MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – II

PAPER 6E –GLOBAL FINANCIAL REPORTING STANDARDS

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

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

Working notes should form part of the answers.

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

ANSWER TO CASE STUDY 1

I. Answers to Multiple Choice Questions

1. **Option (d) : Nil**
2. **Option (a) : ₹ 5 million**
3. **Option (c) : ₹ 106.25 million**

Reasoning for 1, 2 and 3

Accounting treatment for the machine purchased through foreign currency contract and extracts from the financial statements (statement of comprehensive income and statement of financial position) for the years ended 31st December 20X1 and 31st December 20X2:

In accordance with IFRS 9: Financial Instruments, the treatment would be as under:

Year ended 31st December 20X1 (refer note-1)	**₹' Million**
Statement of Profit & Loss and other comprehensive income	
Gain on revaluation of effective hedging instrument	10
Statement of financial position	
In current assets – derivative financial instrument	10
Year ended 31st December 20X2 (refer note-2)	
Statement of Profit & Loss	
Depreciation of property, plant and equipment	(18.75)
Statement of other comprehensive income	
Gain on revaluation of effective hedging instrument	5
Reclassification of gain on effective hedging instrument (adjusted through PPE)	(15)
Statement of financial position	
Property, plant and equipment	106.25

Note-1: Explanation and supporting calculations – year ended 31st December 20X1

The property, plant and equipment is not recognised in the year ended 31st December 20X1 because the contract to purchase is an executory one.

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At 31st December 20X1 the derivative will be shown on the statement of financial position under current assets at its fair value of ₹ 10 million.

The derivative has a nil cost so a gain in fair value of ₹ 10 million will be reported in the statement of other comprehensive income. Since, the derivative is designated as a hedging instrument, this will be taken to other comprehensive income rather than Statement of profit or loss.

Note-2: Explanation and supporting calculations – year ended 31st December 20X2

Between 1st January 20X2 and 31st March 20X2, a further gain on revaluation of the derivative of ₹ 5 million (₹ 15 million – ₹ 10 million) will be recognised in other comprehensive income.

On 31st March 20X2, the machine will be recognised in property, plant and equipment at cost. The initial amount recognised will be ₹ 140,000,000 (USD 2 million x ₹ 70).

The gain of ₹ 15 million in other comprehensive income must be recognised in profit and loss.

This is done by adjusting the carrying value of the asset at the date of recognition.

Accordingly, depreciation for the current period is ₹ 18.750 million [(₹ 140 million – ₹ 15 million) x 1/5 x 9/12].

Hence, the closing balance in property, plant and equipment is ₹ 106.25 million (₹ 140 million – ₹ 15 million – ₹ 18.750 million).

4. **Option (c) : When the forward contract is settled**

Reason

The financial asset will be removed from the statement of financial position of Skywalk Ltd. when the contract is settled on 31st March 20X2.

5. **Option (d) : All 1, 2 & 3 are correct**

II. Answers to Descriptive Questions (All figures are in ₹ 000)

6. According to *IAS 36: Impairment of Assets,* the entity recognizes impairment loss by allocating it in such a way that the carrying amount of the assets in the unit (or group of units) is reduced in the following order, if the carrying amount of a cash generating unit exceeds its recoverable amount:

- Any goodwill allocated to the cash generating units or group of units
- Other assets of the group pro-rata their carrying values

This pro-rata allocation is subject to some verification as per the IFRS. The entity should not reduce the carrying amount of an asset below the highest of:

- the fair value less cost to sell (if measurable)
- its value in use (if determinable) and
- zero.

Due to this limitation, if it is not possible to allocate an impairment loss to any asset then the amount of impairment loss that would otherwise have been allocated to the asset shall be allocated pro-rata to the other assets of the unit or group of units.

Items	Assets	Provision	Assets	Provision	Assets revised

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	1.9.20X1 ₹ ’000	1.10.20X1 ₹ ’000	Revised 1.10.20X1 ₹ ’000	31.12.20X1 ₹ ’000	31.12.20X1 ₹ ’000
Goodwill	120	(120)	0	0	0
Operating license	720	(120)	600	(60)	540
Bus terminal and rest rooms	180	(30)	150	(30)	120
Tow trucks	180	(30)	150	(30)	120
Bus coaches	600	(300)	300	0	300
	1800	(600)	1200	(120)	1080
		W.N.1		W.N.2	

Working Note 1:

1. Total impairment loss – ₹ 1,800,000 – 1,200,000 = 600,000 as on 1.10.20X1.
2. Goodwill will be totally eliminated. The remaining impairment loss is ₹ 480,000.
3. We have to remove the value of buses that were totally destroyed (₹ 300, 000).
4. The fair value of the rest of the buses is equivalent to cost (as given)
5. Remaining unallocated impairment loss = (₹ 480,000 - ₹ 300,000) = ₹ 180,000
6. The unallocated impairment loss of ₹ 180,000 is allocated as follows:

	₹ ’000	₹ ’000	₹ ’000
	Carrying Value	Impairment Loss	Net value
- Operating licence	720	120	600
- Bus Terminal	180	30	150
- Tow Trucks	180	30	150
	1,080	180	900

Working note 2:

Unallocated impairment loss of ₹ 120,000 is allocated as follows:

	₹ ’000 Carrying Value	₹ ’000 Impairment Loss	₹ ’000 Net value
- Operating licence	600	60	540*
- Bus Terminal	150	30	120
- Tow Trucks	150	30	120
	900	120	780

*On 31st December, 20X1, licence had a fair value of ₹ 540,000.

7. IAS 37 requires that provisions should be made for the unavoidable consequences of events occurring before the reporting date. The steps taken before the reporting date have effectively committed the entity to the closure. The basic principle laid down in IAS 37 is that provision should be made for the direct costs associated with the closure. On this basis the required provision would be:

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	₹ '000
Redundancy costs	30,000
Onerous contract	5,500
Total	35,500

Skywalk Ltd. is committed to paying 8,000 to its pension plan but this will not form part of the closure provision. This is because the payment, when made, will enable the pension plan to discharge actuarial liabilities that are measured at 7,000. This one-off additional retirement benefit cost of 1,000 (8,000 – 7,000) will be recognized in the income statement of Skywalk Ltd. in the year to 31st December 20X1 and the net retirement benefit obligation increased accordingly.

Redeployment costs relate to the ongoing activities of the entity and are not recognized as part of a closure provision. They would only be recognized as liabilities at 31st December 20X1 if Skywalk Ltd. had entered into enforceable obligations to incur the costs.

The lease with 10 years left to run is an onerous contract given the lack of sub-letting opportunities. IAS 37 requires that the provision should be the lower of the cost of fulfilling the contract (1,000 x 6.14 = 6,140) and the cost of early termination (5,500).

The anticipated loss on sale of plant of 9,000 (11,000 – 2,000) is not part of the closure provision. However, under the principles of *IFRS 5 – Non-current assets held for sale and discontinued operations* – the plant would be measured at the lower of the current carrying value (11,000) and fair value less costs to sell (2,000). The plant would be separately displayed in a new statement of financial position caption (non-current assets held for sale).

Future operating losses are not recognized as part of a closure provision as they relate to future events. There is no need to disclose the results of the business segment that is to be closed separately in the current financial year. This is because the business segment does not satisfy the definition of a discontinued operation in the current financial year. IFRS 5 states that a discontinued operation is a component of an entity that is disposed of or classified as held for sale before the year end. This component is being abandoned rather than sold so it will not be classified as discontinued until the closure occurs. In this case this occurs for the year ended 31st December 20X1.

8. Critical date for this project is 31st December, 20X1 when the testing was completed and the new production technique was approved as being technically feasible and commercially viable from that date. Hence, according to *IAS 38 Intangible assets,* all expenses prior to that date would be charged to Income statement as Research cost. Expenses post that date would be treated as development cost which should be capitalized once the project is brought into use and amortized over the life of the asset.

ANSWER TO CASE STUDY 2

I. Answers to Multiple Choice Questions

1. Option (b) : IAS 16 'Property Plant & Equipment'; IAS 41 'Agriculture'

Reason

Para 3(b) of IAS 16 says that this standard does not apply to biological assets related to agricultural activity other than bearer plants.

Further, para 6 of the same standard defines bearer plant as a living plant that:

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(a) Is used in the production or supply of agricultural produce;

(b) Is expected to bear produce for more than one period; and

(c) Has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

Coconut palms are perennial in nature and expected to produce coconuts for more than one period and hence meet the definition of bearer plants.

2. Option (d) : ₹ 231 crore

Reason

Para 16 of IAS 41 says, entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in measuring fair value, because fair value reflects the current market conditions in which buyers and sellers would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract.

Moreover, the OHA contract represents just 7.5% [(15,000 / 2,00,000) x 100] of the total no. of palms in the farm. Hence, the contract price can't be considered for fair valuation of the entire inventory of bearer plants.

The valuation in this case would be as follows:

Adding the fair value for 15,000 (15,000 x 80 x 15 x 5) and 185,000 (185,000 x 80 x 30 x 5) palms, we get INR 231 crore.

3. Option (d) : Statement I & III

Reason

Tender coconuts are the actual fruits of coconut tree. Once they are separated from the tree, they can be converted into many other forms which requires processing. Any processing after the harvest does not qualify as an agricultural produce.

Further para 4 of IAS 41 gives clear examples of bearer plants followed by agricultural produce and further followed by products that are the result of processing after harvest.

A ripe coconut is obtained from the harvested tender coconuts which are dried and then the outer layer peeled for better pricing and then sold to merchants. Since the process of drying and peeling is a post-harvest activity, it does not qualify as an agricultural produce.

4. Option (c) : The above statement is true. Borrowing cost must be capitalised as part of the cost of bearer plants.

Reason

The core principle of IAS 23 is:

"Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense"

Para 5 of the standard defines qualifying asset as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

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Para 7 of IAS 23 *inter-alia* states that, depending on the circumstances, any of the following may be qualifying assets:

(f) bearer plants.

The circumstances of the case justify the capitalization of borrowing cost in respect of new 50,000 coconut palms.

5. Option (c) : Copra

Reason

Refer to answer to descriptive question 2 given at the later part of the solution of this case study.

According to it, copra is no more a reportable segment of the company for financial year 20X5-20X6.

II. Answers to Descriptive Questions

1. Disclosure note regarding biological assets in the books of M. Chinnaswamy & Brothers Ltd.:

"The only group of biological assets of the company is the coconut palms which are bearer plants.

The company in engaged in the activity of coconut farming and it also has several activities related to coconuts in the forward integration of the value chain as follows:

(a) Coconut oil – extracted from copra and sold as hair oil with a brand name

(b) Copra – sold as a cooking spice item to spice dealers / APMC yards

(c) Cookies and Sweets made from coconut as a main ingredient – marketed with a brand name

(d) Tender coconut and tender coconut-based ice cream sold with a brand name

(e) Accessories from Coconut shells – like key chain, toys and cutlery

(f) Coco-pit sold for use in Hydroponic farms and nurseries

As on 31st March 20X6, the company has 200,000 coconut palms which are producing 80 nut per palm on an average annually.

The company has also invested in building another farm where 50,000 coconut palms are being cultivated and nurtured for future expansion plans of the company. These palms would be available for harvest only after 8-10 years from the date of cultivation. These assets are hypothecated to a bank against a term loan.

For the development of these 50,000 coconut palms, the company has made an investment of INR 50.25 crore in addition to the annual maintenance cost for the proper growth and nurturing of the palms.*

** INR 50 crore for the land and INR 25 Lacs for the baby palms which are cultivated in the soil."*

2. If the OHA deal is excluded, the number of palms available with the company are 185,000. For all these 185,000 palms the shells are available with the company for further processing and hence their coco-pit is also available for sale.

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From the 185,000 palms, the total output available during the year

= 148,00,000 nuts (185,000 x 80)

Particulars	**Revenue (INR crore)**
Coconut oil	13.33
Copra	5.06
Sweets & Cookies (20.72 lacs kg x INR 240 per kg)	49.73
Tender coconut [(19.5% of 148 lac nuts x INR 40 per nut) + (15,000 palms x 80 nuts x INR 15 per nut)]	13.344
Coconut shells (148 lacs x INR 30 per shell)	44.40
Coco pit (20 lacs kg x INR 8 per kg)	1.60
Total Revenue	**127.464**

Reportable segments:

Based on 10% criteria for revenue, Copra and Coco pit are not reportable segments. Other reportable segments are as follows:

Segment information: (all numbers in INR Crore)

Particulars	**Coconut Oil**	**Sweets & Cookies**	**Tender Coconut**	**Coconut Shells**
Segment revenue	13.33	49.73	13.344	44.40
Segment assets	NA	(5.16 + 6.85) 12.01	5.37	NA
Segment liabilities	NA	(2.13 + 6.51) 8.64	2.12	NA

3. Amount borrowed for the new farmland (50,000 coconut palms area) is INR 40 crore at 10% p.a. (specific borrowing). Building of the farmland has started from 1st July 20X5 onwards and hence for the financial year 20X5-20X6, the borrowing cost eligible for capitalization is for 9 months. At 10% p.a. the eligible borrowing cost for 9 months is INR 3 crore [INR 4 crore x (9 / 12)]

Disclosure regarding borrowing costs:

During the year, the company has capitalized borrowing cost of INR 3 crore which pertains to new bearer plants being cultivated by the company in the form of coconut palms.

The capitalization rate used to determine the amount of such borrowing cost is 10% which is also the rate of interest charged by the bank.

ANSWERS TO THE CASE STUDY 3

Answers to Multiple Choice Questions

1. Option (c)

2. Option (d) None of the above

Reason: Refer Answer 7

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3. Option (d) Gain ₹ 17,250

Reason:

Refer Answer 9

4. Option (a) ₹ 28,140

5. Option (c) ₹ 20,700

Reason for MCQ 4 and 5

Statement of calculation of revised profit of Armstrong Ltd as on 30th September 20X3

Particulars	Amount ₹
Profit before considering adjustment of rewinding of discount	67,600
Less: Discounting	(20,700)*
Adjusted profit for the period 60% holding by parent	46,900
Profit attributable to equity shareholders of Blueberry Ltd (60% x 46,900)	28,140

Working Note

Particulars	Amount ₹
Liability to be settled on 1st October 20X4	3,00,000
Less: Discounting at 8% on 1st October 20X3 (300,000 x 0.926) = 2,77,800	22,200
Less: Discounting at 8% on 1st October 20X2 (300,000 x 0.857) = 2,57,100	20,700*
Present value of liability as on 1st October 20X2	2,57,100

Since the calculation of revised profit of Armstrong Ltd is carried as on 30 September 20X3, the entry would be:

Statement of Profit & Loss	Dr.	₹ 20,700	
To Liability			₹ 20,700

(Being unwinding of discount carried out by charging to finance cost)

II. Answers to Descriptive Questions

6. The loan given to the customer would be regarded as a financial asset. The relevant International Finance Reporting Standard is *IAS 32 – Financial Instruments Presentation*, and *IFRS 9 – Financial Instruments*. It provides that financial assets are normally measured at fair value.

Where the financial asset is one where the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these inflows rather than dispose of the asset to a third party, then IFRS 9 allows the asset to be measured at amortized cost using the effective interest method.

Assuming this method is adopted, then the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value ₹ 21,00,000.

Under the effective interest method, part of the finance income is recognized in the current period rather than all in the following period when repayment is due.

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The income recognized in Statement of Profit & Loss for the year ended 30th September 20X3 is ₹ 144,900 (₹ 21,00,000 x 6.9%).

In the absence of information regarding the financial difficulties of the customer, the financial asset at 30th September 20X3 would have been ₹ 2,244,900 (₹ 21,00,000+ ₹ 144,900).

However, the information regarding financial difficulty of the customer is objective evidence that the financial asset has suffered impairment at 30th September 20X3.

The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate.

Under the revised estimates the closing carrying amount of the asset would be ₹ 20,57,998 (₹ 22,00,000 / 1.069).

The reduction in carrying value of ₹ 186,902 (₹ 22,44,900 – ₹ 20,57,998) would be charged to Statement of profit or loss for the year ended 30th September 20X3 as an impairment of a financial asset.

7. Treatment in accordance with *IFRS 2 – Share based payment*

(a) Extracts from financial statements for year ended 30th September 20X3

Estimate of total cost of award:

250,000 share options (50 x 5000) can potentially be awarded.

Based on estimates of employee retention at the latest Statement of Financial Position date it is likely that 220,000 (44 x 5,000) will actually be awarded. It is appropriate to take account of changed estimates of this nature.

The total expected cost of this award is ₹ 990,000 (220,000 x ₹ 4·50). This cost is estimated using the fair value of the option at the grant date and is not adjusted where the fair value of the option subsequently changes.

The target share price is a market condition and so is ignored when assessing the amount of vesting.

Treatment in financial statements for the year ended 30 September 20X3

1/2 of the total costs (₹ 495, 000) is recognized in the financial statements.

The debit entry is either to the income statement as an employment cost (taken to cost of sales, distribution costs or administrative expenses as appropriate). The credit entry is to a share option account as a separate component of equity.

(b) Potential impact on financial statements for the years ended 30th September 20X4 and 20X5

(i) Year ended 30 September 20X4

Since the total estimated cost of the award is ₹ 990, 000 and the estimates made previously have proved accurate, a further charge of ₹ 495, 000 is debited either to the income statement and credited to a separate component of equity.

The closing balance on the separate equity component will be ₹ 990,000.

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(ii) Year ended 30 September 20X5

The number of options that are exercised will be 198,000 (220,000 x 90%). Blueberry Ltd will receive cash of ₹ 29,70,000 (198,000 x ₹ 15).

891,000 (990,000 x 90%) will be transferred from the share options account within equity to the share premium account.

₹ 198,000 will be included in the share capital account.

₹ 36,63,000 (198,000 x (₹ 15 – ₹ 1) + ₹ 891,000) will be included in the share premium account.

The remaining balance of ₹ 99,000 on the share options account will be transferred directly to retained earnings when the options lapse.

There will be no impact on the Statement of Profit & Loss.

8. **(a)** On 1 April 20X3, it is necessary to compare the carrying amount of the business component (₹ 40 million) with its fair value less costs to sell (₹ 28 million). Since fair value less costs to sell is lower, the business component is written down to ₹ 28 million, resulting in a loss of ₹ 12 million.

This loss of ₹ 12 million is regarded as an impairment loss that is treated in accordance with IAS 36 – *Impairment of Assets*.

The impairment loss is first allocated to the goodwill, leaving a nil balance.

The balance of the impairment loss of ₹ 2 million (₹ 12 million – ₹ 10 million) is allocated to property, plant and equipment, leaving a balance of ₹ 23 million (₹ 25 million – ₹ 2 million).

Because the property, plant and equipment is part of a disposal group that is classified as held for sale, it is not subjected to further depreciation after 1st April 20X3.

(b) By 30 September 20X3 the estimated disposal proceeds of the business had increased to ₹ 31 million. This means that part of the impairment loss has reversed.

The reversal of an impairment loss on goodwill is not permitted. Its carrying amount remains at nil.

However, a reversal of ₹ 2 million can be recognised on the property, plant and equipment at 30 September 20X3, restoring its carrying amount to ₹ 25 million.

The business component is a discontinued operation because it is a component of Blueberry Ltd that has been classified as held for sale by 30 September 20X3.

Therefore, Blueberry Ltd will disclose a single amount on the face of the statement of comprehensive income. This amount will comprise the profit after tax of ₹ 3 million and the net amount recognised as an impairment loss of ₹ 10 million (₹ 12 million – ₹ 2 million).

9. Treatment under *IFRS 9 – Financial Instruments* would be as under:

STATEMENT OF FINANCIAL POSITION as at 30th September 20X3 (Extracts)

Financial Assets:	₹
Interest rate option (W1)	15,250
6% debentures in Fox Ltd. (W2)	153,000
Shares in Cox Ltd. (W3)	187,500

STATEMENT OF COMPREHENSIVE INCOME (Extracts)

Finance Income:	
Gain on interest rate option (W1)	5,250
Effective interest on 6% debentures (W2)	12,000

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Workings

W1 Interest rate option

This is a derivative and so it must be treated as at fair value through profit or loss

Particulars	₹	₹
Initial measurement (at cost)		
Dr. Financial Asset	10,000	
Cr. Cash		10,000

At 30.09.20X3

Particulars	₹	₹
(re-measured to fair value)		
Dr. Financial Asset (₹ 15,250 - ₹ 10,000)	5,250	
Cr. Profit or loss		5,250

Financial Assets (₹ 10,000 + ₹ 5,250) = ₹ 15,250 (Statement of Financial Position)

Gain on interest option = ₹ 5,250 (Statement of Profit & Loss)

W2 Debentures

On the basis of information provided, this can be treated as a held-to-maturity Investment

Particulars	₹	₹
Initial measurement (at cost)		
Dr. Financial Asset	150,000	
Cr. Cash A/c		150,000

At 30.09.20X3 (Amortized cost)

Particulars	₹	₹
Dr. Financial Asset (₹ 150,000 x 8%)	12,000	
Cr. Finance Income		12,000
Dr. Cash (₹ 150,000 x 6%)	9,000	
Cr. Financial asset		9,000

Amortized cost at 30.09. 20X3

(₹ 150,000 + ₹ 12,000 – ₹ 9,000) = **₹ 153,000 (Statement of Financial Position)**

Effective interest on 6% debenture = **₹ 12,000 (Statement of Profit & Loss)**

W3 Shares

These are treated as an available for sale financial asset (shares cannot normally be Held to maturity and they are clearly not loans or receivables)

Particulars	₹	₹
Initial measurement (at cost)		
Dr. Financial Asset (₹ 50,000 x ₹ 3.50)	175,000	
Cr. Cash A/c		175,000

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At 30.09.20X3 (Re-measured at fair value)

Particulars	₹	₹
Dr. Financial Asset (₹ 50,000 x 3.75 – 175,000)	12,500	
Cr. Equity		12,500

Shares in Cox Ltd (₹ 175,000 + ₹ 12,500) = ₹ 187,500 (Statement of Financial Position)

ANSWER TO CASE STUDY 4

I. Answers to Multiple Choice Questions

1. **Option (b) : Current financial Liability**

2. **Option (b) :Current financial Liability**

Reason for 1 & 2

Para 74 of IAS 1 "Presentation of Financial Statements" states that when an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

3. **Option (b) : ₹ 60,000 is credited to profit and loss account and ₹ 4,40,000 is credited to other comprehensive income.**

Reason

Para 39 of IAS 16 states that if an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

4. **Option (b) : 7 years useful life for the engine, 3 years useful life for the tyres, and 9 years useful life to be applied for the balance cost of the jet.**

Reason

As per para 43 of IAS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Further, para 44 of IAS 16 states that an entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part.

Hence, the useful life of the significant component of each asset is determined separately for computing depreciation for the private jet.

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5. **Option (a) : 9 years of composite useful life**

> **Reason**
>
> US GAAP generally does not require the component approach of depreciation.

II. Answers to the Descriptive Questions

6. **(i)** Para 47 of IAS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

In this case, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	23 million	
Goodwill (bal. fig.)	Dr.	1.4 million	
To Bank			17.5 million
To NCI (23 x 30%)			6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x ₹ 84 -= ₹ 117.6.

(ii) **Determination of unrealized profit for elimination from consolidated financial statements**

Sale price of inventory = 4.20 million EURO

Unrealised profit on it = 1.80 million EURO (4.20 million - 2.40 million)

Exchange rate as on date of purchase of inventory = 83 ₹/EURO

Unrealised profit on it = 1.80 million x 83 ₹/ EURO = ₹ 149.40 million

Para 39 of IAS 21 *inter alia* states that income and expenses for each statement presenting profit or loss and other comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions.

In the given case, purchase of inventory is an expense item shown in the statement of profit or loss. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

7. It might be difficult to place significant reliance on internal management projections where an entity will be loss making for the first eleven years of its existence. Projections become more subjective, the greater the period that is considered for sufficient taxable profits. However, if an entity is reliably able to project future taxable profits, then it can recognise deferred tax assets.

In the given situation, it is assumed that the future forecast of the entity to earn taxable profit on estimates of sales to inter-group companies is probable. Hence, the deferred tax asset could be recognised in the standalone financial statements of Season Ltd.

However, in the consolidated financial statements of the group wherein Season Ltd. is a member, should not recognise the deferred tax asset as sales to inter-group company and profit thereon will be eliminated.

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Alternatively, para 27 of IAS 12 inter alia states that an entity recognises deferred tax asset only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

In the given case, it is not probable that Season Limited will earn taxable profits in the future. Also, the forecasted profit is based on sales to inter-group only. Hence, the management of Season Limited should not recognise any deferred tax asset as future probability is not certain.

8. Under US GAAP, a variety of inventory costing methodologies such as LIFO, FIFO, and/or weighted-average cost are permitted. For companies using LIFO for US income tax purposes, the book/tax conformity rules also require the use of LIFO for book accounting/reporting purposes. However, as per IFRS the use of LIFO is precluded.

Further, as per para 19 of IFRS 10, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. As per para B87 of the standard, if a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Since Monsoon Ltd. is a parent company who will be preparing the consolidated financial statements as per IFRS, it has to remeasure the inventory of USA based subsidiary company as per the inventory method and accounting policies followed by Monsoon Ltd.

9. As per para 27 of IFRS 13, a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Para 28 states that the highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

Para 29 states that highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best

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use. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the land is to develop a commercial complex. Although the developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as IFRS 13 does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

10. As per para 86 of IFRS 13, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Para 87 states that the unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, Monsoon Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Para 82 of IFRS 13 states that Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability.

If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

ANSWERS TO THE CASE STUDY 5

I. Answers to Multiple Choice Questions

1. Option (A) : Purchase consideration ₹ 11 crore, net asset value ₹ 8 crore.

Reason:

In the given case the measurement period ends by 1 January 20X4 (being one year from the date of acquisition) and accordingly, the entity cannot adjust the accounting with 1 February 20X4 values. The provisional accounting has to be corrected with the details available as on 30 November 20X3.

As per para 45 of IFRS 3, if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the

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measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

2. **Option (A) : Changed to Euro at the end of financial year 20X3-20X4, if it is considered that the underlying transactions, events and conditions of business have changed.**

Reason

As per para 9 of IAS 21, 'The Effects of Changes in Foreign Exchange Rates', the primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash.

Further, para 13 states that an entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

In the given case, since the events and conditions have been changed during the year ended 31 March 20X4, the entity can change to Euro at the end of financial year 20X3-20X4.

3. **Option (D) : Expenses incurred for food court and gaming should be capitalised.**

Reason

Paragraph 7 of IAS 16 'Property, Plant and Equipment', requires that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further as per paragraph 10 of IAS 16, an entity evaluates under this recognition principle all its property, plant and equipment cost at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

In view of the above, since it is probable that the construction of food court and gaming zone will result into flow of future economic benefits to the entity in the form of increase in sales and the cost of construction can be measured reliably, accordingly, the subsequent cost of construction of food court and gaming zone should be capitalised in the cost of mall as an item of property, plant and equipment.

4. **Option (A) : Statement of Profit or Loss A/c Dr. ₹ 5.2 crore**

To Current Liability A/c ₹ 5.2 crore

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Reason

Free Bird Limited is required to make provision for the claim from customer K as per IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of ₹ 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31 March, 20X4.

5. **Option (D): It will be considered as contingent asset only and shall not be recognized.**

Reason

As per para 31 of IAS 37, Free Bird Limited shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized in the financial statements of 31 March, 20X4.

II. Answers to Descriptive Questions

6. The discontinuation of old defined pension plan is a curtailment event. Free Bird Limited is supposed to recognised gain or loss on settlement when the legally bind agreement has been reached, that eliminates all further legal or constructive obligations for the benefits provided under the pension plan in exchange for lump sum payment.

As per para 109 of IAS 19 'Employee Benefits', the gain or loss on a settlement is the difference between:

(a) the present value of the defined benefit obligation being settled, as determined on the date of settlement

(b) the settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement.

Accordingly, Free Bird Limited recognises a settlement gain of ₹ 2 crore (ie ₹ 7 crore – ₹ 5 crore) in its financial statements for the year ended 31 March 20X4.

7. **DTL created on accumulation of undistributed profits as on 31.3.20X4**

	Carrying value	Value as per tax records	Tax base	Taxable temporary differences	Total Deferred tax liability @ 20%	Charged to P&L during the year
a	b	c	d	E= b-d	F = e x 20%	g
31 March 20X3	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore
31 March 20X4	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

8. (a) **In case defer tax is created only on account of depreciation**

	Carrying value without revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year
A	b	c	d	E= b-d	F = e x 20%	g
31 March 20X3	22 crore	22 crore	22 crore	nil	nil	nil

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Less: Depreciation for the year 20X3-20X4	(2 crore)	(1.25 crore)				
Carrying value as on 31 March 20X4	20 crore	20.75 crore	20.75 crore	(0.75 crore)	DTA (0.15 crore)	DTA (0.15 crore)

(b) Computation of tax effect taking into account the revalued figures and adjusting impact of tax effect on account of difference in depreciation

S. No.		Carrying value after revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year	Charged to OCI during the year
	a	**b**	**c**	**d**	**E= b-d**	**F = e x 20%**	**g**	**h**
I	31 March 20X3	40 crore	22 crore	22 crore	18 crore	DTL 3.6 crore	-	DTL 3.6 crore
IV	Revalued again on 31.3.20X4 (It is assumed that revaluation has been done after taking into consideration the impact of depreciation for the current year)	45 crore	20.75 crore (22-1.25)	20.75 crore	24.25 crore	DTL 4.85 crore	DTA (0.15 crore) (Refer table (a) above)	DTL 5 crore (Refer Note below) [5 DTL (B/F) – 0.15 DTA = 4.85 DTL]
V	Additional DTL/DTA required during the year (IV-I)					DTL 1.25 crore	DTA (0.15 crore) (Refer table (a))	DTL (1.40 crore) (Refer Note below)

Note:

As per para 65 of IAS 12 'Income Taxes', when an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur.

Here, it is important to understand that only the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income. However, tax effects on account of depreciation of asset and the adjustment of the tax base are recognized in profit and loss.

Accordingly, first of all the tax effect has been calculated assuming that there is no revaluation (Refer Table (a) above). Later the DTA arrived due to difference in depreciation is adjusted with the DTL created due to revaluation. DTA of ₹ 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of ₹ 1.40 crore will be charged to OCI. Net effect in the year 31.3.20X4 will be DTL 1.25 crore (DTL 1.4 crore – DTA 0.15 crore) [Refer Table (b) above].

9. The option to acquire shares in KS Ltd. would be regarded as a derivative financial instrument. This is because the value of the option depends on the value of an underlying variable (KS Ltd.'s share price). As per paragraph 4.1.4 and 4.2.1 of IFRS 9 'Financial Instruments', all derivatives are measured at fair value. On 1 April 20X3, when Free Bird Limited purchased 10 lakh options to acquire shares in KS Ltd. at ₹ 0.25 per option, Free Bird Limited will recognise Option Asset for ₹ 2.5 lakh by passing the following journal entry:

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Option on KS Ltd. shares To Bank	Dr.	₹ 2.5 lakh	 ₹ 2.5 lakh

Free Bird Limited shall measure the option at fair value at the end of every reporting period and also before exercise. The increase in share price on exercise date represents fair value of the option as the time value is zero on exercise date. Therefore, Free Bird Limited will measure the option at ₹ 6 lakh [10 lakh option x (2.6 – 2)] and recognise fair value gain of ₹ 3.5 lakh in profit or loss.

The following journal entry will be passed:

Option on KS Ltd. shares To Fair value gain	Dr.	₹ 3.5 lakh	 ₹ 3.5 lakh

On exercise of the option on 31 December 20X3, Free Bird Limited will pay ₹ 20 lakh for 10 lakh shares of KS Ltd and the option derivative will be converted to shares of KS Ltd. Therefore, Free Bird Limited will pass the following entry:

Investment in KS Ltd. equity shares	Dr.	₹ 26 lakh	
To Bank			₹ 20 lakh
To Option on KS Ltd. shares			₹ 6 lakh

Paragraph 5.1.1 of IFRS 9 'Financial Instruments' requires that the transaction costs shall be added to fair value if the financial asset is measured at other than fair value through profit or loss.

In the given case, ₹ 1 lakh incurred by Free Bird Limited for acquiring equity shares of KS Ltd. will not be added to the fair value of the equity shares of KS Ltd. This is because equity shares of KS Ltd. are classified at fair value through profit or loss in accordance with paragraph 4.1.4 of IFRS 9 Financial Instruments. Therefore, Free Bird Limited shall recognise ₹ 1 lakh incurred on acquisition of equity shares of KS Ltd. in profit or loss as on 31 March 20X4.

The investment is included in the statement of financial position at 31 March 20X4 as a current asset at its fair value of ₹ 29 lakh. The increase in fair value of ₹ 3 lakh is taken to the profit and loss.

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