Test Series: March, 2019

MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – II

PAPER 6E: GLOBAL FINANCIAL REPORTING STANDARDS

Suggested Answers / Hints

SOLUTIONS TO CASE STUDY 1

Solution 1 ((a) INR 10.2 Million exchange loss)

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 1st December 2017, the date of the contract. As no payment has been made to the American supplier by 31st March 2018 the contract must be translated at the 31st March spot rate to calculate the gain or loss on foreign exchange, as illustrated below:

Date	Transaction currency amount $ m	Exchange rates	Functional currency amount INR m
01/12/2017	10.2	65	663
31/03/2018	10.2	66	673.2
Exchange loss			10.2

Solution 2 & 3 (solution 2 – (a) INR 0.101304 Million, solution 3 – (a) INR 0.634344 Million)

Lease of specialised manufacturing equipment with LRUS

The lease with LRUS must be treated as a finance lease as it meets the following indicators of a finance lease as per IAS 17 Leases:

- The term of the lease is for the majority of the economic life of the asset. in this instance the lease term is for three years and the expected life of the manufacturing equipment is also three years.
- At the inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset. in this instance, at a discount rate of

10% the present value of the lease payments is just below the fair value of the leased asset, as follows:

	Year 0	Year 1	Year 2	Year 3
	INR m	INR m	INR m	INR m
Payment	0.48	0.48	0.48	0.24
Discount factor 10%	1	0.909	0.826	0.751
Present value	**0.48**	**0.43632**	**0.39648**	**0.18024**
Total present value				**1.49304**

As the present value of the lease payments is less than the fair value of the leased asset we recognise the asset at present value of lease payments.

The substance of this transaction is therefore that XYZ Ltd has borrowed a sum of money from LRUS to purchase the machinery. Although legal title will not pass to XYZ Ltd until it exercises its option to buy the machinery at the end of the lease, XYZ Ltd has acquired an asset.

- XYZ Ltd has control over the machinery and it is probable that economic benefits will flow to XYZ Ltd from the machinery.

The calculation of the annual interest charges over the term of the lease is set out below:

Year	Balance b/f	Repayment	Balance for interest	Interest	Closing balance	Current liability	Non-current liability
	INR m	INR m	INR m	INR m	INR m	INR m	INR m
a	b	c	d	e=d x 10%	f = d + e	g	h=f-g
31/03/2018	1.49304	0.48	1.01304	0.101304	1.114344	0.48	0.634344

Solution 4 ((c) INR 0.34 Million)

Warranty on supply only wind turbines

Warranty provisions are 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.

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 INR 510000 therefore 100% of annual gross margin must be INR 25500000

	%age	**Annual sales**	**Product under warranty at 31/03/2018**	**Percentage expected to be returned**	**Warranty provision**
		INR m	**INR m**	**INR m**	**INR m**
Gross margin	30%	25.5			
Selling price	100%	85	42.5	2%	0.85

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

Solution 5 ((b) Maintenance contract INR 7,820,000, Supply contract INR 31,280,000)

Value of individual contracts		INR m
	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.

	INR m
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

Solution 6 ((c) INR 31.54 Million)

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 31/03/2018	**INR m**
Turbines	31.28
Maintenance contract 7.82 x 2/60	0.26067
	31.54067

Solution 7 ((a) Current liability INR 1564000, Non-current liability INR 5995330)

	INR m
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

		Dr INR m	**Cr INR m**
Revenue (39.1-31.54067)	Dr.	7.55933	
To Deferred income < 1 year			1.564
To Deferred income > 1 year			5.99533

Solution 8 & 9 (solution 8 – (a) INR 4,32,480, solution 9 – (b) INR 4,23,470)

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**	**Cumulative charge**	**Recognition to date**	**Annual charge**
31.3.2017	300	480	9.01	1,297,440	432,480	0	432,480
31.3.2018	300	475	9.01	1,283,925	855,950	432,480	423,470

Solution 10 ((d) INR 10.2 Million)

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 INR 84 m. 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:

	31/03/18
	INR m
Opening Book Value	98.4
Depreciation	2.4
Carrying value	96
Revaluation	84
Revaluation loss	12

Journal Entry

		Dr INR m	Cr INR m
Revaluation surplus	Dr.	10.2	
Revaluation of property plant and equipment	Dr.	1.8	
To Property plant and equipment			12

Solution 11

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 2016-17 financial statements also. The consequences of failing to report the share option scheme in the 2016-17 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 2016-17 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	Cumulative charge	Recognition to date	Annual charge
31.3.2017	300	480	9.01	1,297,440	432,480	0	432,480
31.3.2018	300	475	9.01	1,283,925	855,950	432,480	423,470

Journal Entry

		Dr INR m	Cr INR m
Administrative expenses	Dr.	0.42347	
Retained earnings	Dr.	0.43248	
To Share option reserve			0.85595

Solution 12

Working Notes

1. Investment in associate (as per equity method)

			INR m
Cost			13.6
Less: Share of post-acquisition profits and reserves			
Balance as on 31.3.2018			
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

		INR m	INR m
		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 = INR 0.51 x 25% = INR 0.1275 m
- 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

	INR m
Profit as per Statement of Comprehensive Income (52.7 x 25%)	13.175
Less: Unrealised profit	(0.1275)
	13.0475

4. Calculation of depreciation on leased property

The depreciation charge will be over the shorter of the lease term and the useful life of the machinery, in this case three years.

	INR m
Cost	1.49304
Depreciation (cost / 3 years)	(0.49768)
Net book value as on 31.3.18	0.99536

5. Adjustment entry required to be passed relating to lease of machinery

The adjustments required to the financial statements are therefore:

		Dr. INR m	Cr. INR m
Property, plant and equipment	Dr.	1.49304	
To Finance lease liabilities <1 year			0.48
To Finance lease liabilities >1 year			1.01304
(Initial recording of lease)			

Finance lease liabilities < 1 year	Dr.	0.48	
To Cost of goods sold			0.48
(Transfer of first lease payment from cost of goods sold)			
Finance costs	Dr.		0.101304
To Finance lease liabilities >1 year			0.101304
(Finance lease interest charge)			
Depreciation	Dr.	0.49768	
To Property, plant and equipment			0.49768
(Depreciation on leased asset)			

6. Adjustment entry required to be passed for exchange loss

The exchange loss of INR 10.2m 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.

As per IAS 2 Inventories, the goods still held in inventory at 31st March 2019 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:

		Dr. INR m	Cr. INR m
Administration Expenses	Dr.	10.2	
To Accounts Payable			10.2

7. Adjustment entry required for warranty provision

The adjustment required to the financial statements is therefore:

		Dr. INR m	Cr. INR m
Warranty provision – cost of goods sold	Dr.	0.34	
To Warranty provision – current liabilities			0.34

8. Adjustment entry for revaluation of property

		Dr INR m	Cr INR m
Revaluation surplus	Dr.	10.2	
Profit or loss A/c (Revaluation of property, plant and equipment)	Dr.	1.8	
To Property, plant and equipment			12

Statement of Profit & Loss Account & Other comprehensive income

For the year ending 31 March 2018

	WTM	Exchange Loss	Lease	Warranty	Maint. Contract	Share Option	Property Reval	WTM	Associate	Consolidate
	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m
Revenue	421.6				-7.55933			414.04067		414.04067
Cost of goods sold	-136		0.48	-0.34				-135.86		-135.86
Selling and Distribution expenses	-34							-34		-34
Administration Expenses	-20.4	-10.2	-0.49768			-0.42347		-31.52115		-31.52115
Finance Costs	-17		-0.101304					-17.101304		-17.101304
Share of Profit of Associate									13.0475	13.0475
Profit before Tax	214.2	-10.2	-0.118984	-0.34	-7.55933	-0.42347		195.558216	13.0475	208.605716
Tax expense	-42.5							-42.5		-42.5
Profit for the year	171.7	-10.2	-0.118984	-0.34	-7.55933	-0.42347		153.058216	13.0475	166.105716
Other Comprehensive income							-1.8	-1.8		-1.8
Total Comprehensive income for the Year	171.7	-10.2	-0.118984	-0.34	-7.55933	-0.42347	-1.8	151.258216	13.0475	164.305716

Statement of Financial Position

As on 31 March 2018

	WTM	Exchange Loss	Lease	Warranty	Maint. Contract	Share Option	Property Reval	WTM	Associate	Consolidate
	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m	INR m
ASSETS										
Non-current assets										
Plant, property and equipment	450.5		0.99536				-12	439.49536		439.49536
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							515.99536	25.925	541.92036
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							862.79536	25.7975	**888.59286**
Equity and Liabilities										
Issued share capital	255							255		255
Share Premium	13.6							13.6		13.6
Retained earnings	280.5	-10.2	-0.118984	-0.34	-7.55933	-0.85595	-1.8	259.625736	25.7975	285.423236
Share option reserve						0.85595		0.85595		0.85595
Revaluation Surplus	10.2						-10.2	-		-
Total Equity	559.3							529.081686		554.879186
Non-current liabilities	265.2		0.634344		5.99533			271.829674		271.829674
Current liabilities	49.3	10.2	0.48	0.34	1.564			61.884		61.884
Total Liabilities	314.5							333.713674		333.713674
Total equity and liabilities	873.8							862.795674	-	**888.59286**

XYZ Ltd Group Consolidated Statement of Profit or Loss and Other Comprehensive Income

for the Year Ended 31.3.2018

		INR m
Revenue		414.04067
Share of profit of Associate		13.0475
	A	427.08817
Cost of goods sold		135.86
Selling and Distribution expenses		34
Administration expenses		31.52115
Finance costs		17.101304
	B	218.482454
Profit before Tax	A-B	208.605716
Tax expense		42.5
Profit for the year		166.105716
Other comprehensive income		1.8
Total comprehensive income for the year		164.305716

XYZ Ltd Group

Consolidated Statement of Financial Position as at 31.3.2018

ASSETS	**INR m**
Non-current assets	

Property, plant and equipment	439.49536
Intangible assets	25.5
Investment property	37.4
Investment in PQR Ltd	39.525
	541.92036
Current assets	
Inventories	186.8725
Trade Receivable	102
Prepayments	1.7
Cash	56.1
	346.6725
Total Assets	**888.59286**
Equity and Liabilities	
Issued share capital INR 1 ordinary shares	255
Share premium	13.6
Retained earnings	285.423236
Share option reserve	0.85595
Revaluation surplus	-
Total equity	554.879186
Non-current liabilities	271.829674
Current liabilities	61.884
	333.713674
Total equity and liabilities	**888.59286**

SOLUTIONS TO CASE STUDY 2

Solution 1

To determine whether arrangement contains lease under IFRS, A Ltd. should consider the following:

(a) Is the fulfilment of the arrangement dependent on the use of a specific asset or assets?

- Specific asset is not explicitly identified in the arrangement, however, the ATM machine and related assets are specifically developed to meet the bank's need.
- A Ltd. maintain proper records for all assets dedicated to the bank ATM network. However, as a general practice A Ltd. maintains the fixed asset register ATM site wise.

- Prior written approval of the bank is required for shifting/ closing any particular ATM site. A Ltd. cannot sell/ dispose-off any of the ATMs and related assets without prior written communication from the bank.

Thus, it can be said that implicitly a particular ATM is identified and dedicated to the bank for its use and the bank is dependent on the use of this specific asset.

(b) Whether the arrangement conveys the right to use the asset?

S. No.	Conditions to be evaluated that conveys the right-to-use the asset	Evaluation
1	*Is it remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and is the price that the purchaser will pay for the output neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output?*	The entire utility generated from the assets is always utilised by the purchaser (Bank). When transactions are done by customers of other banks, the bank on whose ATM the transaction is being done will earn a certain fee on the same. In the present case, payment of fee by UVW Bank is based on per transaction basis. Thus, the said condition is not fulfilled as the price is contractually fixed per unit of output and it is equal to the current market price. Hence, other conditions will have to be further evaluated.
2	*Does the purchaser obtain or control more than an insignificant amount of the output or other utility of the asset?*	As discussed above, the entire utility generated from the assets is always utilised by the purchaser (Bank).
3	*Does the purchaser have the ability or right to operate the asset or direct others to operate the asset in a manner it determines?*	The 'right to operate or direct others to operate the asset' relates to the ability to make decisions about when and how the asset will be used to meet specific needs of the purchaser (Bank). In the above case, A Ltd. is required to operate the ATM site as per the standard operating procedure or other specifications laid down by the bank. Clear roles and responsibilities for each party is laid down in the agreement. Prior approval of the bank is required for shifting/ closing the ATM Site. All RBI circulars, notices and promotional material to be displayed at the ATM site

		or on the ATM will have to be approved by the bank prior to be being displayed. Thus, it can be said that the bank has the ability to operate or direct A Ltd. to operate the ATM site in the manner it desires.
4	*Does the purchaser have the ability or right to control physical access to the underlying asset?*	The 'right to control physical access' relates to the ability to prevent others from using or accessing the asset for their needs or restricting the ability of the supplier to move or use the asset as it desires. In the present arrangement, the bank restricts the rights of A Ltd. for advertising or promoting using the ATM machine/ site. Advertising/ promotional material as approved by the bank can be displayed on the machine/ site. In case of advertising by third/external party, the bank generally shares a portion of the revenue with A Ltd. In case of relocation of the site initiated by A Ltd., prior approval of the bank is required, without the same A Ltd. cannot proceed with any kind of relocation or shifting. Thus, it can be said that bank has the ability/ right to control physical access to the underlying asset.

Thus, there is a right of use of ATM and, thus, the arrangement contains a lease of ATM.

<u>Classification of lease</u>

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

S. No.	**Classification whether the lease is a finance lease or an operating lease**	**Evaluation**
1	*The lease transfers ownership of the asset to the lessee by the end of the lease term.*	The arrangement does not automatically transfer the ownership of the asset to the lessee at the end of lease term. There is an option with the bank to take-over the assets on termination of agreement.

2	*The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.*	The arrangement contains an option that the ATM machine and related assets may be taken over by the bank at sufficiently lower price, however the bank generally does not opt for this takeover. The bank does not have the expertise to run a ATM site, it needs to hire a service provider to do the same for it thus on takeover of ATM or related assets the bank independently will not be able to run the ATM site. Considering the cost of maintaining the inventory of assets, selling the assets at scrap value does not seem to be a very viable option for the bank. Taking into account the above reasons and the historical trend that bank does not take over the assets on termination of agreement, it can be said that this condition is not fulfilled as it is not reasonably certain that the bank will exercise the option.
3	*The lease term is for the major part of the economic life of the asset even if title is not transferred.*	Life of ATM machine is 10 years, whereas the term of the arrangement is generally 5 years. Thus, it can be said that the lease term is not for a major part of the economic life of the asset.
4	*At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.*	In case of per transaction fee, the lease rentals are contingent in nature and, thus, it is difficult to comment whether minimum lease payments amounts to substantially all of the fair value of leased asset.
5	*The leased assets are of such a specialised nature that only the lessee can use them without major modifications.*	The assets installed are as per the specific requirements of the bank, but the same cannot be considered to be of specialised nature since the company follows a general practice of converting these ATMs into white label ATMs on termination of agreement.

Thus it can be concluded that the arrangement is an operating lease.

Separating payments for the lease and other payments

In case of the above arrangement, there are two elements involved:

(a) Lease of the ATM machine and related assets

(b) Services for management of ATM site (such as ATM managed services, ATM site management, first-line maintenance, consumables management services, cash management services, cash replenishment services and reconciliation activity).

The arrangement contains lease but there are other elements also involved which pertains to provision of services. Considering the guidance under IFRS, consideration paid for other elements should be separated at the inception of the arrangement on the basis of their fair values. For the purpose of separating the payments, A Ltd. will estimate the lease payments by reference to a lease agreement for a comparable asset that contains no other elements, or estimate the payments of other elements in the arrangement by reference to comparable agreement and then deducting these payments from the total payments under the arrangement.

Solution 2

In order to determine whether a transaction/acquisition involves a Business Combination which to be covered within the scope of IFRS 3, the transaction should satisfy the definition of business contained under Para B7 of Appendix B to IFRS 3.

To constitute a business combination following conditions are provided in Para B7 of Appendix B to IFRS 3:

Criteria	Whether these criteria are satisfied
Input	Input in the form of tangible items such as building, furniture and fixtures, lobby, reception, dining area are present at the time of purchase of hotel from B Ltd. Hence, this criterion is met.
Process	Before the purchase of hotel by A Ltd. from B Ltd., B Ltd. has already entered into an agreement with D Ltd. dated 7 March 2008 for the provision of technical audit, pre-operating, marketing, management services in respect of the said hotel. Further, on transfer of the hotel by B Ltd. to A Ltd., the agreement with D Ltd. for operating and running the hotel was assigned to A Ltd. On a mere formality, A Ltd. had to enter into a separate agreement with D Ltd. before transfer of hotel by B Ltd. for provisions of operating and running business of the hotel. In the current case, D Ltd. was already present and was capable of supplying the missing element (i.e., the hotel management services) for producing the output. Also, the easier it is to obtain the missing element in a relatively short period of time, the more likely the activities are a business. Hence, this condition is also satisfied.
Output	Further, with the provision of input and process, output can be generated.

	However, it is not mandatory to have output on the date of business combination. IFRS 3 only provides that outputs are the results of input and processes applied to those inputs that provide and have the ability to provide a return in the form of dividend, lower cost or other economic benefits directly to the investor. Since economic benefits will flow to A Ltd. from operation of the business, output will be generated by applying processes to the input. Hence, the third condition is also satisfied.

Since, the above mentioned criteria are satisfied, the transaction can be said to be business which will be covered in IFRS 3, Business Combinations. Thus, purchase of hotel by A Ltd. from B Ltd. is a business combination considering the principles of IFRS 3.

Solution 3

Non-convertible debentures (NCDs)- In case of NCDs, the issuer has a contractual obligation to pay interest at the specified percentage of the face value of NCDs and redeem the principal at par/ premium upon maturity. When an instrument requires mandatory redemption by the issuer for a fixed or determinable amount, a contractual obligation to pay cash at redemption exists and, therefore, the instrument should be presented as a financial liability. Accordingly, NCDs issued by A Ltd. should be considered as financial liability in its book because such NCDs have a contractual obligation to pay interest to the investor at a specified percentage (15%) and redeem the principal at premium (20%).

Compulsorily convertible debentures (CCDs)- From an issuer's perspective, an instrument that is convertible into a fixed number of equity shares compulsorily comprises of two components. The first is a financial liability (issuer's contractual obligation to deliver cash or another financial asset for payment of interest). The second is an equity instrument, to convert it into a fixed number of the entity's ordinary shares. A Ltd. has issued CCDs to public which are mandatorily convertible into equity shares of the Company. Further, the Company is liable to pay 5% p.a. interest on face value of the CCDs issued. For CCDs, A Ltd.'s obligation to make scheduled payments of interest is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option. Further, the equity instrument is an embedded option to convert the liability into equity of the issuer. This option has value on initial recognition even when it is out of the money. A Ltd. on conversion of CCDs at maturity, should derecognise the liability component and recognise it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity. Thus, A Ltd. should separately recognise the liability and equity component in the CCDs issued to public.

Solution 4

(i) Assessment of the arrangement using the definition of derivative included under IFRS 9

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics: a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying'). b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. c) it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

b) the initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 20,000 on inception.

c) the contract is settled in future

The derivative is a forward exchange contract.

As per IFRS 9, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

(ii) Accounting on 1st April, 2018:

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

(iii) Accounting on 30th June, 2018:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Profit and loss A/c Dr. To derivative financial liability (Being mark to market loss on forward contract recorded)	25,000	 25,000

(iv) Accounting on 30th September, 2018:

The change in value of the derivative forward contract shall be recorded as a derivative financial liability in the books of A Ltd. by recording the following journal entry:

Particulars		**Dr. Amount (₹)**	**Cr. Amount (₹)**
Derivative financial liability A/c	Dr.	10,000	
To Profit and loss A/c			10,000
(being partial reversal of mark to market loss on forward contract recorded)			

(v) Accounting on 31st December, 2018:

The value of the derivative forward contract shall be recorded as a derivative financial asset in the books of A Ltd. by recording the following journal entry:

Particulars		**Dr. Amount (₹)**	**Cr. Amount (₹)**
Derivative financial liability A/c	Dr	15,000	
Derivative financial asset A/c	Dr	12,000	
To Profit and loss A/c			27,000
(being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)			

(vi) Accounting on 31st March, 2019:

The settlement of the derivative forward contract by actual purchase of USD 20,000 shall be recorded in the books of A Ltd. by recording the following journal entry:

Particulars		**Dr. Amount (₹)**	**Cr. Amount (₹)**
Cash (USD Account) @ 20,000 x 66	Dr.	13,20,000	
Profit and loss A/c	Dr.	52,000	
To Cash @ 20,000 x 68			13,60,000
To Derivative financial asset A/c			12,000
(being loss on settlement of forward contract booked on actual purchase of USD)			

Solution 5- (d) Quoted price (sale price) of identical unrestricted equity adjusted for effect of restriction

In accordance with IFRS 13, fair value should be measured based on the quoted price (sale price) for an otherwise identical unrestricted equity instrument of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction. The adjustment would reflect the amount market participants would demand, due to risk relating to the inability to access public market for the specified period.

Solution 6- (d) Value of inventory on an item by item basis is INR 14,290 and on a group basis is INR 14,540

Item by item basis: Cost or NRV whichever is less	
A	INR 1,900
B	INR 5,000
C	INR 4,400
D	INR 2,990
	INR 14,290
Group basis:	
Cost or NRV whichever is less	INR 14,540
(Cost INR 14,600: NRV INR 14,540)	

Solution 7- (c) An amount of INR 2,000 should be credited to statement of profit and loss and amount of INR 1,000 should be credited to revaluation surplus.

Increase in carrying value of an asset is recognised directly in OCI and in equity as revaluation surplus. However, increase is recognised in statement of profit and loss to the extent it reverses a revaluation decrease of same asset previously recognised in statement of profit and loss.

Solution 8- (b) 9.5%

Particulars	Outstanding liability	Interest
5 years bank loan	INR 60 lacs	INR 8 lacs
20 years bank loan	INR 100 lacs	INR 6 lacs
Bank overdraft	INR 40 lacs	INR 5 lacs

Capitalisation rate = (8 + 6 + 5)/ (60 + 100 + 40) = 9.50%

Solution 9- (b) INR 4,360 lacs (approx.)

Years	Cash flow (INR lacs)	Discount factor @10%	Present value (INR lacs)
Year 0	-	1.0000	-
year 1	1,050	0.9091	955
year 2	1,103	0.8264	912
year 3	1,158	0.7513	870
year 4	1,216	0.6830	831
year 5	1,276	0.6209	792
Value in use			**4,360**

Solution 10- (b) INR 1,47,65,450

Particulars	Amount
Cash paid	INR 90,00,000
Deferred consideration (50,00,000 x 1/1.10)	INR 45,45,450
Legal fees	INR 11,70,000
Stamp duty	INR 50,000
Cost of patent	**INR 1,47,65,450**

Solution 11- (d) A Ltd. is required to use the cost model for measurement of patent; revaluation model can only be used in case of presence of active market for the asset.

In accordance with IAS 38, intangible assets may be accounted for under revaluation model only when there is an active market for those assets.

Solution 12- (c) A Ltd. should classify the plot as an investment property.

A Ltd. should classify the property as an investment property. Although management has not determined a use for the property after the park's development takes place, in the medium-term the land is held for capital appreciation. IFRS considers land as held for capital appreciation, if an entity has not determined that it will use the land either as owner-occupied property or for short term sale in the ordinary course of business.

Solution 13- (a) The insolvency of a major credit customer

Solution 14- (b) Pension fund is a defined contribution plan and A Ltd. should record an expense of INR 1,35,000 with an accrual of INR 15,000.

This is a defined contribution plan. The charge to statement of profit or loss should be INR 1,35,000 (i.e., INR 27,00,000) x 5%. Thus, there will be accrual of INR 15,000 (i.e., INR 1,35,000 – INR 1,20,000).

SOLUTIOSN TO CASE STUDY 3

Solution 1

IAS 38 defines an intangible asset as being identifiable, non-monetary and without physical substance, where an asset is a resource controlled by an entity as a result of past events from which future economic benefits are expected to flow to the entity.

Criteria for recognition of intangible asset

IAS 38 defines control of an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The cost incurred by A Ltd. to develop the prototype/ design is in the nature of asset which is controlled by the entity and arises as a result of past events from which future economic benefits are expected to flow to the entity, the cost incurred will only help A Ltd. to manufacture, design, develop and produce exhaust system in future wherein the past events are categorised as development cost incurred by the company to develop the prototype/ design from which future benefits are expected to flow to the entity.

Future benefits will accrue to A Ltd. in the form of sale of exhaust systems to B Ltd. which has been developed by the company, the transaction has commercial substance and within the control of A Ltd. All the cost incurred in developing the prototype is identifiable as the cost is capable of being separated and is capable of being sold or transferred to any party. However, A Ltd. is under contractual obligation to not share the design of the prototype developed except with B Ltd. or vendors nominated by B Ltd. The control of prototype is also with A Ltd. as it has the power to obtain future economic benefit from the resource and can also restrict access of others to the asset.

An intangible asset should 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

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

An entity is required to classify the expense between research plan and development plan. The expenses incurred at the time of research plan will be treated as an expense when it is incurred.

The cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria, i.e., the costs incurred in the development phase. IAS 38 prohibits reinstatement of expenditure previously recognised as an expense. An intangible asset arising from development should be recognised if, and only if, an entity can demonstrate all of the following criteria:

Criteria	Whether the criteria as mentioned is met?
(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.	All the development cost for developing the prototype such as the cost of material, labour cost, power, technical approvals for development of that component are incurred by A Ltd. This seems to suggest the technical feasibility of the prototype. Hence, this condition is satisfied.
(b) its intention to complete the intangible asset and use or sell it.	Sale of components is dependent on development of the prototype. Considering the facts of the case and also the fact that A Ltd. is in the business of automotive supply, one can assume that A Ltd. has the intention to complete the prototype and use it for producing exhaust systems in future. Hence, this condition is satisfied.
(c) its ability to use or sell the intangible asset.	In the present case, A Ltd. will be using the prototype in manufacturing, designing, developing of exhaust pipe. Thus, A Ltd. has the ability to use the intangible asset. Hence, this condition is satisfied.
(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.	The assessment of the entity to attain future economic benefit from use of the prototype is established by the way of use of the prototype in manufacture of the component and using that component to attain economic benefit by the way of sale of components. Hence, this condition is also met.
(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.	The ability of adequate technical, financial and other resources to complete the development can be ascertained by A Ltd.'s business plan showing the resource requirement and the entity's ability to secure those resources. From the facts of the case, it can be assumed that the company has adequate resources to carry on its activities and the management is committed to carry on its activities. Hence, this condition is satisfied.
(f) its ability to measure	Nothing in the facts of the case showcase that A Ltd. is not

reliably the expenditure attributable to the intangible asset during its development	able to measure the expenditure attributable to prototype under development. Thus, it can be assumed that this condition is also met.

Thus, the prototype under development should be classified as an intangible asset. All costs incurred after the conditions mentioned above are met, should be eligible for capitalisation.

Solution 2

1. Shares of X Ltd., subsidiary of A Ltd. of INR 10,00,000
   - Yes, however, investment in subsidiary is generally not covered under IFRS 9.
2. Advance given to C Ltd. for purchase of goods of INR 50,000
   - No, there is no contractual right to receive cash/other financial assets.
3. Investment in perpetual debt amounting to INR 2,00,000 carrying an interest at 10%
   - Yes, instrument contains contractual right to receive interest at stated rate.
4. Prepaid expense of INR 20,000
   - No, there is no contractual right to receive cash/ other financial assets.
5. Deferred tax asset of INR 16,200
   - No, not arising because of contractual arrangement.
6. Input Tax Credit receivable of INR 4,560
   - No, not arising because of contractual arrangement.
7. Lease deposit paid of INR 1,00,000
   - Yes, the lessee has contractual right to receive lease deposit at the end of lease term.
8. Shares of A Ltd. amounting to INR 1,50,000 held by ESOP Trust
   - No, own equity instruments are not financial asset for the entity.
9. USD-INR option held by A Ltd. as a buyer of the option
   - Yes, financial instruments include not only primary financial instruments but also derivatives instruments. Since the entity is option buyer, it is potentially favourable to the entity.
10. Gold bullion of INR 60,00,000
    - No, it's a commodity. Although gold bullion is highly liquid, there is no contractual right to receive cash or another financial asset.

Solution 3

In accordance with the technical guidance given under IFRS 10, three factors need to be analysed in order to assess level of control by A Ltd. over relevant activities of D Ltd.:

(a) A Ltd.'s power over D Ltd.

(b) A Ltd.'s exposure, or rights, to variable returns from its involvement with D Ltd.

(c) A Ltd.'s ability to use its power over D Ltd. to affect the amount of the investor's returns.

These three factors can be further analysed in the following manner:

A. Power	B. Returns	C. Linkage
• Voting rights • Potential voting rights (e.g., options/ convertible instruments) • Decision-making rights within a management contract • Removal rights	• Dividends • Remuneration • Economies of scale, cost savings, scarce products, proprietary knowledge, synergies or other returns that are not available to other interest holders.	• Scope of its authority • Rights held by other parties • Remuneration • Exposure to variability from other interests

First step, to analyse control of A Ltd. over D Ltd., is to identify the relevant activities of D Ltd. D Ltd.'s relevant activities are analysed as under:

As per the guidance under IFRS 10, relevant activities are activities of D Ltd. that significantly affect its returns. D Ltd.'s main objective is to operate and maintain the outlet at airport. The main relevant activities for D Ltd. are as follows:

- Procuring of goods/products for selling it at the outlet
- Incurring operating expenses and marketing of the goods and services.
- Availing or borrowing any funds or other working capital facilities to finance the operations of D Ltd.
- Preparation and approval of annual business plan including capital & operating budgets.

Most of the above mentioned relevant activities are covered under affirmative voting items of the shareholders' agreement.

Power

The power of A Ltd. over D Ltd. may be further analysed as under:

Basis of evaluation	**Facts**	**Evaluation**
(a) Voting rights:	Power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. A Ltd. holds 66.93% shareholding in D Ltd. (directly 17.03% and indirectly through its subsidiary E Ltd. - 49.9%). Accordingly, A Ltd. 4 directors on the Board (1 director appointed by A Ltd. and 3 directors by E Ltd.).	A Ltd. has majority of voting power, hence it has right to control through voting power.
(b) Potential voting rights	When assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive. Further, when considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the investor has with the investee.	Though Shareholders Agreement contains Call Option to be exercise by E Ltd. upon expiry of the License Agreement; but such rights can only be exercised upon termination, hence not exercisable currently. Hence, none of the parties hold any other option/contract which gives any exercisable controlling right to any other party.
(c) Right to appoint board of directors	IFRS 10 includes rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to	A Ltd. has the right to represent itself on the Board of Directors of D Ltd. and have control over composition of the Board (3 – E

and key personnel	direct the relevant activities can give an investor power over the investee. **Board:** As per the shareholders' agreement, A Ltd. and E Ltd. has the right to appoint 1 and 3 directors respectively out of total number of 7 directors and remaining 3 directors are appointed by F Ltd. **CEO:** CEO of D Ltd. shall be nominated by F Ltd. and CFO by E Ltd. but appointed by Board by simple majority. However, appointment of CEO nominated by F Ltd. cannot be rejected for more than 2 times. **Other key management personnel:** Head of Procurement and head of Retail shall also be appointed by Board by simple majority.	Ltd. and 1 – A Ltd.) and key management personnel. However, A Ltd. doesn't have control over appointment of the CEO as nomination of CEO cannot be rejected more than 2 times by A Ltd.
(d) Decision making rights	When assessing control of an investee, an investor shall consider how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities. As per the Shareholders Agreement, CEO is responsible for day-to-day management and operations of D Ltd.; and CFO is overall in-charge of and be responsible for the financial affairs and accounts of D Ltd. Further, CEO shall be responsible for preparing and submitting for discussion and approval, an annual business plan, capital and operating budgets for D Ltd. • Decisions related to ordinary	Approval by simple majority constitutes more than 50% i.e. 4 out of 7 directors of D Ltd. Though Board meeting can only be held if at least one representative of A Ltd., E Ltd. and F Ltd. are present in the meeting, but A Ltd. has 4 directors on board (after considering members of its subsidiary E Ltd.); therefore A Ltd. has control over the decision making in case of operations and management of D Ltd.

	items are subject to Boards' approval in the meeting with simple majority.	
	• Decisions related to affirmative voting items require consent of at least one director of E Ltd., A Ltd. and F Ltd. Such items include majority of the relevant activities of D Ltd. such decisions related to financing in excess of Rs. 5,00,00,000 incurring operating expenses and marketing expenses in excess of Rs. 5,00,00,000 and INR 2,00,00,000 respectively.	Affirmative voting items provide participating rights to all the shareholders for approving key decisions related to such relevant activities. Thus, it can be concluded that unanimous consent of all the three parties is required to approve the relevant activities of D Ltd.; and A Ltd. doesn't have control over the relevant activities of D Ltd.
	• Further, in the case of deadlock all the parties will resolve the dispute mutually	Since none of the party has casting/veto vote in case of deadlock, hence it shall not impact the above analysis.
(e) Removal or kick out right	Substantive rights to remove the decision maker (removal rights) and to remove the decision maker without cause shall also be evaluated for assessing the power. As per the Shareholders' Agreement, neither party has any kick out rights in D Ltd.	None of the parties have removal or kick-out rights.
Conclusion: Basis all discussion, it may be concluded that though A Ltd. has majority of voting rights and control over the board composition but doesn't have control over the relevant activities of D Ltd.		

Return

Basis of evaluation	**Facts**	**Evaluation**
(a) Dividends	An investor controls an investee if and only if the investor has exposure, or rights, to variable returns from its involvement with the investee. E Ltd. and A Ltd. hold 49.9% and 17.03% voting power in D	A Ltd. is exposed to or has right to the variable return up to an extent of 66.93 percent.

	Ltd. respectively; and accordingly has a right to receive variable return up to the extent of its shareholding in D Ltd.	
(b) Other returns	A Ltd. does not have any other variable interest from D Ltd.	NA
Conclusion: On the basis of above, it may be concluded that A Ltd. has an exposure to/ right to variable returns.		

<u>Linkage</u>

Based on the discussion, it is clear that A Ltd. does not have the power to direct the relevant activities of D Ltd. but has the exposure to the variability of returns from D Ltd. in terms of dividends. Hence, A Ltd. do not have the ability to affect its variable returns from D Ltd.

<u>Joint Control</u>

Further, IFRS 11 requires that an arrangement to be called a joint arrangement, joint control must exist between the parties. Joint control exists when the decisions about the relevant activities require the unanimous consent of the parties sharing control.

As assessed, simple majority constitutes more than 50% i.e. 4 out of 7 nominee directors of D Ltd. Since, E Ltd. and A Ltd. have 3 and 1 director(s) on board; therefore, A Ltd. has control over the decision making in case of operations and management of D Ltd.

Further, consent of at least one director of E Ltd., A Ltd. and F Ltd. is required in Board Meeting and one representative of E Ltd., A Ltd. and F Ltd. in General Meeting for approving any resolution listed in Affirmative Voting Items.

Though unanimous consent of all the shareholders is required for passing affirmative voting items however such consent is mutually inclusive with simple majority consent. Therefore, for approving key decisions related to relevant activities simple majority votes are required which votes must include vote of each of the shareholder. Hence, joint control doesn’t exist over the decisions related to relevant activities of D Ltd.

Based on the above analysis, it can be concluded that:

A. Power: A Ltd. does not have the power and ability to control the relevant activities of D Ltd.

B. Return: A Ltd. is entitled to return to the extent of its shareholding (including shareholding of E Ltd.) in D Ltd.

C. Linkage: A Ltd. does not have the current ability to affect it returns from D Ltd. through its control over the relevant activities of D Ltd.

Hence, it can be established that A Ltd. does not control the relevant activities of D Ltd.

Further, though unanimous consent is required and joint control doesn't exist over the decisions related to relevant activities of D Ltd. as any of the two or more shareholders do not have control in absolute terms.

Significant influence

In accordance with IAS 28, significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. From the above facts of the case, it can be said that A Ltd. has significant influence over D Ltd. Therefore, A Ltd. should account for its investment in D Ltd. as an associate.

Solution 4- (c) Higher of value of land used in the manufacturing operation and value of land as a vacant site for residential use

In this case, the highest and best use is determined from the higher of:

- Value of land used in the manufacturing operation
- Value of land as a vacant site for residential use (transformation costs, e.g., costs to demolish the manufacturing facility, etc. would be considered in the value of land as a vacant site)

Solution 5- (d) An amount of INR 2,000 should be charged to revaluation surplus and amount of INR 1,000 should be charged to statement of profit and loss.

In case of decrease in carrying value of an asset, revaluation surplus is debited to the extent recognised previously and balance, if any, is charged to statement of profit or loss.

Solution 6- (b) Change in annual depreciation to INR 15,000 for next 4 years.

A Ltd. should amend the annual provision for depreciation to charge the unamortised cost (namely INR 60,000) over the revised remaining life of 4 years. Consequently, it should change depreciation for the next 4 years to INR 15,000 per annum.

Solution 7- (a) Accounting base = INR 5,00,000; tax base = INR 7,00,000; taxable temporary difference = INR 2,00,000

Solution 8- (d) Asset held for sale

The business would be classified as held-for-sale because the delay is caused by events or circumstances beyond the entity's control, and there is evidence that the entity is committed to selling the business.

Solution 9- (d) Revenue should be recognised at INR 4,000 on 1 April 2017; subsequent adjustment to be accounted for under IFRS 9

Revenue should be recognised at INR 4,000 (1,000 shares x INR 4) at the beginning of the year. Any subsequent change in the fair value of the shares received is not recognised within revenue but instead accounted for in accordance with IFRS 9.

Solution 10- (b) Impairment loss of INR 90,000

The recoverable amount is the greater of the fair value less costs to sell and value in use.

Fair value less costs to sell = INR 3,80,000

Value in use = INR 4,10,000

Recoverable amount = INR 4,10,000.

Impairment loss = Carrying amount – recoverable amount

= INR 5,00,000 – INR 4,10,000 = INR 90,000.

Solution 11- (c) INR 18,000

Inventory is valued at the lower of cost or net realisable value. Since the item of raw material will be processed before sale and the sales order is profitable, there is no reason to believe that net realisable value will be lower than cost. Thus, the inventory item should be valued at cost of INR 18,000.

Solution 12- (b) Joint venture

A Ltd. does not control the arrangement because it needs the agreement of R Ltd. when making decisions. This would imply that A Ltd. and R Ltd. have joint control of the arrangement because decisions about the activities of T Ltd. cannot be made without A Ltd. and R Ltd. agreeing. In the consolidated financial statements of A Ltd., T Ltd. should be accounted for as a joint venture.

Solution 13- (b) Overdraft and balance in high-interest account

To qualify as cash equivalents, an item must be readily convertible into cash having an insignificant risk of a change in value. Furthermore, it should be held for the purpose of meeting short-term cash commitments.

Bank overdraft is generally an integral part of company's cash management. Thus, it should be considered as component of cash.

The balance of INR 5,00,000 in a high-interest account is readily available since only 28 days' notice is required to access it. Also, the money is held for short-term purposes (i.e., working capital needs).

Shares are not cash equivalents since they possess significant risk of change in value.

Note: Alternative answers may be possible for certain questions of the case study, depending upon the view taken.