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Test Series: May, 2020

MOCK TEST PAPER 1

FINAL (NEW) COURSE

PAPER 6E: GLOBAL FINANCIAL REPORTING STANDARDS

ANSWERS

ANSWER TO CASE STUDY 1

I. Answers to Multiple Choice Questions

1. Option (a) : Rs. 10.2 Million exchange loss

Reason:

XYZ Ltd purchased raw materials from American company. As XYZ Ltd agreed the value of the contract in US dollars rather than in their functional currency, the Indian rupee, XYZ Ltd is subject to exchange rate risks. Any movement in the Indian rupee to US dollar exchange rate between the transaction date and the date the contract is settled will give rise to either an exchange gains or loss in accordance with IAS 21.

The contract will initially be recorded in Indian rupee at the spot rate on 1 December 20X1, the date of the contract. As no payment has been made to the American supplier by 31 March 20X2 the contract must be translated at the 31 March spot rate to calculate the gain or loss on foreign exchange, as illustrated below:

Date	Transaction currency amount $ in million	Exchange rates	Functional currency amount Rs. in million
1.12.20X1	10.2	65	663
31.3.20X2	10.2	66	(673.2)
Exchange loss			10.2

2. Option (c) Rs. 0.34 million

Reason:

Warranty on supply only wind turbines

Warranty is an assurance warranty so warranty provisions is governed by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The potential warranty claims meet the criteria to be recognised as a provision:

- A present obligation as a result of a past event.
- A probable outflow of economic benefits.
- It may be reliably measured.

IAS 37 requires large populations of events, such as warranties, to be measured at probability weighted value. The warranty covers problems arising in the first 6 months after purchase.

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Warranty claim covers 2% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed XYZ Ltd has no potential for re-imbursement from its supplier regarding the faulty goods.

A calculation of warranty provision is set out below:

2% of annual gross margin is Rs. 5,10,000 therefore 100% of annual gross margin must be Rs. 2,55,00,000

	%age	Annual sales	Product under warranty at 31 March 20X2	Percentage expected to be returned	Warranty provision
		Rs. in million	Rs. in million	Rs. in million	Rs. in million
Gross margin	30%	25.5			
Selling price	100%	85	42.5	2%	0.85

The warranty provision should therefore be increased by Rs. 0.34 million (Rs. 0.85 million – Rs. 0.51 million). As the provision is expected to be used in the next 6 months no discounting is required.

3. Option(b) : Maintenance contract Rs. 7,820,000, Supply contract Rs. 31,280,000

Reason:

Value of individual contracts	Rs. in million
Supply and fit contract	34 m
Maintenance contract	8.5 m
	42.5 m
Less: Value of combined contract	(39.1 m)
Discount	3.4 m

Apply the discount to each individual component of the contract on pro-rata basis based on its individual fair value as follows.

	Rs. in million
Fair value of turbines (34/42.5) x 39.1	31.28
Fair value of maintenance contract (8.5/42.5) x 39.1	7.82
	39.1

4. Option (c) : Rs. 31.54 million; Current liability Rs. 15,64,000, Non-current liability Rs. 59,95,330

Reason:

As we have received full payment for the maintenance contract, but it still has 58 months still to run, we must record the payment received in advance as deferred income, splitting it between amounts to be received in less than one year and greater than one year.

Revenue recognised on 31.3.20X2	Rs. in million
Turbines	31.28
Maintenance contract (7.82 x 2/60)	0.26067
	31.54067

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Liability- current and non-current

	Rs. in million
Deferred income < 1 year [7.82 x (12 months/ 60 months)]	1.564
Deferred income > 1 year [7.82 x (60-12-2 months/ 60 months)]	5.99533

Journal Entry

		Rs. in million
Dr.	Revenue (39.1-31.54067)	7.55933
Cr.	Deferred income < 1 year	1.564
Cr.	Deferred income > 1 year	5.99533

5. Option (a) Rs. 4,32,480; Rs. 4,23,470

Reason

The relevant calculations for computation of annual charge on account of share option reserve are shown below:

Year-end	Number options	Expected number of employees	FV of option	Expected cost	Year	Cumulative charge	Recognition to date	Annual charge
31.3.20X1	300	480	9.01	1,297,440	1	432,480	0	432,480
31.3.20X2	300	475	9.01	1,283,925	2	855,950	432,480	423,470

II. Answers to Descriptive Questions

6. The share option scheme would be governed by IFRS 2 share based payments, under this IFRS all entities are required to recognise share based payments in their financial statements, XYZ Ltd should therefore have recognised this in their 20X0-20X1 financial statements also. The consequences of failing to report the share option scheme in the 20X0-20X1 financial statements will be determined by IAS 8 accounting policies, changes in accounting estimates and errors.

The share option scheme is an equity settled transaction, XYZ Ltd is receiving services from the staff in return for the granting of the share options. They must therefore measure the fair value of the share options at the grant date and charge the expected cost through the statement of profit or loss.

The failure to recognise the share option scheme in the 20X0-20X1 financial statements is a prior period error. According to IAS 8 material prior period errors should be corrected retrospectively as soon as discovered by restating the comparatives for the prior periods presented. XYZ Ltd must therefore restate the comparatives, which will impact the retained earnings brought forward.

The relevant calculations and adjustments to the financial statements are shown below:

Year-end	Number options	Expected number of employees	FV of option	Expected cost	Year	Cumulative charge	Recognition to date	Annual charge
31.3.20X1	300	480	9.01	1,297,440	1	432,480	0	432,480
31.3.20X2	300	475	9.01	1,283,925	2	855,950	432,480	423,470

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Journal Entry

		Rs. in million
Dr.	Administrative expenses	0.42347
Dr.	Retained earnings	0.43248
Cr.	Share option reserve	0.85595

7. **Working Notes:**

1. **Investment in associate (as per equity method)**

			Rs. in million
Cost			13.6
Less: Share of post-acquisition profits and reserves			
Balance as on 31.3.20X2			
Retained Earnings	130.9		
Revaluation surplus	5.1	136	
Pre-acquisition balance			
Retained Earnings	30.6		
Revaluation surplus	1.7	(32.3)	
		103.7	
Share of XYZ Ltd. (103.7 x 25%)			25.925
			39.525

2. **Provision for unrealised profit – associate**

			Rs. in million
		Total sale	Remain in investment
Selling price	150%	2.55	2.04
Profit	50%	0.85	0.51
Cost price	100%	1.70	1.53

- Provision for unrealised profit = Rs. 0.51 million x 25% = Rs. 0.1275 million
- Reduce closing inventory and retained earnings by unrealised profit
- Inter-company balances between parent and associate are not eliminated.

3. **Share of profit of associate**

	Rs. in million
Profit as per Statement of Comprehensive Income (52.7 x 25%)	13.175
Less: Unrealised profit	(0.1275)
	13.0475

4. **Adjustment entry required to be passed for exchange loss**

The exchange loss of Rs. 10.2 million will increase the accounts payable balance of the statement of financial position and be charged as an expense in the statement of profit or loss and other comprehensive income.

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As per IAS 2 Inventories, the goods still held in inventory at 31 March 20X3 must be valued at the lower of their cost and net realisable value. Assuming no damage or impairment has occurred regarding these goods, they should be recorded at the spot rate on the date of purchase, as this is the cost to XYZ Ltd. There will therefore be no change to the inventory value. The exchange loss is a finance cost. The adjustment required in the financial statements is therefore:

		Rs. in million
Dr.	Administration Expenses	10.2
Cr.	Accounts Payable	10.2

5. Adjustment entry required for warranty provision

The adjustment required to the financial statements is therefore:

		Rs. in million
Dr.	Warranty provision – cost of goods sold	0.34
Cr.	Warranty provision – current liabilities	0.34

6. Adjustment entry for revaluation of property

Revaluation of property

According to IAS 16 *Property, Plant and Equipment* all purchased items of property, plant and equipment are initially recognised at cost, after this an entity may choose to apply the cost model, where PPE is carried at cost less accumulated depreciation, or the revaluation model, where an item of PPE is carried at re-valued amount.

If the revaluation model is used the entire class of PPE to which that asset belongs must be re-valued. The frequency of revaluation depends on the movements in the fair value of the items being re-valued, but where there are significant movements in fair value annual revaluations may be required.

In this instance there has been a significant movement in fair value, the manufacturing property must therefore be re-valued to Rs. 84 million. The decrease must reduce the previous re-valuation surplus related to the manufacturing property to zero, with any remaining decrease recognised immediately in the statement of profit or loss for the period.

The relevant calculations and adjustments to the financial statements are shown below:

	31 March 20X1
	Rs. in million
Opening Book Value	98.4
Depreciation	(2.4)
Carrying value	96
Revaluation	(84)
Revaluation loss	12

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Journal Entry

		Rs. in million.
Dr.	Revaluation surplus	10.2
Dr.	Profit or loss A/c (Revaluation of property, plant and equipment)	1.8
Cr.	Property, plant and equipment	12

Statement of Profit & Loss Account & Other comprehensive income

For the year ending 31 March 20X2 (Rs. in million)

	WTM	Exchange Loss	Warranty	Maint. Contract	Share Option	Property Reval	WTM	Associate	Consolidate
Revenue	421.6			-7.55933			414.04067		414.04067
Less: Cost of goods sold	-136		-0.34				-136.34		-136.34
Selling and Distribution expenses	-34						-34		-34
Administration Expenses	-20.4	-10.2			-0.42347		-31.02347		-31.02347
Finance Costs	-17						-17		-17
Share of Profit of Associate								13.0475	13.0475
Profit before Tax	214.2	-10.2	-0.34	-7.55933	-0.42347		195.6772	13.0475	208.7247
Tax expense	-42.5						-42.5		-42.5
Profit for the year	171.7	-10.2	-0.34	-7.55933	-0.42347		153.1772	13.0475	166.2247
Other Comprehensive income						-1.8	-1.8		-1.8
Total Comprehensive income for the Year	171.7	-10.2	-0.34	-7.55933	-0.42347	-1.8	151.3772	13.0475	164.4247

Statement of Financial Position

As on 31 March 20X2 Rs. in million

	WTM	Exchange Loss	Warranty	Maint. Contract	Share Option	Property Reval	WTM	Associate	Consolidate
ASSETS									
Non-current assets									
Plant, property and equipment	450.5					-12	438.5		438.5
Intangible assets	25.5						25.5		25.5
Investment Property	37.4						37.4		37.4
Investment in PQR Ltd	13.6						13.6	25.925	39.525
	527						515	25.925	540.925
Current assets									
Inventories	187						187	-0.1275	186.8725
Trade Receivable	102						102		102
Prepayments	1.7						1.7		1.7
Cash	56.1						56.1		56.1
	346.8						346.8	-0.1275	346.6725
Total Assets	873.8						861.8	25.7975	**887.5975**
Equity and Liabilities									
Issued share capital	255						255		255
Share Premium	13.6						13.6		13.6
Retained earnings	280.5	-10.2	-0.34	-7.55933	-0.85595	-1.8	259.74472	25.7975	285.54222
Share option reserve					0.85595		0.85595		0.85595
Revaluation Surplus	10.2					-10.2	-		-
Total Equity	559.3						529.20067		554.99817
Non-current liabilities	265.2			5.99533			271.19533		271.19533

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Current liabilities	49.3	10.2	0.34	1.564			61.404		61.404
Total Liabilities	314.5						332.59933		332.59933
Total equity and liabilities	873.8						861.8		**887.5975**

XYZ Ltd Group Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Year Ended 31 March 20X2

			Rs. in million
Revenue			414.04067
Share of profit of Associate			13.0475
		A	427.08817
Cost of goods sold			136.34
Selling and Distribution expenses			34
Administration expenses			31.02347
Finance costs			17.00000
		B	218.36347
Profit before Tax	A-B		208.7247
Tax expense			(42.5)
Profit for the year			166.2247
Other comprehensive income			(1.8)
Total comprehensive income for the year			164.4247

XYZ Ltd Group

Consolidated Statement of Financial Position as at 31.3.20X2

	Rs. in million
ASSETS	
Non-current assets	
Property, plant and equipment	438.5
Intangible assets	25.5
Investment property	37.4
Investment in PQR Ltd	39.525
	540.925
Current assets	
Inventories	186.8725
Financial Assets	
Trade Receivable	102
Cash	56.1
Prepayments	1.7
	346.6725
Total Assets	**887.5975**
Equity and Liabilities	
Issued share capital Rs. 1 ordinary shares	255
Other Equity	
Share premium	13.6

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Retained earnings	285.54222
Share option reserve	0.85595
Revaluation surplus	-
Total equity	554.99817
Non-current liabilities	271.19533
Current liabilities	61.404
	332.59933
Total equity and liabilities	**887.5975**

ANSWER TO CASE STUDY 2

I. Answers to Multiple Choice Questions

1 **Option (d) : Rs. 36 million**

2 **Option (c) : Rs. 37.782 million**

3 **Option (b) : Rs. 36.182 million**

Reason for 1, 2 and 3:

In accordance with IFRS 9 '*Financial Instruments'* entities are required to measure financial assets at either amortized cost or fair value depending on the reason for holding them and the nature of the expected returns from the asset.

In the instant case, amortized cost should be used because Johansen Ltd.'s objective is to hold the assets to collect the contractual cash flows associated with it and those cash flows consist solely of the repayment of principal and interest by Carlton Ltd.

The asset will initially be measured at Rs. 36 million (Rs. 40 million x 90 paise).

The finance income for the six months to 31 March 20X2 will be Rs. 1·782 million (Rs. 36 million x 9·9% x 6/12).

The closing asset will be Rs. 37·782 million (Rs. 36 million + Rs. 1·782 million).

This asset will be split into its current and non-current portions.

The interest payment due on 30 September 20X2 of Rs. 1·6 million (Rs. 40 million x 4%) will be a current asset.

The remaining asset of Rs. 36·182 million (Rs. 37·782 million – Rs. 1·6 million) will be non-current.

4 **Option (a) : Non adjusting event**

Reason:

The information regarding the financial difficulty of Carlton Ltd is an event after the reporting period. It is a non-adjusting event as it gives evidence of conditions arising after the end of the reporting period. Since April 20X2, Carlton was a successful company, there were no sign of its non-capability of paying dues. Hence, liquidity problem arose after April, 20X2 will be considered as non-adjusting event. Therefore, the financial statements are not adjusted but Johansen Ltd should disclose the nature of the event and an estimate of its financial effect as non-disclosure could influence the economic decisions users of the financial statements might make.

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5 Option (b) : Rs. 45,10,000

Reason:

The net cost of fulfilling the contract is [(Rs. 15,00,000 x 4·32) – (Rs. 3,00,000 x 0·95 – Rs. 5,00,000 x (4.32 – 0.95))] = Rs. 45,10,000

II. Answers to Descriptive Questions

6. Calculation of purchase consideration:

Particulars	Rs. in million
Market value of shares issued (150 million x 4/3 x Rs. 10)	2,000
Initial estimate of market value of shares to be issued (150 million x 1/5 x Rs. 10)	300
Incremental acquisition costs other than the issue cost of shares	1
Total consideration	2,331

Contingent consideration is recognized in full if payment is probable. Incremental costs associated with the acquisition, other than the issue costs of financial instruments, can be included in the cost of the investment. Where material, future consideration is measured at the present value of the amount payable. In the case of shares to be issued, this is represented by the share price.

Statement of fair value of identifiable net assets at the date of acquisition

Particulars	Rs. in million
As per Bosman Ltd.'s Statement of Financial Position	1,200
Fair value of customer relationships	100
Fair value of research and development project	50
Total net assets acquired	1,350

As per *IAS 38 'Intangible assets'*, intangible assets can be recognized separately from goodwill provided they are identifiable, are under the control of the acquiring entity, and their fair value can be measured reliably.

Customer relationships that are similar in nature to those previously traded, pass these tests but employee expertise fail the 'control' test. Both the research and development phases of in process project can be capitalised provided their fair value can be measured reliably.

Statement of computation of goodwill

Particulars	Rs. in million
Fair value of consideration given	2,331
Fair value of net assets acquired	(1,350)
Goodwill on acquisition	981

As per para 58 of IFRS 3, changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date are measurement period adjustments to be dealt with in accordance with paragraphs 45–49.

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As per para 48 of IFRS 3, the acquirer recognises an increase (decrease) in the amount by means of a decrease (increase) in goodwill.

Accordingly, the changes in the fair value of contingent consideration is recorded as an adjustment to goodwill as follows:

Dr. Goodwill Rs. 30 million

Cr. Contingent consideration Rs. 30 million

7. As per IAS 37 '*Provisions, Contingent Liability and Contingent Assets',* it appears that the future payment of Rs. 2 million is possible, but unlikely. Therefore, it would be appropriate to disclose the possibility of repayment as a contingent liability, rather than actually recognizing it.

IAS 38 '*Intangible assets'* states that before an intangible asset can be recognized, it must meet the definition of an intangible asset and have a cost or value that can be measured reliably.

The definition of an intangible asset requires that the item is identifiable (can be disposed of separately without disposing of the entire business or arising from contractual or other legal rights) and that the identifiable asset can be expected to produce a source of economic benefits that the entity can control.

IAS 38 specifically states that the cost or value of an assembled workforce cannot be recognized as an intangible asset. Training expenditure seems to fail these tests. Therefore, the payment of Rs. 4 million to the agency should be recognized as an expense in the Statement of Profit or Loss.

8. As per *IFRS 2 'Share Based Payment'* the granting of options to senior executives is a share based payment and will need to be recognized as remuneration expenses. The amount to be charged as an expense is measured at fair value of goods and services provided as consideration for the share based payment or at the fair value of share based payments whichever can be more reliably measured.

For measurement purposes, in case of employee share options, the market value of the options on the day these are granted is used as this can be measured reliably.

As at 1 April 20X1, when these options were granted, the market value was Rs. 2, the remuneration expenses therefore would be:

5,000 shares x 50 employees x 90% x Rs. 2 = Rs. 4,50,000 for two year period.

Hence, for the year ended 31 March 20X2 the entry would be:

Dr..	Share based payment remuneration expense	Rs. 2,25,000
Cr.	Equity share based payment reserve	Rs. 2,25,000

9. As per *IAS 37* '*Provisions, Contingent Liabilities and Contingent Assets'***,** closure of a division is a restructuring exercise. IAS 37 states that a constructive obligation to proceed with the restructuring arises when at the reporting date the entity has:

- Commenced activities connected with the restructuring; or
- Made a public announcement of the main features of the restructuring to those affected by it. In this case a public announcement has been made and so a provision will be necessary at 31 March 20X2.

This will result in the following charges to the statement of profit & loss:

(i) Estimate of redundancy costs of Rs. 1.9 million is the best estimate of the expenditure at the date the financial statements are authorized for issue. Changes in estimates after the reporting date are taken account of for this purpose as an adjusting event after the reporting date. No charge is

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necessary for the retraining costs as these are not incurred in 20X1-20X2 and cannot form part of a restructuring provision as they are related to the ongoing activities of the entity.

(ii) Impairment of plant and equipment of Rs. 6·5 million is although not strictly part of the restructuring provision the decision to restructure before the yearend means that related assets need to be reviewed for impairment. In this case the recoverable amount of the plant and equipment is only Rs. 1·5 million. As per IAS 36 '*Impairment of assets'*, property, plant and equipment should be written down to this amount, resulting in a charge of Rs. 6·5 million to the income statement.

(iii) For compensation for breach of contract of Rs. 0.55 million, same principle applies here as applied to the redundancy costs.

(iv) No charge is recognized in 20X1-20X2 with respect to future operating losses of 20X2-20X3. Future operating losses relate to future events and provisions are made only for the consequences of past events.

(v) IAS 37 states that an onerous contract is one for which the expected cost of fulfilling the contract exceeds the benefits expected from the contract. Provision is made for the lower of the expected net cost of fulfilling the contract and the cost of early termination (not available in this case).

The net cost of fulfilling the contract is

Rs. 4.51 million [Rs. 1.5 million x 4·32 – Rs. 0.3 million x 0·95 – Rs. 0.5 million x (4·32 – 0·95)].

ANSWER TO CASE STUDY 3

I. Answers to Multiple Choice Questions

1. Option (c) : Rs. 55 lacs

Reason:

Impairment loss of Building X:	(Rs. in lacs)
Fair value of building	120
Book value	150
Impairment	**30**

Y Ltd. is a cash generating unit (CGU). Hence, as per para 104 of IAS 36, total impairment loss will be prorate allocated to all the assets of CGU.

Impairment loss of Building Y:		
Fair value of building	Book value	Prorated impairment
Building	175	25
PPE	65	9
Total	**240**	**34**
Fair value less costs to sell of the above disposal group	206	
Impairment of the disposal group	34	

Total Impairment loss of Buildings = 30 lacs + 25 lacs = 55 lacs

2. Option (b) Rs.1,48,938

Reason:

Remaining Months	**Rent (Rs.)**	**PV (Rs.)**
April 20X3	50,000	50,000

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May 20X3	50,000	49,646
June 20X3	50,000	49,292
Lease liability		**1,48,938**

3. Option (a) : Rs. 2,50,000

Reason:
Amount recognized in the profit or loss will be the amount of penalty which lessee will pay to terminate the lease

4. Option (a) : Rs. 2 lac

Reason:

Rs. 2 lac is arrived by net of Corporate Bonds in D Ltd and Foreign Govt. Bonds reclassification (6 lac – 4 lac)

5. Option (a) : Rs. 20 lac

Reason:

Rs. 20 lac is calculated as indicator of impairment of inventory as at 31st March 20X3.

II. Answers to Descriptive Questions

6. The accounting implication arising from the selling decisions in relation to X Ltd and Y Ltd depends on the classification of these two entities as per IFRS 5. The first key consideration is whether these two entities are individually a 'disposal group' that meet the criteria for classification as held for sale as per paragraph 6-8 (including paragraph 9 if applicable) and if yes then the next verification is whether they are a discontinued operation as defined in IFRS 5.

The assets of X Ltd being only Building and PPE are to be disposed off in a single transaction and hence are a 'disposal group' as per IFRS 5. Although it is given that X Ltd is being held for recovering its carrying amount through sale rather than continuing use (paragraph 6), one of its main asset i.e. building is not being held for sale in its current condition i.e. it requires additional fit outs before being sold. Also the sale is not highly probable despite there being an agreement in place. Hence the disposal group of X Ltd cannot be classified as held for sale (paragraph 7). Given the results of impairment testing have led to a recoverable amount lesser than the carrying amount, both the PPE and building have to be individually impaired as per para 59-60 of IAS 36.

In the case of Y Ltd, the assets form a disposal group as they are to be disposed of in a single transaction. The criteria for being classified as held for sale is satisfied since the assets are sold in their current condition and their sale is highly probable (given the board resolution, active marketing plan and faster acceptable offers from buyer) within one year from 1st February 20X3 i.e. date of classification as held for sale.

The next step is to determine whether the results of Y Ltd are to be presented as a discontinued operation separate from other continuing operations as per IFRS 5.

Appendix A defines discontinued operation and disposal group as below:

"*A component of an entity that either has been disposed of or is classified as held for sale and: (a) represents a separate major line of business or geographical area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale*"

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Y Ltd is a separate component of G group since its operations and cash flows are distinctly identifiable and is also to be classified as held for sale as per our analysis in previous paragraph. It also represents a separate geographical area of operation (being located in Cochin). Hence the results of Y Ltd for the year ending 31st March 20X3 have to be presented as those of a discontinued operation as per paragraph 33 of IFRS 5.

Further, since it is within the scope of IFRS 5, the requirements of impairment accounting are governed by paragraphs 18-23 of IFRS 5 which require calculation of impairments as applicable to a cash generating unit in paragraphs 104 and 122 of IAS 36. Thus, the impairment calculated for individual assets in Y Ltd (CGU) are bound to be different from what they would be if they are calculated as if they are individual assets as per IAS 36. Since the fair value less costs to sell is less than the carrying amount of the disposal group, impairment has to be accordingly calculated and recognized in P/L.

7. Following the decision of management regarding the leases, the following are the accounting implications:

MG Street lease

Since the lease has become costlier, renewal of the lease is no more a prudent decision. As such there is no reasonable certainty that the renewal option will be exercised. Hence the lease term has to be revised by excluding the renewal term from the initial assessment of 5 years as per para 21(b) of IFRS 16. This will be reflected in the form of a reduction in the amount of lease liability initially recognized with a corresponding impact on the related ROU asset (refer para 39-40(a) of IFRS 16).

Lease of service apartment at Tagore Street

As per para 68 of IAS 37, if the unavoidable cost of meeting the lease obligation (i.e. lease rent) exceeds the expected economic benefits from captive use of the service apartment for essential and productive purposes, the contract is an onerous contract. Here, amount recognized in profit and loss for the period ending 31st March 20X3 on account of Tagore street lease would be the lower of PV of future ease payments and penalty amount.

Calculation of future lease payment and its present value:

Months	Rent (Rs.)	PV (Rs.)
April 20X3	25,000	25,000.00
May 20X3	25,000	24,844.72
June 20X3	25,000	24,690.41
July 20X3	25,000	24,537.05
August 20X3	25,000	24,384.64
September 20X3	25,000	24,233.19
October 20X3	25,000	24,082.67
November 20X3	25,000	23,933.09
December 20X3	25,000	23,784.44
January 20X4	25,000	23,636.71
February 20X4	25,000	23,489.89
March 20X4	25,000	23,344.00
April 20X4	25,000	23,199.00

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May 20X4	25,000	23,054.91
June 20X4	25,000	22,911.71
TOTAL	**3,75,000**	**3,59,126**

Lower of Rs. 3,59,126 and Rs. 2,50,000 is Rs. 2,50,000

Hence penalty being lower of cost of performance is Rs. 2,50,000.

The entity has to provide for the present obligation measured as the lower of cost of fulfilling it (i.e. present value of future rent payments) and any compensation or penalties arising from terminating the lease (i.e. the Rs 2.50 lacs specified in the contract).

Investments held by the entity

Item	IFRS/IAS Ref.	Impact
Equity shares of ABC Ltd (listed)	IFRS 9.5.6.7	There is a change in the business model from FVOCI to FVTPL due to being held for trading. As no amounts are lying in OCI, no impact arises due to reclassification
Trade receivables (acquired from Parent)	IFRS 9.4.1.2	No impact as only the contractual balance is expected to be collected by holding till maturity or by re-assigning to parent.
Corporate Bonds in D Ltd	IFRS 9.5.6.4	There is a change in the business model from Amortised cost to FVOCI. Uplift in carrying amount of Rs. 6 lacs recognized in OCI.
Bonds issued by the parent country's Government	IFRS 9.5.6.5	There is a change in the business model from FVOCI to Amortised cost. An amount of Rs.4 lacs being the accumulated gain in OCI is removed from OCI and adjusted to Financial asset. This adjustment affect OCI but does not affect profit or loss.
10000 Equity shares of Rs.100 each	IAS 28.22(b)	Loss of significant influence over the entity. Fair value of the investment has to be recomputed with any gain or loss to be immediately recognized in P/L.
10% Unsecured Debentures issued at face value of Rs.10 lacs	IAS 28.38	To be included as part of the investment in the associate as the settlement is no more planned nor likely to occur in the foreseeable future and accounted as per equity method instead of as a financial asset per IFRS 9.

8. As per paragraph 3 of IAS 10,

"*Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised by the Board of Directors in case of a company, and, by the corresponding authorizing authority in case of any other entity for issue.*"

Events after the reporting period are of two types viz. (1) adjusting event and (2) non-adjusting event. Adjusting events are those that provide evidence of conditions that existed at the end of the reporting period and as such require adjusting the carrying amount of assets and liabilities for the effect of such

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events. Non Adjusting events are those that are indicative of conditions that arose after the reporting period and hence only require disclosures to their effect.

Thus any event that occurs between 1st April 20X3 and 15th May 20X3 is regarded as an event after reporting period for the purpose of IAS 10.

Below table summarises the position regarding the various year end events:

Event	Type as per IAS 10	Impact
Penalty resulting from the inspection	Adjusting event	This is an adjusting event as it is indicative of conditions (i.e. non-compliance) that already existed on 31st March 20X3. There is a present obligation which is not expected to result in outflow of resources embodying economic benefits. So no provision is required as per para 14 of IAS 37.
Distributors claim	Non - Adjusting event	The claim arose due to fall in demand for inventories that occurred post the announcement of the results of the inspection. It is an event after reporting period and does not require adjustment to any values as at 31st March 20X3 as per para 10 of IAS 10. However, in the next reporting period a share based payment expense has to be recognized at the fair value of the equity instruments issued as the fair value of goods is not reliably available as per para 7 of IFRS 2.
V Ltd.'s take-over of inventories	Not an event for this reporting period	The official communication of the decision of take over that can be regarded as authentic for the purpose of accounting occurred only after the date of authorization of financial statements for issue i.e. 15th May 20X3. In the next reporting period a distribution expense has to be recognized with a corresponding dividend payable which will be fair valued with reference to the fair value of the inventories and reversed when settled. Changes in fair value of dividend payable are recognized in Profit or Loss (Refer IFRS 10).

ANSWER TO CASE STUDY 4

I. Answers to Multiple Choice Questions

1. Option (c) : The statement is false as the contract does not give any right to the operator to control the use of Express highway

Reason:

As per IFRIC 12, in a service concession arrangement, infrastructure within the scope of Service Concession Arrangement shall not be recognized as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

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2. Option (b) : An intangible asset

Reason:

Para 17 of IFRIC 12 says that the operator shall recognise an intangible asset to the extent that it receives a right to charge the users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

Hence the same can't be recognized a financial asset but an intangible asset.

3. Option (b) : Part of intangible asset (capitalised)

Reason:

Borrowing cost during the construction period shall be capitalized as part of the qualifying asset as per IAS 23. This is further supported by Para 22 of IFRIC 12 which says that borrowing costs attributable to the arrangement shall be recognized as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of public service). In this case borrowing costs attributable to the arrangement shall be capitalized during the construction phase of the arrangement in accordance with IAS 23.

4. Option (d) : Sources of funding the construction of a public service utility

Reason:

Disclosure requirements in Service Concession Arrangement as per SIC 29 does not refer to sources of funding the infrastructure.

5. Option (b) : Cost incurred in building the Express highway till the same is open to public use

Reason:

Para 47 of IAS 38 Intangible Assets says that in order to recognise an intangible asset the cost of the asset has to be measured reliably. It further says that the fair value of an intangible asset is reliably measurable if:

a) The variability in the range of reasonable fair value measurements is not significant for that asset or

b) The probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

In the instant case measuring the cost incurred for the asset is more reliable than measuring the value of toll that can be collected.

II. Answers to Descriptive Questions

6. Computation of cost of intangible asset:

Distance of normal (plain) road = Total length of Express Highway – Total distance of tunnel – Total distance of bridges

= 409 km- 19 km – 17 km = 373 km

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Estimated cost of Express Highway:

Normal (plain) road	373 km x 2.95 crore	1,100.35 crore
Add: Tunnel road	19 km x 3.78 crore	71.82 crore
Add: Bridges	17 km x 4.58 crore	77.86 crore
		1250.03

Actual cost of construction = 99.02% of the estimate

= 1250.03 x 99.02% = Rs. 1237.78 crore.

Sources of finance:

(a) **Government grants:** Since the operator has no liability towards these grants, the same shall be deducted from cost of the public infrastructure for the purpose of Service Concession Arrangement.

Since Government grant was based on estimated cost the value of grants was –

30% x Rs. 1250.03 crore = Rs. 375 Crore.

(b) **By Banks**

Since ADB will changre interest from inauguration date, nothing will be capitalised as per IAS 23.

However, the borrowing cost of loan from nationalized bank shall be added to the cost as per the requirement of IAS 23 read with IFRIC 12.

Commercial loan from nationalised Bank = 1250.03 x 20% = Rs. 250 crore

The borrowing cost of Rs. 250 crore (loan amount) for 19 months (construction period) at 10% would be: (Rs. 250 crore x 10%)/12 month x 19 month = Rs. 39.58 crore.

So, the cost of construction would be: (1237.78 – 375) + 39.58 = Rs. 902.36 crore

7. Revenue disclosure

During the year the company has recognised a revenue of Rs. 66.89 crore from the service concession arrangement of building Express Highway from Pune and Hyderabad with Entry / Exit to Solapur.

Working Notes: (not part of the disclosure)

Toll collection during the 1st year of operations:

(i) **For the entire route:**

Type of Vehicle (1)	No. of vehicles entered (2)	%age of return vehicles (3)	Return Vehicles (4) = (2) x (3)	Total vehicle using the Express Highway (5) = (2) + (4)	Toll Tariff (Rs.) (6)	Toll collected (7) = (5) x (6)
Car/Jeep/SUV	2,24,189	96%	2,15,221	4,39,410	650	28,56,16,500
Truck/Bus/Van	55,109	99%	54,558	1,09,667	1,150	12,61,17,050
Goods Carrier/ Heavy Trucks	27,519	100%	27,519	55,038	2,050	11,28,27,900
						52,45,61,450

(ii) **For Solapur Entry and Exit only:**

Type of Vehicle (1)	No. of vehicles entered (2)	%age of return vehicles (3)	Return Vehicles (4) = (2) x (3)	Total vehicle using the Express Highway (5) = (2) + (4)	Toll Tariff (Rs.) (6)	Toll collected (7) = (5) x (6)
Car/Jeep/SUV	1,15,803	95%	1,10,013	2,25,816	350	7,90,35,600
Truck/Bus/Van	28,601	99%	28,315	56,916	600	3,41,49,600

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Goods Carrier/ Heavy Trucks	14,149	100%	14,149	28,298	1100	3,11,27,800 **14,43,13,000**

So, total revenue collected during the first year of operation was Rs. 66,88,74,450 or **Rs. 66.89 crore**

8. During the year the company has recognised a revenue of Rs. 66.89 crore from the service concession arrangement.

The loss before tax from the service concession arrangement :

Particulars	**Rs. in crore**
Revenue from Service Concession Arrangement	66.89
Less: Borrowing cost paid to ADB (W.N.1)	(10.75)
Borrowing cost paid to Nationalised Bank (W.N.2)	(14.6)
Toll collection and Supervision cost @ 10% of revenue	(6.69)
Amortization cost (W.N.3)	(42.97)
Profit (loss) before tax	**(8.12)**

Working Notes:

1. **Borrowing cost on ADB loan:**

   Loan amount Rs. (1250.03 x 50%) = 625.015 crore

   EMI for 20 year loan at 3% would be Rs. 3.5 crore (as given in the scenario).

   Total repayment amount would be (20 years x 12 month x 3.5 crore per month)

   = Rs. 840 crore

   Interest element would be (840 crore - 625.015 crore) Rs. 214.985 crore.

   So, on the equated cost basis, the annual interest cost for year 1 would be

   = 214.985 crore / 20 year

   = Rs. 10.75 crore

2. **Borrowing cost on Nationalised Bank loan:**

   Loan amount Rs. 250 crore

   EMI for 10 year loan at 10% would be Rs. 3.3 crore.

   Total repayment amount would be (10 year x 12 month x 3.3 crore) = Rs. 396 crore

   Interest element would be (396 crore – 250 crore) is Rs. 146 crore.

   So, on equated cost basis, the annual interest cost for year 1 would be

   = 146 crore / 10 year = Rs. 14.6 crore

3. **Amortization cost:**

   Cost of intangible asset is Rs. 902.36 crore.

   This asset will be amortized over a period of 21 years (the right to collect tolls).

   So the annual amortization cost would be = 902.36 crore / 21 years = 42.97 crore

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CASE STUDY 5

I. Answers to Multiple Choice Question

1. Option (b) : No; Yes

Reason:

As per para 49 of IAS 38 'Intangible Assets', internally generated goodwill shall not be recognised as an asset. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost

The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset and

(b) the recognition criteria

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

Since patent meets this requirement, it should be presented in balance sheet accordingly.

2 Option (d) : The software cost would be charged to revenue

Reason:

As per IAS 38 'Intangible Assets', an intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably

The software cost would be charged to revenue as no future economic benefits will flow to the entity from it. Hence, it does not meet the criteria laid down under IAS 38 'Intangible Assets'.

3 Option (b) : Rs. 1.6 million

Reason:

In accordance with IAS 38 'Intangible assets', the value of the trademark will not be amortized since its useful life is indefinite. However, it will be tested for impairment annually. The recoverable amount is Rs. 1.6 million (Rs. 0.1 million less than the carrying value of Rs. 1.7 million).

Therefore, there is an impairment loss of Rs. 0.1 million. This amount will be deducted from the carrying value and recognized in the statement of profit or loss as at 30th September 20X2.

4 Option (c) : Rs. 1.7 million

5 Option (a) : Profit of Rs. 0.2 million

Reason:

Computation of reassessed net assets is as under:

Particulars	Rs. in million
Total Assets (A)	5.0
Liabilities	3.0
Add: Contingent liabilities	0.3

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Total revised liabilities (B)	3.3
Net Assets (A-B) = (C)	1.7
Purchase consideration (D)	1.5
Gain on bargain purchase (C –D) = (E)	0.2

The reassessed net assets acquired are worth Rs. 1.7 million; purchase consideration, Rs. 1.5 million. There is an excess of Rs. 0.2 million (gain on bargain purchase), which would be immediately recognized in Statement of Profit or Loss.

II. Answers to Descriptive Questions

6. Cost to be capitalized of new specialized machinery:

Particulars	**Rs. in million**
Cost of construction of new site	6.00
Cost of new machinery	20.00
Cost of installation	0.30
Freight	0.40
Trial run cost	0.42
Total cost of Machinery	**27.12**

Note: The dismantling cost of Rs. 1,000,000 must have been added in capitalization of the older machinery, hence cannot be capitalized along with the new specialised machinery.

The New Machinery is valued at the fair value given in the case study. Accordingly entry of acquisition of new machinery will be: **Rs. in million**

Dr	New Machinery	20.00
Dr	Loss on old Machinery (Rs. 5.00 – Rs. 4.00)	1.00
Cr	Old Machinery	5.00
Cr	Bank	16.00

Trial run costs are included in the cost of the machinery as it is incurred to ensure that the machine is in working condition.

Cost of launching amounting to Rs. 5 lac and the initial loss amounting to Rs. 1 million are not to be recognized as cost of the machinery.

7. The excess of carrying value over the tax base of PPE creates a taxable temporary difference of Rs. 17 million (Rs. 44 million – Rs. 27 million) and a deferred tax liability of Rs. 4.25 million. The liability in 20X0-20X1 was Rs. 2 million, so the increase of Rs. 2.25 million (Rs. 4.25 million – Rs. 2 million) is charged to the Income statement. However, the portion of deferred tax liability that relates to the property revaluation should be charged against other comprehensive income instead of income statement profit. This is Rs. 1.5 million (Rs. 6 million x 25%), which reduces the deferred tax expense in the Statement of Profit or Loss to Rs. 0.75 million (Rs. 2.25 million – Rs. 1.5 million). Hence deferred tax expense of Rs. 0.75 million and Rs. 1.5 million is to be charged in Statement of Profit or Loss and Other Comprehensive Income respectively.

The intangible asset has a carrying value of Rs. 9 million. As it has already qualified for tax relief, it has a tax base of Rs. nil. Therefore, taxable temporary difference of Rs. 2.25 million (Rs. 9 million x 25%) will be charged to the Statement of Profit or Loss as an expense.

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The consolidated accounts will be adjusted for the unrealized profit of Rs. 0.6 million

[(Rs. 4 million – Rs. 3 million) x 60 %]. This will reduce the group inventory from Rs. 2.4 million (60% x Rs. 4 million) to Rs. 1.8 million (Rs. 2.4 million – Rs. 0.6 million) and will reduce group profit by Rs. 0.6 million. However, the tax charge in the consolidated income statement is based on the individual company accounts, which include the unrealized profit. Therefore, a temporary difference of Rs. 0.6 million x 25% = Rs. 0.15 million. This is a deferred tax asset resulting in a credit to the Income statement which can be recognized against the larger deferred tax expense.

The loan will be recorded in the financial statements at Rs. 19 million, net of the issue costs of Rs. 1 million. The issue costs will then affect the income statement by way of a reduction in future finance costs. However, the tax relief has already been given to these costs. There lies a taxable temporary difference as the issue costs have a carrying amount of Rs. 1 million and tax base as Rs. Nil. This results in a deferred tax liability of Rs. 0.25 million (Rs. 1 million x 25%) charged to the Statement of Profit or Loss.

The overall charge for deferred tax that will appear in the Statement of Profit or Loss would be:

Particulars	Rs. in million
Deferred tax liability on excess of carrying value of PPE	0.75
Deferred tax liability on intangible assets (9 million x 25%)	2.25
Deferred tax liability on loan (1 million x 25%)	0.25
Total deferred tax liability:	3.25
Less: Adjustment of deferred tax asset on unrealized profit on group inventory	(0.15)
Net deferred tax liability	3.10

8. As per Ind AS 8 'Accounting Policies, Accounting Estimates and Errors, prospective application of a change in accounting policy has to be done since retrospective application is not practicable.

Property, plant and equipment at the end of 31st March,20X2:		Rs. in million
As per the engineering survey:		
Valuation of PPE		17,000
Estimated residual value		3,000
Average remaining asset life (years)	7	
Depreciation expense on existing property, plant and equipment		
for 20X1-20X2 (new basis) (17,000 – 3,000)/7		2,000

From the start of 20X1-20X2, Blue Ocean group changed its accounting policy for depreciating property, plant and equipment, so as to apply components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values.

The policy has been applied prospectively from the start of the year 20X1-20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years.

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The impact on the financial statements for 20X1-20X2 would be as under:

Particulars	Rs. in million
Increase the carrying amount of property, plant and equipment at the start of the year (17,000-11,000)	6,000
Increase the opening deferred tax provision (6,000 x 30%)	1,800
Create a revaluation surplus at the start of the year (6,000 – 1,800)	4,200
Increase depreciation expense by (Rs.2,000 – Rs.1,500)	500
Reduce tax expense on depreciation (30%)	150

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