₹ 10,00,000

<i>During periods to repayment- to recognise interest</i>			
<i>Year 1</i>			
Loan to D Ltd. A/c	Dr.	₹ 75,100	
To Interest income A/c			₹ 75,100
<i>Year 2</i>			
Loan to D Ltd. A/c	Dr.	₹ 82,610	
To Interest income A/c			₹ 82,610
<i>Year 3</i>			
Loan to D Ltd. A/c	Dr.	₹ 91,290	
To Interest income A/c			₹ 91,290
Note- Interest needs to be recognised in statement of profit or loss. The same cannot be adjusted against capital contribution recognised at origination.			

<i>On repayment</i>			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to D Ltd. A/c			₹ 10,00,000

Journal entries in the books of D Ltd.

<i>At origination</i>			
Bank A/c	Dr.	₹ 10,00,000	
To Loan from A Ltd. A/c			₹ 7,51,000
To Equity Contribution in A Ltd. A/c			₹ 2,49,000

<i>During periods to repayment- to recognise interest</i>			
<i>Year 1</i>			
Interest expense A/c	Dr.	₹ 75,100	
To Loan from A Ltd. A/c			₹ 75,100
<i>Year 2</i>			
Interest expense A/c	Dr.	₹ 82,610	
To Loan from A Ltd. A/c			₹ 82,610
<i>Year 3</i>			
Interest expense A/c	Dr.	₹ 91,290	
To Loan from A Ltd. A/c			₹ 91,290

<i>On repayment</i>			
Loan from A Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000

Working Note:

Years	Amount outstanding (opening)	Interest	Amount outstanding (closing)
Beginning of year 1		-	₹ 7,51,000
End of year 1	₹ 7,51,000	₹ 75,100	₹ 8,26,100
End of year 2	₹ 8,26,100	₹ 82,610	₹ 9,08,710
End of year 3	₹ 9,08,710	₹ 91,290	₹ 10,00,000

- 4.8. (a) In present case, the said compressor's carrying amount will be recovered principally through sale and not through its continuing use. Further, the asset is retired from active use and it is kept idle, hence compressor is available for immediate sale in its present condition. Since the time, compressor was classified as 'assets held for disposal', A Ltd. was committed to sell the compressor and for such sale it invited global bids as well to fetch good price for such compressor. A Ltd. always had the intention of selling it immediately on receiving good price for the compressor. On receipt of bid from the buyer U Ltd., A Ltd. initiated procedure to sell the compressor to him, but due to disagreement regarding currency of sales consideration at a later stage, a dispute arose between both the parties and the matter was taken to the Court, which later got transferred to the Arbitrator. Also a stay order has also been

issued by the Court, restricting A Ltd. to sell the asset to any other party till the matter is resolved by the arbitrator, with whom case is currently pending. As a result, A Ltd. is not able to sell the compressor till the matter is resolved, pursuant to High Court's stay order. Till date, A Ltd. has complied with all the orders/ instructions received from the Court / arbitrator and is awaiting arbitrator's verdict on this matter, which is expected to be July 2X14. As on today, subject to the stay order, A Ltd. is still committed to sell the compressor. The compressor is currently not in use, but kept it idle, ready for sale. Hence, based on the facts of the case and considering the principles under IFRS 5, it can be said that A Ltd. is committed to sell the compressor but due to factors beyond the control of A Ltd., i.e., stay order from the Court, it is restricted from selling the compressor till the matter is resolved by the assigned arbitrator. Hence, till the matter is resolved, compressor should be classified as 'non-current assets held for sale'.

- (b) As on 31 March 2X11, in Indian GAAP audited financial statements of A Ltd., compressor is classified as 'assets held for disposal' and valued at lower of net book value (carrying amount) and net realisable value, i.e., ₹ 6,522,681 in the present case. As per the guidance under IFRS 5, non-current assets held for sale should be measured at lower of carrying amount and fair value less costs to sell. There is a difference between the term 'net realisable value' and 'fair value less costs to sell', i.e., net realisable value is an exit price for an asset, whereas fair value less costs to sell is an entry price, i.e., price to be paid for acquiring an asset. Considering the facts in the present case, one can infer that 'fair value less costs to sell' is greater than 'net realisable value'. Hence, in the opening IFRS Statement of financial position of A Ltd., compressor should be valued at carrying amount, since on 31 March 2X11, carrying amount is less than net realisable value and net realisable value is less than fair value less costs to sell.

ANSWER TO CASE STUDY 5

I. Answers to Multiple Choice Questions

- 5.1. Option(c); ₹ 203

Reason

As per IAS 2 in IFRS, inventory is valued at lower of cost or net realisable value per unit.

Original cost ₹ 210.00

Net realisable value ₹ 203.00 ('225-'22)

Hence inventory value would be ₹ 203 per unit being lower of cost or net realisable value.

- 5.2. Option (b); ₹5,00,000

Reason

The amount of revenue recognized in year ending 31 March 20X2 would be ₹ 5,00,000

(₹ 50 x 10,000).

- 5.3. Option (c); ₹15,00,000

Reason

Under IFRS 15, revenue to be reported for the year ending 31 March 20X2 will be ₹15,00,000.

5.4. Option (c); Recognized as amortized cost and measured through effective interest method

Reason
Recognised as amortized cost and measured through effective interest method in accordance with IFRS 9.

5.5. Option(b)

Equity component	Debt component
95,53,600	4,46,400

Reason	
Computation of debt component of convertible debentures as on 1 April 20X1 is as under:	
	₹
Present value of the principal repayable after four years	
(1,00,00,000 x 1.12 x 0.636 (12% discount factor)	71,23,200
Present value of interest	
8,00,000 x 3.038 (4 years cumulative 12% discount factor)	<u>24,30,400</u>
Value of debt component	95,53,600
Equity element	<u>4,46,400</u>
<u>TOTAL VALUE OF THE INSTRUMENT</u>	<u>1,00,00,000</u>
Therefore, the debt element of the instruments is ₹ 95,53,600 and equity element would be ₹ 4,46,400.	

5.6. The treatment would be in accordance with the provisions of *IFRS 15 – Revenue from contract with customers*.

First we work out the numbers of points granted = 1,000.

The fair value of each point becomes = (₹1.25 x 800/1,000) = ₹1.

Accordingly, recognition of revenue is deferred to the tune of ₹1,000 (₹1 x 1,000).

Year 20X1

At the end of 1st year, 400 points have been redeemed in exchange for groceries. Hence, revenue recognized would be as under

$$= 400/800 \times ₹1,000 = ₹500$$

Year 20X2

In Year 2, management revises expectations and now it is felt that 900 points will be redeemed. During the second year, 410 points are redeemed, bringing the total redemption to 810 points.

Cumulative revenue recognized is as under:

$$₹ 1,000 \times 810 / 900 = ₹ 900, \text{ out of which } ₹500 \text{ was recognized in Year 1.}$$

Hence revenue to be recognized in Year 2 would be ₹400.

Year 20X3

In the third year balance 90 points are redeemed taking the total points redeemed to (400+410+90) = 900. As per the problem management continues to expect 900 points will be redeemed. Hence the

revenue recognized in the third year will be (₹ 1,000 – ₹ 500 - ₹ 400) = ₹ 100. Accordingly, all the revenue amounting to ₹ 1,000 originally deferred is now recognized.

5.7. Veracruz Ltd – Consolidated Statement of Financial Position as at 31st December 20X2

	₹	₹
Assets		
Non-current assets		
Intangible assets		
Goodwill (WN3)		11,000
Tangible assets (50,000 + 25,000)		75,000
Investments		25,000
Current assets		
Inventories (24,000 + 4,000 + 3,000) (WN6)	31,000	
Receivables (12,000 + 10,000 – 10,000)	12,000	
Cash at bank (4,000 + 2,000)	<u>6,000</u>	49,000
Total assets		1,60,000
Equity and Liabilities		
Capital and reserves		
Ordinary shares (75,000 + 7,500)	82,500	
Retained earnings (W.N.4)	28,000	1,10,500
Share Premium		15,000
Non-controlling interest (W.N.5)		8,000
Current liabilities		
Payables (25,000 + 8,500 – 7,000)		26,500
Total Liabilities		1,60,000

Workings:

Working Note 1

Computation of group share

Item	% Holding
Total value of shares	15,000
Par value of shares acquired by Veracruz Ltd	11,250
Percentage holding	75%
Non-controlling interest	25%

Working Note 2

Computation of consideration

Item	₹	₹
Purchase consideration: two shares of Veracruz Ltd against 3 shares of Camden Ltd, market price of Veracruz Ltd shares is ₹ 3. Hence: (2/3 x 11,250 shares x ₹3)		22,500

Since this transaction has not been given effect in books, the entry would be as under:		
Dr Investment	22,500	
Cr Share Capital		7,500
Cr Share Premium		15,000

Working Note 3

Computation of Goodwill (on acquisition date) (₹)

Item	Veracruz Ltd	Camden Ltd
Consideration		22,500
Fair value of non-controlling interest		<u>7,000</u>
		29,500
Ordinary shares in Camden Ltd books	15,000	
Retained earnings (pre-acquisition)	<u>3,500</u>	<u>18,500</u>
Goodwill on purchase of shares of Camden Ltd		<u>11,000</u>

Working Note 4

Post-acquisition reserves (₹)

Item	Veracruz Ltd	Camden Ltd
Retained earnings as on 31.12.20X2	25,000	7,500
Less: Pre-acquisition reserves		<u>(3,500)</u>
		<u>4,000</u>
Share	3,000 (75%)	1,000(25%)
To consolidated SOFP	28,000	

Working Note 5

Non-controlling interest

Item	₹
Fair value of non-controlling interest	7,000
Post-acquisition reserves	<u>1,000</u>
Total to consolidated SOFP	<u>8,000</u>

Working Note 6

Intra company receivables and payables cancel out to the extent of ₹ 7,000.

Balance amount of ₹ 3,000 is treated as goods-in-transit and included under inventories.

Working Note 7

Intra-company loan stock of ₹10,000 gets cancelled out in SOFP.

5.8. The treatment is as under:

- (a) The carrying value of the asset is ₹ 4,20,000 (₹ 5,00,000 – ₹ 80,000) and the tax base is ₹ 3,75,000 (₹ 5,00,000 – ₹1,25,000). Assuming that the asset will be written down to nil value both for accounts and tax purposes, this difference will be reversed in future, hence it is temporary in nature. Therefore, the temporary difference is ₹ 45,000 (₹ 4,20,000 – ₹ 3,75,000). This will be taxable temporary difference and give rise to a deferred tax liability of ₹ 45,000 x 20% = ₹ 9,000.

- (b) The fair value of the building is ₹4,00,000 whereas the carrying value is ₹ 2,00,000. This signifies that the building will be sold at ₹ 4,00,000 in the future. Since the company has to pay tax on this sale in future, it needs to account for the deferred tax now. Hence taxable temporary difference would be ₹ 2,00,000 ($₹4,00,000 - ₹2,00,000$) and deferred tax liability would be ₹ 40,000 ($₹ 2,00,000 \times 20\%$).
- (c) Carrying value of sales tax payable is ₹ 10,000 in 20X1 whereas the tax base is nil as the amount would be actually paid in 20X2. Hence this will give rise to deductible temporary difference of ₹ 10,000 and deferred tax asset would be ₹ 2,000 ($₹ 10,000 \times 20\%$).
- (d) Since penalty is not a deductible expenditure as per local tax laws, this difference between accounting and tax profits will never be reversed in the future. Hence this is a permanent difference and will not have any impact on deferred tax.