

CA FINAL

FINANCIAL REPORTING GUESS QUESTION PAPER

(Based on Pattern analysis by CACHinmaya Hegde)

Disclaimer (Read carefully)

The Question answers given below are prepared by the faculty as per their views and experience. Faculty has no connection with the ICAI Examination committee in any manner. This is purely for practice purpose only. The working notes, notes and assumptions, if any stated, are purely the views of the respective faculty and students are encouraged to go through them and apply the same in the examination as a good practice. No assurance is given that the answer keys of the Institute of Chartered Accountants of India used for valuation are the same. However, utmost care has been taken while designing the below suggested answers. Feedback is welcome.

PAPER – 1 : FINANCIAL REPORTING (NEW SYLLABUS)**Time Allowed – 3 Hours****Maximum Marks – 100**

- 1. The question paper comprises two parts, Part I and Part II.**
- 2. Part I comprises Case Scenario based Multiple Choice Questions (MCQs)**
- 3. Part II comprises questions which require descriptive type answers.**

*Wherever necessary, suitable assumptions may be made and disclosed by way of a note.
Working notes should form part of the answers*

Part I**Question 1****(10 Marks)**

B Global Enterprises is a multinational conglomerate with operations spanning various sectors, including manufacturing, technology, and services, across multiple countries. It adheres to Indian Accounting Standards (Ind AS) for maintaining its books of accounts and preparing its annual consolidated financial statements. The fiscal year ends on 31st March, and the enterprise is currently in the process of finalizing its accounts for the year ended 31st March 2024

As the Finance Controller of B Global Enterprises, you oversee the financial reporting process and ensure compliance with the applicable accounting standards and regulations. Your team of assistant accountants has compiled the financial data, and they need your expert opinion on several complex transactions before they can finalize the financial statements.

Company has reported Rs 60,000 as pre tax profit in first quarter and expects a loss of Rs 15,000 each in the subsequent quarters. It has a corporate tax slab of 20 percent on the first Rs 20,000 of annual earnings and 40 per cent on all additional earnings.

B Global deals in the commodities which is sold in 2 different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The price that would be received is Rs 78, transaction costs in that market are Rs 9 and the costs to transport the asset to that market are Rs 6.

In Market B:

The price that would be received is Rs 75, transaction costs in that market are Rs 3 and the costs to transport the asset to that market are Rs 6.

Company has purchased goods worth Rs 40,00,000 during the year. Out of this, 75% of the goods are sold. The company values the closing inventory at Rs 10,00,000 ie., at Cost. You are given to understand that the expected selling price is Rs 11,00,000 and that the company would incur 10% commission to make the sale

Company borrowed an amount of Rs. 150 crores on 1.4.2023 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant capitalized Rs. 19.50 crores for the accounting period ending on 31.3.2024. Due to surplus fund out of Rs. 150 crores an income of Rs. 3.50 crores was earned and credited to profit and loss account.

Based on the above answer the following

(i) What is Average Annual Income tax rate

- (a) 20%
- (b) 10%
- (c) 40%
- (d) 25%

(ii) What is the fair value of the asset, if market A is the principal market

- (a) Rs 78
- (b) Rs 75
- (c) Rs 72
- (d) None of the above

(iii) What is the fair value of the asset, if none of the markets is principal market

- (a) Rs 63
- (b) Rs 69
- (c) Rs 72
- (d) Rs 66

(iv) Closing stock of the company is valued at

- (a) Rs 990,000
- (b) Rs 10,00,000
- (c) Rs 11,00,000
- (d) None of the above

(v) The amount of Borrowing costs to be capitalized is

- (a) Rs 16.5 Cr
- (b) 0
- (c) Rs 14 Cr
- (d) Rs 13 Cr

Solution

(i) A

Amount of income tax expense reported in each quarter would be as below:

Expected total Income = Rs 15,000 [60,000- (15,000 x 3)]

Expected tax as per slabs = 15,000 x 20% = Rs 3,000

Average Annual Income tax rate = 3,000/15,000 = 20%

(ii) C

If Market A is the principal market

If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs.

Fair Value of the asset will be

	Rs
Price receivable	78

Less: Transportation cost	(6)
Fair value of the asset	<u>72</u>

(iii) B

If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

Determination of most advantageous market:

	Rs	Rs
	Market A	Market B
Price receivable	78	75
Less: Transaction cost	(9)	(3)
Less: Transportation cost	(6)	(6)
Fair value of the asset	<u>63</u>	<u>66</u>

Since the entity would maximise the net amount that would be received for the asset in Market B i.e. Rs 66, the fair value of the asset would be measured using the price in Market B.

Fair value of the asset will be

	Rs
Price receivable	75
Less: Transportation cost	(6)
Fair value of the asset	<u>69</u>

(iv) A

Cost		10,00,000
NRV		
SP	11,00,000	
Less :Selling expenses	1,10,000	9,90,000
Closing stock to be valued at		Rs.990,000

(v) D

	Rs. (in crores)
Interest paid (11% on Rs.150 crores)	16.50
Less: Income on temporary investment from specific borrowings	<u>3.50</u>
Borrowing costs to be capitalised	13.00

Question 2

(10 Marks)

Super Sounds Limited had the following transactions during the Financial Year 2019-2020.

(i) On 1st April 2019, Super Sounds Limited purchased the net assets of Music Limited for ₹ 13,20,000. The fair value of Music Limited's identifiable net assets was ₹ 10,00,000. Super Sounds Limited is of the view that due to popularity of Music Limited's product, the life of goodwill is 10 years.

(ii) On 4th May 2019, Super Sounds Limited purchased a Franchisee to organize musical shows from Armaan TV for ₹ 80,00,000 and at an annual fee of 2% of musical shows revenue. The Franchisee expires after 5 years. Musical shows revenue were ₹ 10,00,000 for financial year 2019-2020. The projected future revenues for financial year 2020-2021 is ₹ 25,00,000 and ₹ 30,00,000 p.a. for remaining 3 years thereafter.

(iii) On 4th July 2019, Super Sounds Limited was granted a Copyright that had been applied for by Music Limited. During financial year 2019-2020, Super Sound Limited incurred ₹ 2,50,000 on legal cost to register the Patent and ₹ 7,00,000 additional cost to successfully prosecute a copyright infringement suit against a competitor.

The life of the Copyright is for 10 years. Super Sound Limited follows an accounting policy to amortize all intangible on SLM (Straight Line Method) basis or any appropriate basis over a maximum period permitted by relevant Ind AS, taking a full year amortization in the year of acquisition.

Based on the above answer the following

- (i) What of the following is the correct reporting format in balance sheet
- Gross block at cost Add Accumulated depreciation equals to Net block
 - Gross block at cost Less depreciation for the year equals to Net block
 - Gross block at cost Less Accumulated depreciation equals to Net block
 - Only net block to be reported
- (ii) If there are no indicators representing impairment of goodwill then
- Goodwill Should be amortized over useful life
 - Goodwill Should be amortized over Maximum of 10 years
 - Goodwill Should not be impaired
 - Goodwill acquired in a business combination for impairment annually
- (iii) Carrying Amount of Franchise in the balance sheet is
- Rs 80,00,000
 - Rs 64,00,000
 - Rs 70,00,000
 - Its not intangible asset
- (iv) Carrying Amount of Copyright in the balance sheet is
- Rs 250,000
 - Rs 225,000
 - Rs 7,00,000
 - Its not intangible asset

(v) Total Carrying Amount of intangible asset in the balance sheet is

- (a) Rs 250,000
 (b) Rs 225,000
 (c) Rs 7,00,000
 (d) None of the above

Solution

(i) C

Recommended format

	Assets	Gross Block (Cost)			Accumulated amortisation			Net block	
		Opening balance ₹	Additions ₹	Closing Balance ₹	Opening balance ₹	Additions ₹	Closing Balance ₹	Opening balance ₹	Closing Balance ₹
1									
2									
3									

(ii) D

As per Ind AS 36, irrespective of whether there is any indication of impairment, an entity shall test goodwill acquired in a business combination for impairment annually. This implies **that goodwill is not amortised annually but is subject to annual impairment, if any.**

(iii) B

As per the information in the question, the limiting factor in the contract for the use is time i.e., 5 years and not the fixed total amount of revenue to be generated. Therefore, an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is

inappropriate and amortisation based on time can only be applied.

Franchise	80,00,000
Less: Amortisation (over 5 years)	<u>-16,00,000</u>
Balance to be shown in the balance sheet	<u>64,00,000</u>

(iv) B

Copyright	2,50,000
Less: Amortisation (over 10 years as per SLM)	<u>-25,000</u>
Balance to be shown in the balance sheet	<u>2,25,000</u>

(v) D

		₹
1	Goodwill on acquisition of business	
	Cash paid for acquiring the business	13,20,000
		=
	Less: Fair value of net assets acquired	<u>10,00,000</u>
	Goodwill	<u>3,20,000</u>
2	Franchise	80,00,000
		=
	Less: Amortisation (over 5 years)	<u>16,00,000</u>

3	Balance to be shown in the balance sheet	64,00,000
	Copyright	2,50,000
	Less: Amortisation (over 10 years as per SLM)	<u>-25,000</u>
	Balance to be shown in the balance sheet	<u>2,25,000</u>

		Gross Block (Cost)			Accumulated amortisation			Net block	
		Opening balance ₹	Additions ₹	Closing Balance ₹	Opening balance ₹	Additions ₹	Closing Balance ₹	Opening balance ₹	Closing Balance ₹
1	Goodwil	-	3,20,000	3,20,000	-	-	-	-	3,20,000
2	Franchise	-	80,00,000	80,00,000	-	16,00,000	16,00,000	-	64,00,000
3	Copyright	-	<u>2,50,000</u>	<u>2,50,000</u>	-	<u>25,000</u>	<u>25,000</u>	-	<u>2,25,000</u>
		-	<u>85,70,000</u>	<u>85,70,000</u>	-	<u>16,25,000</u>	<u>16,25,000</u>	-	<u>69,45,000</u>

Question 3

(10 Marks)

Venus Ltd. (Seller-lessee) sells a building to Mars Ltd. (Buyer-lessor) for cash of ₹ 28,00,000. Immediately before the transaction, the building is carried at a cost of ₹ 13,00,000. At the same time, Seller- lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with an annual payment of ₹ 2,00,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in accordance with Ind AS 115 "Revenue from Contracts with Customers". The fair value of the building at the date of sale is ₹ 25,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee. Present Value (PV) of annual payments (20 payments of ₹ 2,00,000 each discounted @ 12%) is ₹ 14,94,000.

Buyer-lessor classifies the lease of the building as an operating lease

Based on the above answer the following

(i) How much amount is considered as additional financing provided by Buyer-lessor to Seller-lessee

- (a) NIL
- (b) Rs 100,000
- (c) Rs 200,000
- (d) Rs 300,000

(ii) How much amount is considered as Relating to the rights transferred to Buyer-lessor (Accounting by Venus Ltd. (seller-lessee)):

- (a) NIL
- (b) Rs 626,880
- (c) Rs 726,880
- (d) Rs 826,880

(iii) How much amount is considered to be ROU asset and lease liability in the books of lessee

- (a) NIL
- (b) Rs 11,94,000
- (c) Rs 14,94,000

(d) Rs 3,00,000

(iv) How much amount is considered to be Financial liability in the books of lessee

(a) NIL

(b) Rs 11,94,000

(c) Rs 14,94,000

(d) Rs 3,00,000

(v) At the commencement date, Seller-lessee accounts for debiting

(a) Building and Lease liability

(b) Bank and ROU Asset

(c) ROU asset and lease liability

(d) None of the above

Solution

(i) D

Considering facts of the case, Venus Ltd. (seller-lessee) and Mars Ltd. (buyer-lessor) account for the transaction as a sale and leaseback.

Firstly, since the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer - lessor make adjustments to measure the sale proceeds at fair value. Thus, the amount of the excess sale price of ₹ 3,00,000 (as calculated below) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

Sale Price:	28,00,000
Less: Fair Value (at the date of sale):	<u>(25,00,000)</u>
Additional financing provided by Buyer-lessor to Seller-lessee	<u>3,00,000</u>

The present value of the annual payments is ₹ 14,94,000 (as given in the question).

Out of this ₹ 14,94,000, ₹ 3,00,000 relates to the additional financing (as calculated above) and balance ₹ 11,94,000 relates to the lease.

(ii) B

At the commencement date, Seller-lessee measures the ROU asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right-of-use retained by Seller-lessee, calculated as follows:

Carrying Amount (A)	13,00,000
Fair Value (at the date of sale) (B)	25,00,000
Discounted lease payments for the 20 year ROU asset (C)	11,94,000
ROU Asset [(A / B) x C]	6,20,880

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor, calculated as follows:

Fair Value (at the date of sale) (A)	25,00,000
Carrying Amount (B)	13,00,000
Discounted lease payments for the 20-year ROU asset (C)	11,94,000
Gain on sale of building (D) = (A - B)	12,00,000
Relating to the right to use the building retained by Seller-lessee (E)=[(D/A)xC]	5,73,120

Relating to the rights transferred to Buyer-lessor (D - E)

6,26,880

(iii) B

The present value of the annual payments is ₹ 14,94,000 (as given in the question).

Out of this ₹ 14,94,000, ₹ 3,00,000 relates to the additional financing (as calculated above) and balance ₹ 11,94,000 relates to the lease.

(iv) C

Financia liability is combination of lease liability 11,94,000 + borrowing 3,00,000 = 14,94,000

(v) B

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Bank / Cash A/c Dr.	28,00,000	
ROU Asset A/c Dr.	6,20,880	
To Building		13,00,000
To Financial Liability		14,94,000
To Gain on rights transferred		6,26,880

Part II

Question 1

(14 Marks)

The Balance Sheet of David Ltd. and Parker Ltd. as of 31st March, 2019 is given below:

(Rs in lakh)

Assets	David Ltd.	Parker Ltd.
Non-current assets:		
Property, plant and equipment	400	600
Investment	300	200
Current assets:		
Inventories	300	100
Financial assets		
Trade receivables	400	200
Cash and cash equivalents	150	200
Others	300	300
Total	1,850	1,600
Equity and Liabilities		
Equity		
Share capital - Equity shares of Rs 100 each for Parker Ltd. & Rs 10 each for David Limited	500	400
Other Equity	700	275
Non-current liabilities:		
Long term borrowings	200	300

Long term provisions	100	80
Deferred tax	20	55
Current liabilities:		
Short term borrowings	130	170
Trade payables	200	320
Total	1,850	1,600

(i) David Ltd. acquired 70% shares of Parker Ltd. on 1st April, 2019 by issuing its own shares in the ratio of 1 share of David Ltd. for every 2 shares of Parker Ltd. The fair value of the shares of David Ltd. was Rs 50 per share.

(ii) The fair value exercise resulted in the following :

- a. Fair value of property, plant and equipment (PPE) on 1st April, 2019 was Rs 450 lakh.
- b. David Ltd. agreed to pay an additional payment as consideration that is higher of Rs 30 lakh and 25% of any excess profits in the first year after acquisition, over its profits in the preceding 12 months made by Parker Ltd. This additional amount will be due after 3 years. Parker Ltd. has earned Rs 20 lakh profit in the preceding year and expects to earn another Rs 10 lakh.
- c. In addition to above, David Ltd. also has agreed to pay one of the founder shareholder-Director a payment of Rs 25 lakh provided he stays with the Company for two years after the acquisition.
- d. Parker Ltd. had certain equity settled share-based payment award (original award) which got replaced by the new awards issued by David Ltd. As per the original term, the vesting period was 4 years and as of the acquisition date the employees of Parker Ltd. have already served 2 years of service. As per the replaced awards, the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:
 - i. Original award - Rs 6 lakh
 - ii. Replacement award - Rs 9 lakh
- e. Parker Ltd. had a lawsuit pending with a customer who had made a claim of Rs 35 lakh. Management reliably estimated the fair value of the liability to be Rs 10 lakh.
- f. The applicable tax rate for both entities is 40%.

You are required to prepare opening consolidated balance sheet of David Ltd. as on 1st April, 2019 along with workings. Assume discount rate of 8%

Solution

Consolidated Balance Sheet of David Ltd as on 1st April, 2019 (Rs in lakh)

	Amount
Assets	
Non-current assets:	
Property, plant and equipment	850.00
Investment	500.00
Current assets:	
Inventories	400.00
Financial assets:	

Trade receivables	600.00
Cash and cash equivalents	350.00
Others	600.00
Total	3,300.00
Equity and Liabilities	
Equity	
Share capital - Equity shares of Rs 100 each	514.00
Other Equity	1,067.49
Non Controlling Interest	173.70
Non-current liabilities:	
Financial liabilities:	
Long term borrowings	500.00
Long term provisions (100+80+23.81)	203.81
Deferred tax	11.00
Current liabilities:	
Financial liabilities:	
Short term borrowings	300.00
Trade payables	520.00
Provision for law suit damages	10.00
Total	3,300.00

Working Notes:

a. Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at Rs 450 lakh.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, Rs 3 lakh (6 x 2/4) is considered as a part of purchase consideration and is credited to David Ltd equity as this will be settled in its own equity. The balance of Rs 3 lakh will be recorded as employee expense in the books of Parker Ltd over the remaining life, which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case, Rs 30 lakh is the minimum payment to be paid after 3 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or Rs 30 lakh whichever is higher. In the given case, since the criteria is the minimum what is expected to be paid, the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 8%.

d. The additional consideration of Rs 25 lakh to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of Parker Ltd.

(15 Marks)

Working notes**Computation of Purchase Consideration Rs in lakh**

Particulars		Amount
Share capital of Parker Ltd.		400
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		50
Purchase consideration (2,00,000x70%xRs 50 per share) (A)		70.00
Deferred consideration after discounting Rs 30 lakh for 3 years @ 8% (B)		23.81
Replacement award - Market based measure of the acquiree award ie Fair value of original award (6) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award ie (6 x 2 / 4) (C)		3.00
Purchase consideration (A+B+C)		96.81

Allocation of Purchase consideration

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	600	450	(150)
Investment	200	200	-
Inventories	100	100	-
Financial assets:			-
Trade receivables	200	200	-
Cash and cash equivalents	200	200	-
Others	300	300	
Less: Financial Liabilities			
Long term borrowings	(300)	(300)	-
Long term provisions	(80)	(80)	-
Deferred tax	(55)	(55)	-
Financial Liabilities			
Short term borrowings	(170)	(170)	-
Trade payables	(320)	(320)	-
Contingent liability	-	(10)	(10)
Net assets (X)	675	515	(160)
Deferred tax asset on fair value adjustment (160 x 40%) (Y)		64	160
Net assets (X+Y)		579	
Non-controlling interest (NCI) (579 x 30%) rounded off		173.70	
Capital reserve (Net assets – NCI – PC)		308.49	
Purchase consideration (PC)		96.81	

Computation of Consolidated amounts of consolidated financial statements

	David Ltd.	Parker Ltd. (pre-acquisition)	PPA Allocation	Total
Assets				
Non-current assets:			(150)	
Property, plant and equipment	400	600		850
Investment	300	200		500
Current assets:				
Inventories	300	100		400
Financial assets:				
Trade receivables	400	200		600
Cash and cash equivalents	150	200		350
Others	300	300		600
Total	1,850	1,600	(150)	3300
Equity and Liabilities				
Equity				
Share capital- Equity shares of Rs 100 each Shares allotted to Parker Ltd. (2,00,000 x 70% x Rs 10 per share)	500		14	514
Other Equity				
Other Equity	700			700
Replacement award			3	3
Security premium (2,00,000 shares x 70% x Rs 40)			56	56
Capital reserve			308.49	308.49
Non-controlling interest	0		173.70	173.70
Non-current liabilities:				
Financial Liabilities				
Long term borrowings	200	300		500
Long term provisions	100	80	23.81	203.81
Deferred tax	20	55	(64)	11
Current liabilities:				
Financial Liabilities				
Short term borrowings	130	170		300
Trade payable	200	320	0	520
Liability for lawsuit damages			10	10
Total	1,850	925	525	3,300

Question 2(a)

(4 Marks)

Mr. Unique commenced business on 1/04/17 with Rs20,000 represented by 5,000 units of the product @ Rs4 per unit. During the year 2017-18, he sold 5,000 units @ Rs5 per unit. During 2017-18, he withdraw Rs4,000.

31/03/18: Price of the product @ Rs4.60 per unit

Average price indices: 1/4/17: 100 & 31/3/18: 120

Find out:

- (i) Financial capital maintenance at Historical Cost
- (ii) Financial capital maintenance at Current Purchasing Power
- (iii) Physical Capital Maintenance

Solution

- (i) Financial Capital Maintenance at historical costs

	Rs	Rs
Closing capital (Rs 25,000 – Rs 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At historical cost)	-	
Introduction (At historical cost)	20,000	(20,000)
Retained profit		1,000

- (ii)

Financial Capital Maintenance at current purchasing power

	Rs	Rs
Closing capital (Rs 25,000 – Rs 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At closing price) (5,000 x Rs 4.80)	24,000	
Introduction (At closing price)	Nil	(24,000)
Retained profit		(3,000)

Physical Capital Maintenance

	Rs	Rs
Closing capital (Rs 25,000 – Rs 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At current cost) (5,000 x Rs 4.60)	23,000	
Introduction (At current cost)	Nil	(23,000)
Retained profit		(2,000)

Question 2(b)

(4 Marks)

Entity sells gym memberships for Rs 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at Rs 6,000 per year. Entity estimates an annual attrition rate of 50% each year. Determine the amount of revenue to be recognised in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

Solution

Allocated price per unit (year) is calculated as follows:

Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175

Total consideration is Rs 12,00,000 $\{(100 \times 7,500) + (50 \times 6,000) + (25 \times 6,000)\}$

Allocated price per membership is Rs 6,857 approx. $(12,00,000 / 175)$

Basis on above, it is to be noted that although entity has collected Rs 7,500 but revenue can be recognised at Rs 6,857 approx. per membership and remaining Rs 643 should be recorded as contract liability against option given to customer for renewing their membership at discount

Question 2(c)**(6 Marks)**

In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Analyse the above situation in accordance with relevant Ind AS.

Solution

Ind AS 8 is applied in selecting and applying accounting policies, and, accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's *financial* statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were approved for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

On the basis of above provisions, the given situation would be dealt as follows:

The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31 March 20X3 financial statements are not a prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31 March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31 March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (ie ₹ 15,000) and fair value less costs to complete and sell (ie ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

Question 3(a)

(4 Marks)

Investment 1 is a contractual right to receive Rs 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

- Investment 2 is a contractual right to receive Rs 1,200 in 1 year and has a market price of Rs 1,083.
- Investment 3 is a contractual right to receive Rs 700 in 2 years and has a market price of Rs 566.

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information

Solution

On the basis of the timing of the contractual payments to be received for Investment 1 relative to the timing for Investment 2 and Investment 3 (that is, one year for Investment 2 versus two years for Investment 3), Investment 2 is deemed more comparable to Investment 1. Using the contractual payment to be received for Investment 1 (Rs 800) and the 1-year market rate derived from Investment 2, the fair value of Investment 1 is calculated as under:

Investment 2 Fair Value Rs 1,083
Contractual Cash flows in 1 year Rs 1,200

$$\begin{aligned} \text{IRR} &= \text{Rs } 1,083 \times (1 + r) = \text{Rs } 1,200 \\ &= (1 + r) = (\text{Rs } 1,200 / \text{Rs } 1,083) = 1.108 \\ r &= 1.108 - 1 = 0.108 \text{ or } 10.8\% \\ \text{Value of Investment 1} &= \text{Rs } 800 / 1.108 = \text{Rs } 722 \end{aligned}$$

Alternatively, in the absence of available market information for Investment 2, the one-year market rate could be derived from Investment 3 using the build-up approach. In that case, the 2-year market rate indicated by Investment 3 would be adjusted to a 1-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect

Question 3(b)

(5 Marks)

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three

years of extended coverage represent a separate performance obligation (i.e. a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is Rs 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are Rs 32,000 and Rs 4,000, respectively. The inventory value of the computer is Rs 14,400. Furthermore, the entity estimates that, based on its experience, it will incur Rs 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

Solution

The entity will record the following journal entries:	Rs	Rs
Cash / Trade receivables Dr.		36,000
Warranty expense Dr.		2,000
To Accrued warranty costs (assurance-type warranty)		2,000
To Contract liability (service-type warranty)		4,000
To Revenue		32,000
(To record revenue and contract liabilities related to warranties)		
Cost of goods sold Dr.	14,400	
To Inventory		14,400
(To derecognise inventory and recognise cost of goods sold)		

The entity derecognises the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. The entity had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognised as an expense as incurred.

Question 3(c)

(5 Marks)

(a) Company A acquires 70% of the equity stake in Company B on July 20, 20X1. The consideration paid for this transaction is as below:

(a) Cash consideration of Rs 15,00,000

(b) 200,000 equity shares having face of Rs 10 and fair value of Rs 15 per share. On the date of acquisition, Company B has cash and cash equivalent balance of Rs 2,50,000 in its books of account. On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of Rs 8,00,000. Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7

Solution

As per para 39 of Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities. As per para 42 of Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

As per para 42A of Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss. Such transactions are accounted for as equity transactions and accordingly, the resulting cash flows are classified in the same way as other transactions with owners.

Considering the above, for the financial year ended March 31, 20X2 total consideration of Rs 15,00,000 less Rs 250,000 will be shown under investing activities as —Acquisition of the subsidiary (net of cash acquired).

There will not be any impact of issuance of equity shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non - cash consideration. Further, in the statement of cash flows for the year ended March 31, 20X3, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.

Question 4(a)

(6 Marks)

Rely Industries issued share-based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

Option I	Period	INR
No of cash settled shares		74,000
Service condition	3 years	
Option II		
No of equity settled shares		90,000
Conditions:		
Service	3 years	
Restriction to sell	2 years	
Fair values		
Equity price with a restriction of sale for 2 years		115
Fair value grant date		135
Fair value as on 31St March	2016	138
	2017	140
	2018	147

Pass the Journal entries?
(10 Marks)

Solution

Equity settlement with cash alternative

At the inception i.e on grant date debt component and equity component is calculated.

Total Proceeds(Equity alternative)= 90,000 shares*115 per share = 1,03,50,000

Less : Debt component(Cash alternative) =74,000*135 per share = 99,90,000

Equity component 3,60,000

	31.3.2016	31.3.2017	31.3.2018
Cumulative expense to be recognised	74000*138*1/3	74000*140*2/3	74000*147*3/3
	34,04,000	69,06,667	1,08,78,000
Cumulative expense recognised	0	34,04,000	69,06,667
Expense for the year(Debt Component)	34,04,000	35,02,667	39,71,333
Expense for the year(Equity Component)	360,000/3		
	<u>120,000</u>	<u>120,000</u>	<u>120,000</u>

Total expense recognised in P&L 35,24,000 36,22,667 40,91,333

Date	Particular	Debit	Credit
31.12.2016	Employee benefits expenses(P&L)	35,24,000	
	To Share based payment reserve (equity)		1,20,000
	To Share based payment liability		34,04,000
31.12.2017	Employee benefits expenses(P&L)	36,22,667	
	To Share based payment reserve (equity)		1,20,000
	To Share based payment liability		35,02,667
31.12.2018	Employee benefits expenses(P&L)	40,91,333	
	To Share based payment reserve (equity)		1,20,000
	To Share based payment liability		39,71,333
Cash settlement			
	Share based payment liability	1,08,78,000	
	To Bank/ Cash		1,08,78,000
	Share based payment reserve (equity)	360,000	
	To Retained earnings(Other Equity)		360,000
	Share based payment liability	1,08,78,000	
	Share based payment reserve (equity)	360,000	
	To Share capital		1,12,38,000

Question 4(b)

(8 Marks)

At 1 April, 20X0, the fair value of the Plan Assets was ₹ 10,00,000. The Plan paid benefits of ₹ 1,90,000 and received contributions of ₹ 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be ₹ 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to ₹ 14,79,200 on the same date. Actuarial losses on defined benefit obligation were ₹ 6,000.

Compounding happens half-yearly. The normal interest rate for 6 months period is 10% per annum, while the effective interest rate for 12 months period is based on the following data:

At 1 April, 20X0, the company made the following estimates based on market prices at that date:

Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
<i>Add:</i> Realized and Unrealized Gains on Plan Assets (after tax)	2.00
<i>Less:</i> Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income' in this case.

(5 Marks)

Solution:

Computation of Expected Return on Plan Assets

Particulars	₹
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25% = ₹ 10,00,000 x 10.25%	1,02,500
<i>Add:</i> Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12]	15,000
Expected Return on Plan Assets	1,17,500

Computation of Actual Return on Plan Assets

Particulars	₹
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
<i>Less:</i> Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)
<i>Less:</i> Contributions received during the year 20X0-20X1	(4,90,000)
<i>Add:</i> Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	2,00,000

Computation of Net Actuarial Gain

Particulars	₹
Actual Return on Plan Assets	2,00,000
<i>Less:</i> Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
<i>Less:</i> Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	76,500

Question 5(a)

(8 Marks)

On 1 April 20X1, Sun Limited guarantees a ₹10,00,000 loan of Subsidiary – Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%. Sun Limited does not charge Moon Limited for providing the guarantee. On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

Provide the accounting treatment of financial guarantee as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3.

Solution:

1 April 20X1

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particulars	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)	Total (₹)
Cash flows based on interest rate of 11% (A)	1,10,000	1,10,000	1,10,000	3,30,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	2,40,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000
Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guarantee contract (at inception)	73,320			

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Investment in subsidiary Dr.	73,320	
To Financial guarantee (liability)		73,320
(Being financial guarantee initially recorded)		

31 March 20X2

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- the amount of loss allowance; and
- the amount initially recognised less cumulative amortization, where appropriate.

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹10,000 (₹10,00,000 x 1%).

The initial amount recognised less amortisation is ₹51,385 (₹73,320 + ₹8,065 (interest accrued based on EIR)) – ₹30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.

Year	Opening balance	EIR @ 11%	Benefits provided	Closing balance
₹	₹	₹		
1	73,320	8,065	(30,000)	51,385
2	51,385	5,652	(30,000)	27,037
3	27,037	2,963*	(30,000)	-

* Difference is due to approximation

The carrying amount of the financial guarantee liability after amortisation is therefore ₹ 51,385, which is higher than the 12-month expected credit losses of ₹ 10,000. The liability is therefore adjusted to ₹ 51,385 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,935	
To Profit or loss		21,935
(Being financial guarantee subsequently adjusted)		

31 March 20X3

At 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹ 30,000 (₹ 10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is ₹ 27,037, which is lower than the 12-month expected credit losses (₹ 30,000). The liability is therefore adjusted to ₹ 30,000 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,385*	
To Profit or loss (Note)		21,385
(Being financial guarantee subsequently adjusted)		

* The carrying amount at the end of 31 March 20X2 = ₹ 51,385 less 12-month expected credit losses of ₹ 30,000.

Question 5(b)

(6 Marks)

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of Rs 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equipment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider?

Solution:**Calculation of additional warranty provisions:**

Warranty claim covers 1% 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:

1% of annual gross margin is Rs 30,000 therefore 100% of annual gross margin must be Rs 30,00,000. Since gross margin is 40%, sales should be Rs 75,00,000. As provide in the question that the sales are evenly spread during the year and given the six month warranty, half of the sales occurred in the second half of the year is still covered within the warranty period as follows.

	% age	Annual sales	Product under warranty at 31 st March, 20X2	Percentage expected to be returned	Warranty provision
		Rs	Rs	Rs	Rs
Gross margin	40%	30,00,000			
Selling price	100%	75,00,000	37,50,000	1%	37,500

The warranty provision should therefore be increased by Rs 7,500 (Rs 37,500 – Rs 30,000). As the provision is expected to be used in the next 6 months no discounting is required.

If the warranty period is 2 years:

Since the outstanding period of warranties is 6 months (i.e. less than a year), no discounting is required. However, if a longer warranty period is to be given, the entity will have to take into account the effect of the time value of money. The amount of provision shall be the present value of the expenditures expected to be required to settle the warranty obligation. (Refer Para 45 of Ind AS 37)

The discount rate shall be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted. (Refer Para 47 of Ind AS 37)

	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision
		Rs	Rs	Rs	Rs
Gross margin	40%	30,00,000			
Selling price	100%	75,00,000	75,00,000	1%	75,000

The warranty provision should therefore be increased by Rs 45,000 (Rs 75,000 – Rs 30,000). Further discounting of provision would be required.