

MOCK TEST PAPER
FINAL COURSE: GROUP – II
PAPER 6E –GLOBAL FINANCIAL REPORTING STANDARDS

Candidates are required to answer any four case studies 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

CASE STUDY 1

Climax Limited ('the Company') is engaged in manufacturing of optical discs and its market comprises domestic sale as well as export to countries in Asia & Europe. With rising demand, the Company plans to set up a new plant in Uttaranchal in special economic zone, that will largely cater to export markets in Indonesia and Germany. The Company is entitled to 100% tax deduction on its profits for next 15 years, but MAT will be payable at the applicable rate in respective years.

The Company has entered into an asset procurement agreement for procurement of plant and machinery for the new plant with a German company – Schmidt GmbH ('Schmidt'). Schmidt shall be responsible for the supply and installation of machinery in premises of Climax including –

- a. Procurement and transportation of machinery
- b. Carrying out erection and installation at Company's premises
- c. Carrying out test runs to ensure machine is in working order.

The cost payable by the Company to Schmidt shall comprise –

- a. Cost of machinery – ₹ 50,00,00,000
- b. Transportation charges – ₹ 7,50,000
- c. Erection and installation charges – ₹ 2,50,000.

The Company has made an advance payment to the extent of 20% of the total cost of machinery (including transportation and installation charges) and the remaining 80% shall be paid only upon expiry of 2 years from erection date. Schmidt has also given a zero-defect warranty for a period of 2 years from the date of installation. In case of any defects in components of the machinery, Company shall be entitled to free replacement for the warranty term. Further, Schmidt agreed to provide an extended warranty and annual maintenance service for an additional consideration of ₹ 3,00,000. Such warranty is payable in advance and effective from the date of payment. The machine has a useful life of 10 years and depreciation is charged using straight line method.

In order to fund its operations, Mr. Vizack, CEO asks the treasury function (set up for the purpose of managing the Company's financing function on a day-to-day basis) to funds through subordinate resources. The Company's credit rating in the market is BBB+ and hence, the Company plans to raise funds through a mix of debt and equity funding considering the high cost of debt it is succumbed to.

The treasury department makes a financing plan for submission at the ensuing board meeting on 31st March, 20X1, wherein it proposes to raise funds through the following resources –

- i. Company will raise loan for ₹ 20,00,000. The loan shall carry interest @ 10% per annum and Company shall pay processing charges and upfront fees for ₹ 4,500. The loan's repayment of principal amount shall be made in 4 equal annual instalments alongwith the interest beginning from 12 months from the date of loan. The funds are expected to be disbursed by 1st April, 20X1. Effective interest rate for the loan is 10.11%.
- ii. Company has entered into an arrangement with ADB Ltd. for issue of compulsorily convertible bonds aggregating to ₹ 50,00,000 (50,000 bonds with face value of ₹ 100 each). The Company shall pay an upfront fee of ₹ 7,50,000. Such bonds shall be convertible into equivalent number of equity shares and shall carry fixed interest rate of 6% per annum for the term of bonds (3 years), payable annually. The term sheet has already been signed and the arrangement with ADB Inc. is expected to be effective 1st April, 20X1. Effective interest rate for the bond is 12.08%.
- iii. Company shall issue optionally convertible debentures ('OCD') for an amount of ₹ 10,00,000 to Raffel Ltd. that are convertible at the option of holder at the end of 2 years. If conversion option is not exercised, then such OCD shall be mandatorily redeemed at issue value. The instrument does not carry any interest. The agreement between Company and Raffel Ltd. for issuance of OCD shall be executed on 1st April, 20X1. Conversion option was not exercised at the end of 31st March, 20X3.

An unsecured debt instrument without conversion option carries interest rate of 12% per annum. Table of discount factors @ 12% per annum is as follows:

Year	Discount factor
1	0.89312
2	0.79743
3	0.71178

For the new business, company sets up a factory in Jaipur and employs 500 employees. In order to facilitate their living, the company engages a contractor for constructing accommodation for its employees. Company incurs an expenditure of ₹ 10,55,50,000 on construction of accommodation, whose completion coincided with the commissioning of its new plant. Such accommodation is proposed to be rented to its employees at monthly rental of ₹ 4,000 which is comparable to market terms.

The housing accommodation has a useful life of 20 years and depreciation is charged using straight line method.

The company plans to have the installation and erection completed before the end of financial year 20X1-20X2 to formally launch the commencement of the new factory in new financial year. Under the contract with Schmidt, an advance payment was made on 1st July. The contract was signed off on 1st July and work commenced immediately upon advance payment was made to Schmidt. Schmidt completed the erection and installation on 1st February, 20X2. As per the company, plant installation and erection did not take substantial period of time.

In financial year ended 31st March, 2XX1, there were no major developments except for the following:

- i. Company agreed with Schmidt for extended period service warranty at the time of entering into arrangement for purchase and installation of machinery. However, the payment for extended warranty was only made on 1st May, 20X2.
- ii. On 1st December, 20X2, the machinery became dysfunctional and the Company filed liquidated damages against Schmidt. The claim was filed in lieu of the product warranty provided by Schmidt for a period of 2 years. However, the same had not been acknowledged by Schmidt. The Company

is confident of getting the claim refund and has accordingly proposed to record such refund in its books.

The Company's effective tax rate (if no tax exemption availed) comes to 34.608%.

You are required to carry out the following:

I. Multiple Choice Questions

1. How would cost of extended warranty be accounted in the books?
 - (a) Capitalised as part of cost of plant & machinery on the date such asset is ready to use
 - (b) Expensed in profit or loss on the date such asset is ready to use
 - (c) No accounting shall be done till it is paid
2. How would processing fee paid on funds raised be accounted?
 - (a) Shall be adjusted in effective interest rate of the underlying financial liability
 - (b) Shall be charged off to profit or loss as and when its incurred
 - (c) Shall be added to cost of qualifying asset as and when it is incurred
3. The machinery constructed takes less than 6 months for its erection and installation. How would interest cost on the funds raised be accounted in the financial statements?
 - (a) Finance cost on cost of plant & machinery shall be capitalised till period of installation
 - (b) Finance cost on amount paid for plant & machinery shall be capitalised till period of installation
 - (c) No finance cost shall be capitalised.
4. Would deferred tax be recognised in books?
 - (a) Yes, at the effective tax rate of 34.608%
 - (b) No, deferred tax is not recognised if profits are not taxable
 - (c) Yes, to the extent such deferred tax is reversing in the period on which profits shall be taxable
5. For the claim filed by the Company against Schmidt, how would such claim be accounted in books?
 - (a) Recorded by way of adjustment from cost of asset
 - (b) Charged off to profit or loss
 - (c) Disclosed as a contingent asset in the financial statements

(2 Marks each)

II. Descriptive Questions

6. For the financial year ended 31st March, 20X2, compute the value to be recognised in the books and also pass the journal entries for all the funds raised by the Company along with the deferred tax adjustments. **(8 Marks)**
7. Determine the value of PPE (including the housing accommodation built for employees) to be recognised in the books for the year ended 20X2 and pass necessary journal entries for the financial year ended 31st March, 20X2 along with the deferred tax adjustments. Under Income-tax Act, plant and machinery is eligible for 25% depreciation on written down value method (WDV) and building is entitled to depreciation @ 10% per annum on WDV plus additional 5% depreciation for construction

carried out in backward areas. The factory is eligible for this additional depreciation. Under the Income-tax depreciation is charged for half of the year, even if an asset is used for less than 6 months.

(7 Marks)

CASE STUDY 2

ABC Co is an NGO research organisation (not-for-profit) whose main source of revenue is grants from various other NGOs and Government agencies. It operates through a team of research staff that are highly qualified and skilled. The grants received are subject to conditions attached regarding their spending on various designated projects. The financial year ending is 31st December of every year.

Salient features of the funding agreements executed in 2XX1 are as below:

- The research organisation owns all the intellectual property that is generated out of various research projects conducted on behalf of the government. The deadline for completion of all these research projects is 3 years i.e. 2XX4. Total grants receivable from such agreements are ₹ 1.80 cr. As per these contracts, the Government will pay the funds annually in equal instalments within 10 days of the acceptance of the annual performance report (deadline being 31 January of the succeeding year for the preceding calendar year). In 2XX1, a total of ₹ 0.60 cr was received from the Government. Any unused amounts are carried over to the next financial year. These contracts contain a standard clause providing for refunding of any excess unused amount lying with ABC if the contract is terminated for any reason. ABC Co is expected to spend all the amounts received and submit a financial acquittal report at the end of the project.
- The research projects conducted on behalf of Government require depositing the data on a national repository designated by Government as and whenever a research finding arises. Each Government contract is for providing research services under a single research project and each research project has a single objective. The research organisation licenses the resulting IP relating to the transferred research findings on non-exclusive basis to the Government for using it in relation to its public welfare purposes. These projects are carried out as per a pre-agreed work plan and annual budget.
- The research projects conducted on behalf of other NGOs specify only the research activities to be performed and do not require transferring any resulting research findings to the other NGO at various intervals. Such projects also have pre-agreed work plan with the other NGO. Similar to Government contracts, each NGO contract is for providing research services under a single research project and each research project has a single objective of discovery. The other NGOs do not provide any background IP. There are three types of such projects as below:
 - **Type 1** - Agreements that require transfer of an IP to the other NGO at the end of the term of the project which end in 2XX3. These IPs are highly customised. Periodic updates regarding the project activities are to be given with financial acquittal reports. Maximum amount receivable under such agreements is ₹ 1.15 cr. As per the terms, ABC Co is entitled to reimbursement of costs incurred till date if the contract is terminated due to default of the other NGO or by convenience.
 - **Type 2** - Agreements that only require dissemination of any research related information to be done as per the research organisation's public dissemination policy (The policy does not specify number of publication of newsletters or journals regarding the research findings). Total amount receivable under such agreements is ₹ 0.50 cr. No specific project term and the contract is in force until either party terminates the agreement.

- **Type 3** – Agreements that require ABC to hold specific number of seminars or conferences on the titled research project to create project awareness about the research findings. Maximum amount receivable is ₹ 1 cr. Project term is 2 years ending in 2XX2.
- Type 1 contracts require payment of the consideration (i.e. actual amount spent) within 30 days of completion of the project. Type 2 grants are received at the beginning of the year and no amount is refundable any time to the other NGO i.e. these amounts may be considered as a contribution to ABC for carrying out its objectives. Type 3 contracts require raising a monthly invoice for the amount of actual expenditure incurred in the immediately preceding month which will be reimbursed only based on satisfactory reports and surveys involving stakeholders. The amount will be paid within 10 days of invoice. ABC Co is expected to spend all the amounts as per the annual budget received and submit a financial acquittal report at the end of the year/project.

During 2XX1, the research organisation also entered in the following agreements:

- (a) an agreement with XYZ NGO which provides as follows:
 - The research organisation has to perform certain activities in connection with a specific research project.
 - Any proceeds arising from selling or licensing the resulting IP will be shared in a certain proportion between the parties
 - XYZ NGO has to make a financial contribution of ₹ 50 lacs
 - Research findings are to be periodically transferred to XYZ NGO for publishing in its quarterly NGO publication but with a mention that the research findings relate to a project carried out by both XYZ NGO and the research organisation in collaboration with each other.
- (b) Project 'OR': An agreement with Government which requires that the research organisation should depute one of its highly skilled research personnel on project 'OR' carried out by a Government agency (selection process done by ABC). As per the agreement, the research staff should be paid a certain fee out of the funds periodically transferred from Government. The selected research staff is required to perform the research and provide specific deliverables as agreed with the Government in a separate agreement. If the researcher breaches the agreement, then the research organisation is **NOT** required to select another research staff and ensure the deliverables are met. Total amount received in 2XX1 for such projects is ₹ 50 lacs. Unspent amounts at the end of each financial year are treated as debt repayable to Indian Government and accordingly recovered.

On 1st December 2XX0, the Indian Government had provided a capital grant of ₹ 15 cr to develop a research centre with specific objective. The following are the details in connection with the research centre:

- The centre will be operated for 5 years.
- The funds were to be utilised to buy or rent out a suitable land and finance the construction costs for the building.
- The land and building will be owned or leased in the name of the organisation. If owned, then the ownership of the land and building will be retained by ABC at the end of the term of the research centre and not required to be transferred to the Government.
- If any amount out of the total ₹ 15 Cr is unspent at the end of the year, it may be carried forward to the next year. Such excess amounts will be repayable only at the end of the 5 year period or on termination of the agreement whichever is earlier and hence they should be invested as per ABC's investment policy and in line with commercial terms.

- The research centre building should be constructed as per pre-agreed specifications

On 15th December 2XX0, ABC entered in a lease agreement with the owner of a land on which the building for research centre is to be developed. Details relating to the lease are as below:

- Lease term is 12 years with **no** option for renewal at the end of the 12 year term;
- Annual rent payable in arrears is ₹ 50,000 from the time the property is occupied;
- The lessor will provide a contribution of ₹ 1.50 lacs to make certain leasehold improvements before using the property. The improvements may start 1st January 2XX1 for which limited access to premises is provided;
- At the end of the lease, ABC has to restore the property to its original condition i.e. make good only if the lessor notifies six months prior to the end or termination of the lease. Alternatively, the lessor may in the six-month notice opt to take over the leasehold improvements at NIL residual value for facilitating its future let out plans. The estimated cost of make good obligations is ₹ 55,000;
- The lease hold improvements (relating to land such as car parking, pavements etc.) were completed by 31st December 2XX1 at a cost of ₹ 1.75 lacs and the property occupation will start on 1st January 2XX2 i.e. the date of commencement of research centre operations;
- During 2XX1 when the leasehold improvement works are being undertaken, lessee has to bear any utility and maintenance charges in relation to works undertaken during the period of works. Actual utility and maintenance costs incurred were ₹ 65,000;
- Rent free period is 1st January 2XX2 to 31st December 2XX3. First year of rent payable is 2XX4;
- As per the accounting policy of ABC, freehold buildings are depreciated at 5%

In the year 2XX1, ABC had spent the total revenue related grant received from Government as below:

These amounts directly relate to the cost of research findings transferred to the repositories during the year:

Payments for purchase of special materials for use in the project	– ₹ 10 lacs
Direct professional labour costs	– ₹ 25 lacs
Legal fees (for registering IP and filing infringement lawsuits)	– ₹ 5 lacs
Cost of sub-contracted services	– ₹ 15 lacs
Costs incurred in relation to audit of accounts (non-reimbursable)	– ₹ 25,000

Amounts spent from grants received from other NGOs under Type 1 agreements as below:

Costs incurred in relation to disputes on infringement over resulting IP	– ₹ 20 lacs
Direct professional labour costs	– ₹ 25 lacs
Cost of direct materials	– ₹ 5 lacs

Amounts spent from grants received from other NGOs under Type 2 agreements as below:

Costs incurred in relation to in-house publications (as per policy)	– ₹ 10 lacs
Direct professional labour costs	– ₹ 25 lacs
Cost of direct materials	– ₹ 5 lacs

Amounts spent from grants received from other NGOs under Type 3 agreements as below:

Costs incurred for conducting dissemination seminars (completed)	– ₹ 10 lacs
Direct professional labour costs incurred on completed events	– ₹ 25 lacs
Cost of direct materials relating to completed events	– ₹ 5 lacs

With respect to Type 3 project, the entity could not reasonably measure the outcome of the performance obligation. However, the entity expects to recover the cost incurred in satisfying the performance obligation.

I. Multiple choice questions

1. What is the amount of revenue that will be recognised in 2XX1 in relation to Government grants received during the year?
 - (a) 1.80 cr
 - (b) 0.60 cr
 - (c) 0.55 cr
 - (d) 1.05 cr
2. What is the amount of revenue that will be recognised in 2XX1 in relation to other Type 1 NGO grants received during the year?
 - (a) 1.15 cr
 - (b) Nil
 - (c) 0.50 cr
 - (d) 1 cr
3. What is the amount of revenue that will be recognised in 2XX1 in relation to other Type 2 NGO grants received during the year?
 - (a) 0.50 cr
 - (b) nil
 - (c) 0.40 cr
 - (d) 1 cr
4. What is the amount of revenue that will be recognised in 2XX1 in relation to other Type 3 NGO grants received during the year?
 - (a) 1 cr
 - (b) 0.40 cr
 - (c) nil
 - (d) none of these
5. What is the date of commencement of the lease?
 - (a) 15th December 2XX0
 - (b) 1st January 2XX1
 - (c) 1st January 2XX2
 - (d) 1st January 2XX3.

(2 Marks each)

II. Descriptive questions

6. CEO of ABC has requested you to prepare a memo explaining in brief how they should go about recognising revenue on the Government grant (excluding capital grants for research centre) and other NGO contracts in 2XX1 giving appropriate reasons for such assessments. **(5 Marks)**
7. As part of the engagement you are also required to provide sample disclosures under IFRS 15 (use tabular form wherever necessary for clarity) reflecting as close as possible the facts and circumstances. In that process you may also identify the missing information required to ensure completeness of disclosures under IFRS 15 and which is required to be furnished by ABC management. **(5 Marks)**
8. Calculate the ROU asset and lease liability relating to the lease agreement mentioned in the case assuming incremental borrowing rate (IBR) of 8.5% p.a. Also prepare lease liability and ROU asset amortisation schedule showing interest expense in each year. Pass journal entries for the year 2XX2. Explain briefly whether and how the calculations will be affected if the lease agreement provided for an option to renew the lease for another 12 years. **(5 Marks)**

CASE STUDY 3

Rainbow Limited is a large manufacturing company that has already adopted IFRS, during the financial year 20X3-20X4. The company is in the process of preparing its financial statements as per IFRS for the financial year 20X4-20X5. Some new developments have taken place during the year and the company is keen that the appropriate accounting treatment and disclosures under IFRS are determined and highlighted to the Board of Directors. Rainbow Limited's CFO has sought your assistance and shared the following details with you:

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ₹ 1,00,000 each, relating to the following ongoing research and development projects:

- (i) The first grant relates to the "Clear River Project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow Limited to commence this research as at 31 March, 20X5.
- (ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident of the technical feasibility and financial viability of this new technology which will be available for sale in the market by 1 April 20X6.

In September 20X4, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before 30 June, 20X5 with necessary audited figures. The financial statements of Rainbow Limited are to be adopted on 31 May 20X5, and thus the claim form would not have been filed with the State Government before adopting of financial statements.

Four years ago, Rainbow Limited had acquired a commercial property for ₹ 40 crore and immediately leased out the same to Turquoise Limited on an operating lease basis. The annual rental as per the agreement was determined to be ₹ 4 crores. As per the terms of the lease agreement, the lessee can cancel the lease by giving three months' notice in writing to the company. Turquoise Limited gave a notice on 1 October 20X4 to vacate the property from 1 January, 20X5. Rainbow Limited uses fair value model for recognition and measurement of investment property. The fair value of such property was ₹ 58 crore as on 1 January, 20X5.

On receiving such notice, Rainbow Limited has started the process of bifurcating the property into 10 identical units of equal size and sell it in the ordinary course of business. The company has incurred ₹12 crore as the expenses towards such conversion 31 March, 20X5. The bifurcation process is still in progress as at that date and the company estimates that they need to spend a further of ₹ 8 crore to complete the project, after which each of these units could fetch ₹ 10 crore.

Rainbow Limited had on 1 April, 20X3 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31 March, 20X6 provided the employee remains in employment till 31 March, 20X6.

On 1 April, 20X3, the Directors of Company estimated that 1,800 employees would qualify for the option on 31 March, 20X6. This estimate was amended to 1,850 employees on 31 March, 20X4 and further amended to 1,840 employees on 31 March, 20X5.

On 1 April, 20X3, the fair value of an option was ₹ 1.20. The fair value increased to ₹ 1.30 as on 31 March, 20X4 but due to challenging business conditions, the fair value declined thereafter. In September 20X4, when the fair value of an option was ₹ 0.90, the Directors repriced the option and this caused the fair value to increase to ₹ 1.05. Trading conditions improved in the second half of the year and by 31 March, 20X5 the fair value of an option was ₹ 1.25. Rainbow Limited decided that additional cost incurred due to repricing of the options on 30 September, 20X4 should be spread over the remaining vesting period from 30 September, 20X4 to 31 March, 20X6.

On 1 April, 20X4, the company issued a convertible bond that matures in five years. The bond can be converted into ordinary shares at any time. Rainbow Limited has calculated that the liability and equity components of the bond are ₹ 80 lakhs for the liability component and ₹ 20 lakhs for the equity component, giving a total amount of the bond of ₹ 1 crore. The interest rate on the bond is 8% and local tax legislation allows a tax deduction for the interest paid in cash. The local tax rate is 30%.

In order to fund an upcoming project, Rainbow Limited borrowed ₹ 5 crores from a scheduled bank during 20X4-20X5. The loan carries market interest rate and is repayable in 3 years. Given that the company invested a significant amount of time preparing the loan documentation and obtaining necessary approvals, Rainbow Limited has requested the bank to include an extension option. Accordingly, if the company so requires, it will have the option to extend the period of the loan at market rates prevailing at that date.

On 1 January, 20X5, Rainbow Limited acquired a 60% stake in Shadow Limited. The cash consideration payable was ₹ 1 crore to be paid immediately, and ₹ 1.21 crores after two years. The fair value of net assets of Shadow Limited at acquisition date was ₹ 3 crores. Rainbow Limited has calculated that its cost of capital is 10%. Non-controlling interest is measured at the proportionate share of identifiable net assets.

Rainbow Limited had purchased equipment P on 1st April, 20X3 for ₹ 1 lakh and this had an estimated useful life of 10 years, with a residual value of zero. The asset is depreciated on a straight line basis. On 31 March, 20X5, Rainbow Limited has revalued equipment P to ₹ 1.04 lakhs.

Rainbow Limited has a current asset of ₹ 60,000 related to interest receivable. The related interest revenue will be taxed on cash basis when it is received.

Answer the following questions based on the facts given above.

I. Multiple Choice Questions

1. Calculate the deferred tax liability arising on the convertible bond as at the 2 year ending 31 March, 20X5.
 - (a) ₹ 30,00,000
 - (b) ₹ 2,40,000
 - (c) ₹ 6,00,000
 - (d) ₹ 24,00,000

2. Calculate the amount of goodwill / gain on bargain purchase arising upon acquisition of Shadow Limited.
 - (a) ₹ 1 crore gain on bargain purchase
 - (b) ₹ 80 lakhs gain on bargain purchase
 - (c) ₹ 20 lakhs goodwill
 - (d) ₹ 41 lakhs goodwill
3. The three year term loan obtained from the bank contains an option to extend the period of the loan at market rates prevailing at that date. State which of the following is correct:
 - (a) It is not an embedded derivative.
 - (b) It is an embedded derivative closely related to the loan.
 - (c) It is an embedded derivative but not closely related to the loan, so it needs to be separately accounted for.
 - (d) It is an embedded derivative but not closely related to the loan, so no further accounting is required.
4. What is the annual depreciation charge on equipment P for years 3 to 10 and what is the amount of revaluation surplus that can be transferred to retained earnings annually?
 - (a) Annual depreciation charge will be ₹ 10,000 and an annual transfer of ₹ 3,000 can be made from revaluation surplus to retained earnings.
 - (b) Annual depreciation charge will be ₹ 10,000, however, annual transfer from revaluation surplus to retained earnings is not permitted.
 - (c) Annual depreciation charge will be ₹ 13,000 and an annual transfer of ₹ 3,000 may be made from revaluation surplus to retained earnings.
 - (d) Annual depreciation charge will be ₹ 13,000, however, annual transfer from revaluation surplus to retained earnings is not permitted.
5. What will be the tax base of interest receivable and how will the same be treated in the financial statements prepared as per IFRS?
 - (a) ₹ 60,000 and Deferred Tax Assets
 - (b) ₹ Nil and Deferred Tax Assets
 - (c) ₹ 60,000 and Deferred Tax Liability
 - (d) ₹ Nil and Deferred Tax Liability

(2 Marks each)

II. Descriptive Questions

6. Suggest the suitable accounting treatment, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31 March, 20X5. **(6 Marks)**
7. With regards to the property previously leased to Turquoise Limited, is Rainbow Limited allowed to change the classification of investment property? If yes, then analyse the accounting implications of the bifurcation currently in progress under the relevant IFRS and prepare a note on the classification, measurement and disclosure as at 31 March, 20X5. **(5 Marks)**
8. Suggest the suitable accounting treatment for share options as on 31 March, 20X5. **(4 Marks)**

CASE STUDY 4

Your advisory client Gamma Limited is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

- ◆ Gamma Limited holds 100% investment in G Limited and D Limited;
- ◆ G Limited and D Limited hold 60% and 40% in GD Limited respectively.
- ◆ Delta Limited is a 100% subsidiary of GD Limited

Gamma Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31 March, 20X4 and the extract of the same is as follows:

Particulars	Attributable to Gamma Limited	Non-controlling interest	Total (₹ in '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	<u>5,000</u>	<u>Nil</u>	<u>5,000</u>
Total Comprehensive Income	<u>44,000</u>	<u>3,000</u>	<u>47,000</u>

The long-term finance of the company comprises of the following:

- (i) 2,00,000 thousand equity shares at the beginning of the year and the company has issued 50,000 thousand shares on 1 July, 20X3 at full market value.
- (ii) 80,000 thousand irredeemable preference shares. These shares were in issue for the whole of the year ended 31 March, 20X4. The dividend on these preference shares is discretionary.
- (iii) ₹ 1,80,000 thousand of 6% Convertible Debentures issued on 1 April, 20X2 and repayable on 31 March, 20X6 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their Convertible Debentures for 1,00,000 thousand ordinary shares in the company. On 1 April, 20X2, the prevailing market interest rate for four-year Convertible Debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in five years is 0.74 and the cumulative present value of ₹ 1 payable at the end of years one to five is 3.31.

In the year ended 31 March, 20X4, Gamma Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

While preparing the financial statements for the year ended 31 March, 20X4, Gamma Limited has observed two issues in the previous year IFRS financial statements (i.e. 31 March, 20X3) which are as follows:

Issue 1:

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31 March, 20X3. While preparing annual financial statements for the year ended 31 March, 20X4, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31 March, 20X3).

Issue 2:

The company had charged off certain expenses as finance costs in the year ended 31 March, 20X3. While preparing annual financial statements for the year ended 31 March, 20X4, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31 March, 20X3).

Additional information:

Gamma Ltd. granted share options to one of its technical directors on the condition that he will not work with a competitor (i.e., non-compete clause) for a period of three years. The fair value of the award at the date of the grant is ₹ 200 thousand, including the effect of the non-compete clause. The share options have been vested immediately.

Gamma Ltd. has inventory of raw material Y of 10,000 units as at 31 March, 20X4 with a carrying amount of ₹ 100 each. The current market value of that raw material is ₹ 95 each. Gamma Ltd. will use the raw material to manufacture a component for a customer. The conversion cost for making the finished goods would be ₹ 130 each. Gamma Ltd. estimates costs to completion and sale of ₹ 50 each and a selling price for the component is estimated to be ₹ 290 each.

Gamma Limited sold a machinery Z for ₹ 900 thousand to a new customer. To get into long term relationship with the customer, the terms of sale also include after sales service to be provided for next three years free of cost. The company also sells the sales service contract separately where the customer buys it after the initial warranty period at ₹ 100 thousand.

Fresho Ltd. is one of the recently acquired subsidiary of Gamma Ltd. It has to adopt IFRS for the first time as at 31 March, 20X4, with 1 April, 20X2 as the date of transition. As at 31 March, 20X2, the value of raw material inventories was incorrectly reported due to an error. The amounts are significant.

Answer the following questions based on the facts given in the case study above:

I. Multiple Choice Questions

1. At what value the raw material Y be measured in the books of Gamma Ltd. as per applicable IFRS?
 - (a) ₹ 950 thousand.
 - (b) ₹ 1,100 thousand.
 - (c) ₹ 1,000 thousand.
 - (d) ₹ 1,600 thousand.
2. How should the revenue be recognised in the books of account for the sale of machinery Z?
 - (a) ₹ 900 thousand is to be recognised as revenue in the year of sale.
 - (b) ₹ 900 thousand is to be recognised at the end of three years after sale.
 - (c) ₹ 900 thousand is to be recognised in the year of sale and ₹ 100 thousand to be spread over next three years.
 - (d) ₹ 810 thousand is to be recognised in the year of sale and ₹ 90 thousand to be spread over next three years.
3. With respect to Fresho Ltd. state whether the error should be reported in the IFRS financial statements and how to rectify it?
 - (a) Fresho Ltd. shall report the impact of the error as a correction to Statement of Profit or Loss for the comparative period i.e., the year ended 31 March, 20X3.
 - (b) The correction shall be reflected in a reconciliation as at the end of the first IFRS reporting period i.e., as at 31 March, 20X3.
 - (c) The impact of the correction is significant and it shall be amortized on a rational and systematic basis in the first two periods of IFRS reporting i.e., years ended 31 March, 20X3 and 31 March, 20X4.

- (d) The first IFRS financial statements shall distinguish the correction of errors from changes in accounting policies and reported as part of the reconciliations as at 1 April, 20X2.
4. What is the correct accounting treatment under IFRS for the share options granted to Gamma Ltd.'s technical director?
- Gamma Ltd. should recognise an expense of ₹ 200 thousand over the period of three years and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.
 - Gamma Ltd. should recognise an expense of ₹ 200 thousand over the period of three years and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.
 - Gamma Ltd. should recognise an expense of ₹ 200 thousand immediately and cannot reverse the expense recognised even if the director goes to work for competitor and loses the share options.
 - Gamma Ltd. should recognise an expense of ₹ 200 thousand immediately and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.
5. The CFO of Gamma Ltd. is trying her best to understand the high level differences between IFRS and US GAAP. Which of the following is the correct hierarchy under US GAAP hierarchy for determining the selling price of a deliverable?
- First, the Vendor-Specific Objective Evidence must be used, if available. If not, then Third Party Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.
 - First, the Best Estimate of Selling Price must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must obtain Third Party Evidence.
 - First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.
 - First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must use Cost plus a Reasonable Margin.
- (2 Marks each)**

II. Descriptive Questions

6. Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable IFRS?
- Secondly, consider this alternative scenario. All other facts remain the same as above, but G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited. Explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.
- (5 Marks)**
7. Based on the details of long term finance provided above, help Gamma Limited compute the following:
- the finance cost of convertible debentures and closing balance as on 31 March, 20X4 to be presented in the consolidated financial statements.
 - the basic and diluted earnings per share for the year ended 31 March, 20X4.
- Assume that income tax is applicable to Gamma Limited and its subsidiaries at 25%.
- (6 Marks)**

8. What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31 March, 20X3? (4 Marks)

CASE STUDY 5

Mega Energy India Limited is a diversified company dealing in various business and has many subsidiaries too. One of its main business was generation of energy through various resources. It is preparing its financial statements under IFRS for the year ended 31 March, 20X4. You are appointed as the IFRS consultant in Mega Energy India Limited. The Company had some queries in accounting of certain transactions that are required to be presented in the financials. As a consultant to the Company, advise the company on the following issues:

1. Uttar Pradesh State Government holds 60% shares in Mega Energy India Limited and 55% shares in Super Power India Limited. Mega Energy India Limited has two subsidiaries namely P Limited and Q Limited. Super Power India Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the key management personnel in Mega Energy India Limited.
2. Mega Energy India Limited grants 150 shares to each employee on 1 April 20X2. There were 300 employees as on that date. The shares will vest in the following manner:
 - (a) As on 31 March 20X3 if the profit for the year increases 15% more than the profit for the year ended 31 March 20X2 Or
 - (b) As on 31 March 20X4 if the Profit for the year ended 31 March 20X3 increases 10% more than the profit for the year ended 31 March 20X2.

The employees should remain in service during the vesting period.

The fair value per share as on the grant date is ₹ 325. The Profit for the year ended 31 March 20X3 increased by 12% as compared to the profit for the year ended 31 March 20X2.

During the year ended 31st March, 20X3, 25 employees left the organisation. Also, it was predicted that further 35 employees will leave in the following year. However, only 28 employees left during the year ended 31 March 20X4.

3. One of the recently acquired subsidiary XYZ limited of Mega Energy India Limited has to present its first financials under IFRS for the year ended 31 March 20X4. The transition date is 1 April 20X2.

The following adjustments were made upon transition to IFRS:

- (a) XYZ limited opted to fair value its land as on the date of transition. The fair value of the land as on 1 April 20X2 was ₹ 10 crore. The carrying amount as on 1 April 20X2 under the existing GAAP was ₹ 4.5 crore.
- (b) XYZ limited has recognised a provision for proposed dividend of ₹ 78 lacs during the year ended 31 March 20X2. It was written back as on opening Statement of financial position date.
- (c) XYZ limited fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is ₹ 75 lacs.
- (d) XYZ limited has an Equity Share Capital of ₹ 80 crore and Redeemable Preference Share Capital of ₹ 25 crore.
- (e) The reserves and surplus as on 1 April 20X2 before transition to IFRS was ₹ 95 crore representing ₹ 40 crore of general reserve and ₹ 5 crore of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.
- (f) The company identified that the preference shares were in nature of financial liabilities.

(g) The company elected not to restate its earlier business combinations.

4. Mega Energy India Limited and Fuel Limited are partners of a joint operation engaged in the business of mining precious metals. The entity uses a jointly owned drilling plant in its operations.

During the year ended 31 March 20X4 an inspection was conducted by the government authorities in the mining fields. The inspection authorities concluded that adequate safety measures were not followed by the entity. As a consequence, a case was filed and a penalty of ₹ 50 crore have been demanded from Mega Energy India Limited.

The legal counsel of the company has assessed the demand and opined that appeals may not be useful, and the appeal orders will be unfavourable to the joint arrangement. Out of ₹ 50 crore (to be paid by Mega Energy India Limited), ₹ 30 crore will be reimbursed by Fuel Limited later, as per the terms of the Joint Operation Agreement. At the year end, actual reimbursement was not received from the Fuel Limited.

5. A factory owned by Mega Energy India Limited was destroyed by fire. Mega Energy India Limited lodged an insurance claim for the value of the factory building, plant, and an amount equal to one year's net profit. During the year there were a number of meetings with the representatives of the insurance company.

Finally, before the year-end, it was decided that Mega Energy India Limited would receive compensation for 90% of its claim. Mega Energy India Limited received a letter that the settlement cheque for that amount had been sent, but it was not received before the reporting date.

6. Mega Energy India Limited has issued 10,00,000, 9% cumulative preference shares. The Company has arrears of ₹ 15 crore of preference dividend as on 31 March 20X4, it includes current year arrears of ₹ 1.75 crore. The Company did not declare any dividend for equity shareholders as well as for preference shareholders.

Further Mega Energy India Limited has also issued certain optionally convertible debentures, which are outstanding as at the year end.

7. Mega Energy India Limited also operates in the travel industry and incurs costs unevenly through the financial year. Advertising costs of ₹ 40 lacs were incurred on 1 July 20X3, and staff bonuses are paid at year-end based on sales. Staff bonuses are expected to be around ₹ 400 lacs for the year; of that a sum of ₹ 60 lacs would relate to the period ending 30 September 20X3.

I. Multiple Choice Questions

1. With respect to a joint operation engaged in the business of mining precious metals, how will the liability be disclosed in the books of Mega Energy India Limited?
- (a) Provision for ₹ 20 crore and a contingent liability for ₹ 30 crore
 - (b) Contingent liability for ₹ 50 crore
 - (c) Provision for ₹ 30 crore and a contingent liability for ₹ 20 crore
 - (d) Provision for ₹ 50 crore.
2. How should Mega Energy India Limited treat the insurance claim against loss of fire in its financial statements?
- (a) Record 90% of the claim as a receivable as it is virtually certain that the contingent asset will be received.

- (b) Do not make any adjustments in the financials and only disclose the contingent asset in the notes on accounts.
 - (c) Wait until next year when the settlement cheque is actually received and not recognize or disclose this receivable at all since at year-end it is a contingent asset.
 - (d) Record 100% of the claim as a receivable at year-end as it is virtually certain that the contingent asset will be received and adjust the 10% next year when the settlement check is actually received.
3. What is the amount of preference dividend to be reduced from profit or loss for the year for calculating basic Earnings Per Share?
- (a) ₹ 15 crore
 - (b) ₹ 1.75 crore
 - (c) ₹ 13.25 crore
 - (d) Noting, as no dividend has been declared by the entity.
4. For the purposes of computation of weighted average number of shares (to arrive at diluted EPS) when should the dilutive potential shares (optionally convertible debentures) be deemed to have been converted into shares?
- (a) At the start of the period.
 - (b) The date of issue of the potential shares
 - (c) At the start of the period or, if issued later, then the date of issue of the potential shares
 - (d) At the end of the period.
5. With respect to point 7, what costs should be included in the entity's financial report for the quarter ended 30 September 20X3?
- (a) Advertising costs ₹ 40 lacs; staff bonuses ₹ 100 lacs
 - (b) Advertising costs ₹ 10 lacs; staff bonuses ₹ 100 lacs
 - (c) Advertising costs ₹ 10 lacs; staff bonuses ₹ 60 lacs
 - (d) Advertising costs ₹ 40 lacs; staff bonuses ₹ 60 lacs

(2 Marks each)

II. Descriptive Questions

6. With respect to point 1,
- (a) Determine the entities to whom exemption from disclosure of related party transactions is to be given in the books of Mega energy India Limited. Also examine the transactions and with whom such exemption applies.
 - (b) What are the disclosure requirements for the entity which has availed the exemption? **(5 Marks)**
7. Determine the employee benefit expenses to be accounted for each year. Also, pass the necessary journal entries. **(5 Marks)**
8. What is the balance of total equity (Equity and other equity) as on 1 April 20X2 after transition to IFRS. Show reconciliation between total equity as per existing GAAP and as per IFRS to be presented in the opening Statement of financial position of XYZ limited as on 1 April 20X2. Ignore deferred tax impact.

(5 Marks)