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CA FINAL NOVEMBER 2018 EXAM

SUBJECT- GFRS

Test Code – FNJ 7005

BRANCH - () (Date :)

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Answer 1:

Ans.1

I. Answers to Descriptive Questions

(a) In the present case, majority consent is required to conduct the relevant activities of C Ltd. A Ltd. has majority voting rights and decisions will be taken by the majority shareholders and A Ltd. also controls the relevant activities of C Ltd. by having control over costing, budgeting, pricing and marketing of the project. A Ltd. exercises control over this entity, it is exposed to variable returns from its involvement with C Ltd. and has the ability to affect those returns through its power over C Ltd. Therefore, considering the guidance under IFRS 10, A Ltd. might have to consolidate C Ltd. as its subsidiary.

(b) Since only three trustees out of ten, are closely related to A Ltd. who actively participate, and all trustees participate in their own capacity. Hence, A Ltd. doesn't have power over the trust. Further, donation given by A Ltd. to trust will never flow back to A Ltd. even in case of dissolution and discount allowed on tuition fee is also not material and not being borne by ABC Foundation. Hence, A Ltd. doesn't have any direct exposure, or rights, to variable returns of the trust. On analysis of the above facts and guidance available under IFRS 10, A Ltd. neither has power nor has exposure to variable returns. Thus, considering the requirement under IFRS 10, control could not be established. Thus, A Ltd. cannot consolidate ABC Foundation as its subsidiary under IFRS.

Ans.2

According to IFRS 9 criteria, A Ltd. and D Ltd. will classify the loan asset and liability, respectively, at amortised cost.

Scenario (a)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. A Ltd. and D Ltd. should recognize financial asset and liability, respectively, at the amount of loan given. Upon, repayment, both the entities should reverse the entries that were made at the origination. It may be noted that this accounting outcome will not apply when there is evidence that the loan is repayable after a period of time, but is disguised as being repayable on demand. Consideration should be given to the substance of the arrangement.

Journal entries in the books of A Ltd.

At origination		
Loan to D Ltd. A/c	Dr.	INR 10,00,000
Bank A/c	Cr.	INR 10,00,000

On repayment		
Bank A/c	Dr.	INR 10,00,000
Loan to D Ltd. A/c	Cr.	INR 10,00,000

Journal entries in the books of D Ltd.

At origination		
Bank A/c	Dr.	INR 10,00,000
Loan from A Ltd. A/c	Cr.	INR 10,00,000

On repayment		
Loan from A Ltd. A/c	Dr.	INR 10,00,000
Bank A/c	Cr.	INR 10,00,000

Scenario (b)

Both A Ltd. and D Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of INR 10,00,000 payable at the end of 3 years using discounting factor of 10%, i.e., INR 7,51,310. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of A Ltd.

At origination		
Loan to D Ltd. A/c	Dr.	INR 7,51,315
Investment in A Ltd. A/c	Dr.	INR 2,48,685
Bank A/c	Cr.	INR 10,00,000

During periods to repayment- to recognise interest		
Year 1		
Loan to D Ltd. A/c	Dr.	INR 75,130
Interest income A/c	Cr.	INR 75,130
Year 2		
Loan to D Ltd. A/c	Dr.	INR 82,645
Interest income A/c	Cr.	INR 82,645
Year 3		
Loan to D Ltd. A/c	Dr.	INR 90,909
Interest income A/c	Cr.	INR 90,909
Note- Interest needs to be recognised in statement of profit and loss. The same cannot be adjusted against capital contribution recognised at origination.		

On repayment		
Bank A/c	Dr.	INR 10,00,000
Loan to D Ltd. A/c	Cr.	INR 10,00,000

Journal entries in the books of D Ltd.

At origination		
Bank A/c	Dr.	INR 10,00,000
Loan from A Ltd. A/c	Cr.	INR 7,51,130
Equity Contribution in A Ltd. A/c	Cr.	INR 2,48,690

During periods to repayment- to recognize interest		
Year 1		
Interest expense A/c	Dr.	INR 75,131
Loan from A Ltd. A/c	Cr.	INR 75,131
Year 2		
Interest expense A/c	Dr.	INR 82,645
Loan from A Ltd. A/c	Cr.	INR 82,645
Year 3		
Interest expense A/c	Dr.	INR 90,909
Loan from A Ltd. A/c	Cr.	INR 90,909

On repayment		
Loan from A Ltd. A/c	Dr.	INR 10,00,000
Bank A/c	Cr.	INR 10,00,000

Working Note:

Years	Amount outstanding (opening)	Interest	Amount outstanding (closing)
Beginning of year 1		-	INR 7,51,315
End of year 1	INR 7,51,315	INR 75,131	INR 8,26,446
End of year 2	INR 8,26,446	INR 82,645	INR 9,09,091
End of year 3	INR 9,09,091	INR 90,909	INR 10,00,000

Ans.3

(a) In present case, the said compressor's carrying amount will be recovered principally through sale and not through its continuing use. Further, the asset is retired from active use and it is kept idle, hence compressor is available for immediate sale in its present condition. Since the time, compressor was classified as 'assets held for disposal', A Ltd. was committed to sell the compressor and for such sale it invited global bids as well to fetch good price for such compressor. A Ltd. always had the intention of selling it immediately on receiving good price for the compressor. On receipt of bid from the buyer, U Ltd., A Ltd. initiated procedures to sell the compressor to him, but due to disagreement regarding currency of sales consideration at a later stage, a dispute arose between both the parties and the matter was taken to the Court, which later got transferred to the Arbitrator. Also a stay order has also been issued by the Court, restricting A Ltd. to sell the asset to any other party till the matter is resolved by the arbitrator, with whom case is currently pending. As a result, A Ltd. is not able to sell the compressor till the matter is resolved, pursuant to High Court's stay order. Till date, A Ltd. has complied with all the orders/ instructions received from the Court/ arbitrator and is awaiting arbitrator's verdict on this matter, which is expected to be July 2018. As on today, subject to the stay order, A Ltd. is still committed to sell the compressor. The compressor is currently not in use, but kept it idle, ready for sale. Hence, based on the facts of the case and considering the principles under IFRS 5, it can be said that A Ltd. is committed to sell the compressor but due to factors beyond the control of A Ltd., i.e., stay order from the Court, it is restricted from selling the compressor till the matter is resolved by the assigned arbitrator. Hence, till the matter is resolved, compressor should be classified as 'non-current assets held for sale'.

(b) As on 31 March 2015, in Indian GAAP audited financial statements of A Ltd., compressor is classified as 'assets held for disposal' and valued at lower of net book value (carrying amount) and net realisable value, i.e., INR 6,522,681 in the present case. As per the guidance under IFRS 5, non-current assets held for sale should be measured at lower of carrying amount and fair value *less* costs to sell. There is a difference between the term 'net realisable value' and 'fair value *less* costs to sell', i.e., net realisable value is an exit price for an asset, whereas fair value *less* costs to sell is an entry price, i.e., price to be paid for acquiring an asset. Considering the facts in the present case, one can infer that 'fair value *less* costs to sell' is greater than 'net realisable value'. Hence, in the opening IFRS balance sheet of A Ltd., compressor should be valued at carrying amount, since on 31 March 2015, carrying amount is less than net realisable value and net realisable value is less than fair value *less* costs to sell.

II. Answers to Objective Type Questions

1. Option (b) : INR 49,60,000

Value of 400 units of chemicals	400 x 10,000	INR 40,00,000
Value of 100 units of chemicals	100 x 9,600	INR 9,60,000
Value of stock on 31 March 2018		INR 49,60,000

Sale value on the reporting date is irrelevant as Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. NRV is not the selling price on the reporting date.

2. Option (d) : INR 27,00,000

Basic price (as per supplier's invoice plus taxes)	INR 20,00,000
Initial delivery and handling costs	INR 4,00,000
Cost of site preparation	INR 2,00,000

3. Option (a) : Deferred tax asset of INR 9,000

Particulars	Carrying amount	Tax base	Temporary difference
At acquisition	INR 1,50,000	INR 1,50,000	Nil
Accumulated depreciation	(INR 50,000)	(INR 50,000)	Nil
Impairment loss	(INR 30,000)	Nil	(INR 30,000)

Tax rate	30%
Deferred tax asset	INR 9,000

4. Option (d) : 20 months

Capitalisation under IAS 23 will commence from the date when the expenditure is incurred (1 May 2016) and must cease when the asset is ready for its intended use (28 February 2018); in this case a 22- month period. However, interest cannot be capitalised during a period where development activity is suspended ie for the period of two months from July, 2017 to August, 2017.

5. Option (c) : Impairment loss for the cash-generating unit of INR 1,00,000 should be first allocated to goodwill (i.e., INR 50,000) and balance impairment loss of INR 50,000 should be allocated on a pro-rata basis between the plant and machinery and technical know-how based on their carrying amounts, at INR 26,000 and INR 24,000, respectively.

6. Option (c) : Intangible asset of INR 2,00,000; expense of INR 8,00,000 (Refer para 65, 74 and 76 of IAS 38)

Research expenditure	Expense as incurred
Development expenditure	• Expense if the recognition criteria for intangible assets are not met • Capitalise once the recognition criteria are met • Past expense cannot be capitalised

7. Option (b) : Single Contract

8. Option (c) : A Ltd. should recognise an expense of INR 1,50,000 immediately and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

   The 'non-compete' clause is a non-vesting condition, because A Ltd. does not receive any services. On the grant date, A Ltd. should immediately recognise a cost of INR 1,50,000, as the director is not providing any future services. A Ltd. cannot reverse the expense recognised, even if the director goes to work for a competitor and loses the share options, because the condition is a non-vesting condition.

9. Option (c) : Current liability even if the lender agreed after reporting date and before authorisation of financial statements for issue, not to demand payment as a consequence.

   If the entity has an unconditional right to defer the settlement of the liability for at least twelve months, the debt should be classified as non-current liability. In the given case, liability becomes payable on demand, therefore, it will be classified as current even if the lender agreed after reporting date and before authorisation of financials for issue, not to demand payment as a consequence.

10. Option (a) : INR 25 lacs

Particulars	**Amount**
Fair value of consideration	INR 60,00,000
Fair value of non-controlling interest	INR 45,00,000
	INR 1,05,00,000
Less: Fair value of net assets	(INR 80,00,000)
Goodwill	**INR 25,00,000**

Note:

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

Answer 2:

I. **Answers to descriptive questions**

Ans.1:

(a) In present case, 13 kms of rail tracks belonging to A Ltd. has been identified as specified asset in the above-mentioned agreement and this asset is required by A Ltd. to fulfil its obligations under the said agreement. There is no other rail track available that connects to Location 2 railway station and enable B Ltd. to transport its cargo to the said station. Hence, it is not practicable for A Ltd. to perform its obligation under this agreement by using alternative railway tracks or any other mode of transport. Accordingly, fulfilment of abovementioned arrangement is dependent on the use of this 13 kms of railway tracks, connecting B Ltd.'s rail tracks to Location 2 railway station. Hence, 13 kms of railway track is a specified asset. In accordance with IFRIC 4 "Determining Whether an Arrangement Contains a Lease", an arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

Technical literature	Analysis
(1) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.	In the present case, B Ltd. has no right over the concerned railway tracks stated in this agreement because of the following factors: • A Ltd. has permitted B Ltd. to run its trains on a portion of A Ltd.'s railway tracks (13 kms out of total 27 kms of rail tracks) leading to Location 2 Railway station. • A Ltd.'s trains shall be given preference over B Ltd.'s trains in movement of cargo over such rail tracks. • B Ltd. shall have no claim on any assets or facilities owned by A Ltd. in respect of railway tracks. • B Ltd. cannot increase number of rake loads without A Ltd.'s prior written approval. • Thus, on reading the above, it can be said that by getting first priority over others and restricting other's traffic, A Ltd. is controlling the rail traffic on its tracks. Hence, it can be concluded B Ltd. has no ability or right to operate these tracks or direct other to operate these tracks.
(2) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset	Considering the facts of the case, it seems that A Ltd. has the right to control physical access to rail tracks and not B Ltd.
(3) Facts and circumstances indicate that it is 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	B Ltd. shall be paying INR 5.5 per MT of cargo transported on such tracks (both inward and outward movements). This rate is contractually fixed for the entire agreement period of 10 years. Such price is arrived by considering length of tracks that will used and frequency at which such

or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is 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.	tracks will be used. Hence, the said criteria is also not getting satisfied.

Based on the above analysis, it is clear that the arrangement between A Ltd. and B Ltd. for letting B Ltd. to run its trains on a portion of A Ltd.'s rail tracks, will not be considered to be a lease arrangement.

(b) In the present case, B Ltd. has transferred the ownership of connecting tracks (i.e., from its port to A Ltd.'s rail tracks) to A Ltd. It clearly states that ownership of connecting tracks and facilities built by B Ltd. will belong to A Ltd. and B Ltd. will have no claim over such connecting tracks. In accordance with the principles of IFRIC 18 "Transfers of Assets from Customers", to determine whether an asset exist for an entity that renders service, the right of ownership on that asset is not essential. Even if ownership of an asset is transferred by the customer to an entity (rendering services), but it is still controlled by the customer, then definition of an asset will not be met for the entity rendering services.

IFRIC 18 provides few factors which can help to ascertain as to who has control over the transferred item of property, plant and equipment. These factors have been discussed below in the context of the present case to determine whether A Ltd. has control over connecting rail track:

Examples	**Whether applicable to present case?**
The entity can exchange that asset for other assets	In present case, the asset received is a rail track. Practically, considering the nature of the asset, it can be said that A Ltd. cannot exchange such a track with any other party for other assets.
Employ it to produce goods or services	A Ltd. can run its own trains on such connecting tracks, without paying for usage.
Charge a price for others to use it	A Ltd. has no intention to charge a price for others to use it.
Use it to settle liabilities, hold it or distribute it to owners	A Ltd. cannot use such connecting rail tracks to settle its own liabilities, or distribute it to owners.
It may have the ability to decide how the transferred item of property, plant and equipment is operated and maintained and when it is replaced	Responsibility of operating and maintaining such track is with B Ltd.

IFRIC 18 further states that an entity receiving the item of property, plant and equipment should consider all relevant facts and circumstances when assessing control over that transferred item. Accordingly, following factors may also be considered while assessing control over connecting rail tracks laid down by B Ltd.:

- These connecting rail tracks (of 2 kms) were laid down by B Ltd. at its own costs.
- Responsibility of maintaining such connecting rail tracks lies with B Ltd., i.e., they have to maintain these connecting rail tracks. However, A Ltd. has right to access to the connecting tracks without paying for usage.
- After expiry of the said agreement, connecting rail tracks will belong to B Ltd. only. Hence, ownership of rail tracks is for 10 years only and not for entire life of the asset.

From the above factors, it can be said that, although ownership of connecting tracks has been transferred to A Ltd. and A Ltd. can have access to such tracks, it does not have substantial control over connecting rail tracks. Also, no future economic benefits are expected to flow to A Ltd. from such connecting rail tracks laid down by B Ltd. Hence, it can be concluded that provisions of IFRIC 18 will not be applicable and A Ltd. cannot recognise connecting rail tracks in its books as an asset.

(c) The agreement between A Ltd. and B Ltd. was entered into with the purpose of allowing B Ltd. to use A Ltd.'s 13 kms of rail tracks for a fixed period of 10 years. There is no transfer of significant risk and rewards incidental to ownership of such tracks to B Ltd. As per the available information, the permission given to B Ltd. is a license given solely for the purpose of hauling traffic and B Ltd. does not have any right over such assets (i.e., rail track). On that basis, we can conclude that there is no sale of rail tracks to B Ltd since INR 10 crores is against permission granted to use A Ltd.'s tracks. As regards sharing of revenue @ INR 5.5 per MT, it is paid for inward and outward movement of cargo on A Ltd.'s railway tracks. Sharing of revenue @ INR 5.5 per MT were agreed between both the parties, based on two factors namely the length of rail tracks to be used and frequency of usage of such tracks. Hence, there is no connection between upfront payment of INR 10 crores and sharing of revenue @ INR 5.5 per MT. INR 10 crores were levied on B Ltd. because A Ltd. wanted to recover some amount against their initial investments made on such rail tracks. As per the agreement, INR 10 crores paid is non-refundable, hence, there is no obligation on A Ltd. to repay back the said amount, irrespective of usage of such tracks by B Ltd. Based on above facts, it can be concluded that such arrangement does not involve sale of assets. The payment is for giving a right to an external party to use an entity's assets over a fixed period. Considering the general principles of para 13 of IAS 18, upfront consideration of INR 10 crores should be treated as a deferred revenue and should be recognised in the statement of profit and loss over the period of 10 years on a straight- line basis.

Ans.2:

In accordance with IFRS 9, a financial guarantee contract meets the definition of an insurance contract and if an issuer applies accounting to such contracts which is applicable to insurance contracts, in such a case issuer may elect to apply either the requirements of IFRS 4 or IFRS 9 to such financial guarantee contracts.

A Ltd. in its Indian GAAP financial statements has disclosed the contract as corporate guarantees under contingent liabilities. Hence, the criteria of previous assertion of this contract as an insurance contract is not met. Hence, as provided above, since the criteria of insurance contract is not met, the said transaction will be covered under IFRS 9 and not under IFRS 4 and the company needs to measure the financial guarantee given by at its fair value.

Measurement of financial guarantee under IFRS 9

Evaluation is required with regards to guarantee given by A Ltd., i.e., whether it is an integral part of the loan or not.

Guarantee is an integral part of the loan if the guarantee provided to the lender forms part of the overall terms of the loan (i.e., if the loan were to be assigned by the lender to a third party, the guarantee would transfer with it). If the guarantee is provided to the lender separate and apart from the original borrowing such that it does not form part of the overall terms of the loan (i.e., if the loan were to be assigned by the lender to a third party, the guarantee would not transfer with it), then such guarantee is a separate unit of account.

I. Accounting in the books of A Ltd.

The same will not affect the recognition in the books of A Ltd. The recognition of financial guarantee is independent to the fact whether the guarantee is a separate unit of account or is not a separate unit of account. Therefore, irrespective of whether the guarantee is considered a separate unit of account, A Ltd. recognises the fair value of the financial guarantee in its separate financial statements as follows:

Investment in subsidiary A/c	Dr.	INR 2 crores
Financial guarantee obligation A/c	Cr.	INR 2 crores

II. Accounting in the books of F Ltd.

With respect to the recognition of financial guarantee contracts, F Ltd. has an accounting policy choice to be applied consistently:

(a) View I- Guarantee is not an integral part of the loan and F Ltd. should perform mirror accounting of what has been done by A Ltd. in its separate financial statements.

(b) View II- Guarantee is an integral part of the loan

If the guarantee is integral to loan, the subsidiary is not required to recognise the value of guarantee separately, instead it will be included in the loan liability. However, if the guarantee is not an integral part of the loan, then the subsidiary is required to recognize the value of guarantee separately as a capital contribution.

A. **If the guarantee is an integral part of the loan:** If the guarantee provided to the lender forms part of the overall terms of the loan (i.e., if the loan were to be assigned by the lender to a third party, the guarantee would transfer with it), F Ltd. should recognise the liability at fair value, including the value of the guarantee provided by the parent (INR 100 crores) as follows:

Cash A/c	Dr.	INR 100 crores
Loan liability A/c	Cr.	INR 100 crores

B. **If the guarantee is not an integral part of the loan:** If the guarantee is provided to the lender separate and apart from the original borrowing such that it does not form part of the overall terms of the loan (i.e., if the loan were to be assigned by the lender to a third party, the guarantee would not transfer with it), F Ltd. should recognise the liability at fair value without the guarantee (assumed INR 98 crores) with the difference being recognised as a capital contribution, as follows:

Cash A/c	Dr.	INR 100 crores
Loan liability A/c	Cr.	INR 98 crores
Capital contribution A/c	Cr.	INR 2 crores

III. Accounting in the consolidated financial statements

Irrespective of whether the guarantee is considered a separate unit of account, the financial guarantee is not separately recognised in the consolidated financial statements of A Ltd.

In consolidated financial statements, the entry passed in separate financial statements of the parent will be reversed.

Financial guarantee obligation A/c	Dr.	INR 2 crores
Investment in subsidiary A/c	Cr.	INR 2 crores

The consolidated group incurred a financial liability with a fair value of INR 100 crores (due to the guarantee of the parent) and therefore, the consolidated statement of financial position includes only that liability, measured on an amortised cost basis.

In case F Ltd. (subsidiary) has accounted the loan considering the guarantee as not an integral part of the loan, then in consolidated financial statements, besides reversal of the entry passed by the parent company, the entry passed in F Ltd. (subsidiary company) with respect to capital contribution by A Ltd. for INR 2 crores shall be eliminated by transferring the same to loan liability as follows:

Capital contribution A/c	Dr.	INR 2 crores
Loan liability A/c	Cr.	INR 2 crores

Ans. 3:

Property	**Classification of properties not held for operational purpose**
A Ltd.'s office building (registered office)	Excess portion of office space has been given on lease to earn rental income. Out of 15 storey building, only 3 floors are occupied by A Ltd. Such excess office space was constructed for the purpose of letting it out. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future. Further, office space given on rent, although in same building, is separately identifiable from other owner occupied portion and hence can be sold separately (if required). Hence, the excess space will qualify to be an investment property.

Flats in Township located in location 1	Excess flats have been given on lease to earn rental income. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees. Further, flats given on rent, can be sold separately from flats occupied by A Ltd.'s employees as they are separately identifiable. A Ltd. also charges its lessees on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence flats given on rent should qualify to be an 'investment property'. With regard to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Flats in township located in location 2	350 flats are given on lease to earn rental income and assuming that management intends to let out these flats on rent in future, such flats should be classified as an 'investment property. With regard to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Hostel located in location 1	Rooms in a hostel have been let out to G Ltd. to be used by its personnel. A Ltd. also charges G Ltd. on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, it should be classified as an 'Investment property'.
Land in location 1	Although management has not determined a use for the property after the park's development takes place, yet in the medium-term the land is held for capital appreciation. As per IAS 40, 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, then it will be considered as land held for capital appreciation. Therefore, management should classify the property as an investment property.
Land in location 1	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period of time, it should be classified as 'Investment property'.
Land in location 2	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period of time, it should be classified as 'Investment property'.

II. **Answers to Objective type questions:**

1. Option (c) : INR 10,00,000

[Hint

Net realisable value of one unit of raw material = Sale price - cost to completion and sale

= INR 160 – INR 50 = INR 110

Carrying value of raw material = INR 100

Inventory of raw material will be kept at lower of costs and net realisable value. Thus, inventory of raw material will be kept at INR 100 per unit, i.e., total of INR 10,00,000 for 10,000 units.]

2. Option (c) : Annual depreciation charge will be INR 13,000 and an annual transfer of INR 3,000 may be made from revaluation surplus to retained earnings.

[**Hint**

The annual depreciation charge for years 3 to 10 will be INR 13,000 (i.e. 104,000/ 8). The amount that may be transferred from revaluation surplus to retained earnings in accordance with para 41 of IAS 16 will be the difference between the depreciation expense based on historic cost (i.e., INR 10,000), and the depreciation expense based on the revalued amount (i.e., INR 13,000). So an annual transfer of INR 3,000 may be made from revaluation surplus to retained earnings as the asset is used by an entity.]

3. Option (a) : INR 6,35,00,000

[Hint

The mid-value is 12,700 per square feet [12,500 + 12,900) x ½]. This would value the property at INR 6,35,00,000 (12,700 x 5,000).]

4. Option (a)

Bank A/c	Dr.	INR 50 lacs
Loan A/c	Cr.	INR 40 lacs
Government grant (deferred income) A/c	Cr.	INR 10 lacs

5. Option (d) : INR 31,00,000

[Hint

Total interest charge for the year ended 31 March 2018 is INR 45,00,000 (600 lacs x 10% x 9/12). Amount to be capitalised is INR 31,00,000 (i.e., INR 45,00,000 – 14,00,000).]

6. Option (a) : A Ltd. should recognise it as an intangible asset.

[Hint

A Ltd. should recognise the customer portfolio as an intangible asset considering the below guidance under para 16 of IAS 38:

An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.]

7. Option (b) : 12-month expected credit losses

Hint

Under the general model of IFRS 9, all assets need to have a loss allowance. Allowance covers either 12-month or lifetime expected credit losses depending on whether the asset's credit risk has increased significantly. Since the loan has just been granted and there has not been a significant increase in credit risk, an allowance equal to 12-month expected credit losses is appropriate.

8. Option (d) : Financial liability to be measured at fair value

[Hint:

The amount of application money is fixed, i.e., INR 10 crores. However, number of shares are variable based on the future fair market value. Therefore, A Ltd. must treat this application balance as a financial liability and measure it at fair value.]

9. Option (a) : INR 20,000 of goodwill

Hint:

Cost of investment	1,00,000 + (1,21,000/ 1.21)	INR 2,00,000
Non-controlling interest	(40% x 3,00,000)	INR 1,20,000
		INR 3,20,000
Less: Net assets of MN Ltd.		INR 3,00,000
Goodwill		INR 20,000

10. Option (c) : A Ltd. should recognise a provision as on 31 March 2018.

Hint

The communication of management's decision to customers and employees on 25 March 2018 creates a valid expectation that the division will be closed, thereby giving rise to a constructive obligation from that date. Accordingly, a provision should be recognised at 31 March 2018 for the best estimate of the costs of closing the division.

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

Answer 3:

1. The key areas of differences where accounting or recognition as per IFRS is required vis-a- vis the current accounting practices, as per Indian GAAP, followed by ABC Limited:

(i) Power purchase agreement contains an embedded lease which needs to be evaluated under IFRIC 4.

(ii) The highway project is a service concession arrangement and will be accounted for as an intangible asset as per IFRIC 12.

(iii) The assets and liabilities of financial services constitute a disposal group held for sale as at 31 March 2016 and for the year then ended and will be accounted for as per IFRS 5.

(iv) The renegotiation of terms related to the term loan taken by ABC Ltd. needs to be evaluated to determine whether it constitutes a substantial modification of terms as per IFRS 9 or not.

(v) Class B equity shares will be accounted for as compound financial instruments as per IAS 32. The payment of dividend is dependent upon availability of profits, an event which is considered outside the control of the issuer and hence represents a financial liability. The feature of conversion into a fixed number of equity instruments i.e. Class A equity shares is an equity feature.

(vi) A-ONE Ltd. will be consolidated as a joint venture under IFRS 11 as the shareholders' agreement between ABC Limited and other shareholders of A-ONE Ltd. provides certain substantive rights which are not merely protective.

(vii) Corporate guarantee given by ABC Limited in respect of loan taken by A-ONE Ltd. will be accounted for as a financial guarantee contract as per IFRS 9.

(viii) ABC Limited has an obligation to restore the mine and related area and the estimated cost of fulfilling that obligation will be provided for in accordance with IAS 37, and capitalised to the cost of the mining license.

(ix) The portfolio of car loans will not be derecognised in the books of B-ONE Ltd. and in the consolidated financial statements of ABC Limited.

(x) The interest free loan from ABC Ltd. to B-ONE Ltd. will be initially recognised at its fair value and the difference between the loan amount and the fair value thereof will be accounted for as an investment in the books of ABC Ltd. and as a capital contribution in the books of B-ONE Ltd.

2. **(a)** The key exemptions available to ABCG on 1 April 2015 i.e. from its date of transition to IFRS, are:

i. ABCG may determine whether the PPA with GOP contains a lease on the basis of facts and circumstances existing at 1 April 2015.

ii. If, for the highway project, it is impracticable for ABC Limited to apply IFRIC 12 retrospectively at 1 April 2015, it shall:

(a) recognise the intangible assets that existed at 1 April 2015;

(b) use the previous carrying amounts of those intangible assets (however previously classified) as their carrying amounts as at 1 April 2015; and

(c) test intangible assets recognised at 1 April 2015 for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at 1 April 2016.

iii. ABC Limited may elect not to apply IFRS 3 retrospectively to its acquisition of B-ONE Ltd.

(b) As per IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments:

i. When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

ii. The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in profit or loss, in accordance with paragraph 3.3.3 of IFRS 9. The equity instruments issued shall be recognized initially and measured at the date the financial liability (or part of that liability) is extinguished.

(c) In the present case, the outstanding amount of interest on the term loan has been converted into CCPS. Each CCPS is convertible into one class A equity shares of Rs. 100 each. As the criteria specified in IAS 32 in respect of definition of equity instrument are satisfied, CCPS are concluded as equity instruments.

(d) Accordingly, as per IFRIC 19, the difference between the carrying amount of financial liability i.e. Rs. 100 crores and the fair value of equity instruments shall be recognised as a gain or loss.

(e) It has been mentioned that in January 2017, an investor showed interest in picking up a strategic stake in ABC Limited at a valuation of Rs. 10,000 crores. This demonstrates that the fair value of all equity instruments of ABC Limited is Rs. 10,000 crores.

(f) Further, it has been mentioned that the total number of equity instruments (on fully diluted basis) is 20 crores (Class A equity shares – 10 crores and Class B equity shares – 10 crores). Accordingly, fair value per equity instrument is Rs. 500. It may be noted that Class B equity shares are in the nature of compound financial instruments and hence it is assumed that the fair valuation of all equity instruments (i.e. Rs. 10,000 crores) is after factoring in the liability component of these compound financial instruments.

(g) Therefore, the fair value of equity instruments to be issued upon conversion of the interest outstanding is: 2,100,000 equity shares x Rs. 500 per share = Rs. 105 crores.

(h) Applying the guidance in IFRIC 19, a loss of Rs. 5 crores will be recognised in the statement of profit or loss.

(i) Next, we need to consider whether the modification of terms of loan to the extent of principal outstanding qualifies as "substantial modification" or not. In order to be able to do that, we refer to guidance in paragraph B3.3.6 of the application guidance of IFRS 9, which provides as below:

(j) "For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability."

Accordingly, the following computation table has been made:

Year	**Cash flow**	**Present value @ 14%**
2018	(88)	(77.19)
2019	(88)	(67.71)
2020	(88)	(59.40)
2021	(88)	(52.10)
2022	(888)	(461.20)
TOTAL		**(717.60)**
PV as % of original loan [(7,176/800) x 100]		**89.70%**

As can be seen from the table above, the present value of the cash flows under the new terms discounted using the original effective interest rate (Rs. 717.61 crores) vary from the original financial liability (Rs. 800 crores) by 10.30%. Accordingly, the debt restructuring tantamount to substantial modification of terms of the loan.

(k) As per para 7 of IFRS 10 (under the head 'Control'):

"Thus, an investor controls an investee if and only if the investor has all the following:

(i) power over the investee;

(ii) exposure, or rights, to variable returns from its involvement with the investee; and

(iii) the ability to use its power over the investee to affect the amount of the investor's returns"

As per paragraph B3 of application guidance (under the head 'Assessing Control') of IFRS 10:

"Consideration of the following factors may assist in making that determination:

(a) the purpose and design of the investee;

(b) what the relevant activities are and how decisions about those activities are made;

(c) whether the rights of the investor give it the current ability to direct the relevant activities;

(d) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee; and

(e) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns."

As per paragraph B12 of application guidance of IFRS 10:

"Examples of decisions about relevant activities include but are not limited to:

(a) establishing operating and capital decisions of the investee, including budgets; and

(b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment."

In the instant case, certain matters cannot be decided by majority of the Board unless there is consent of all the parties. Those matters are evaluated to be relevant activities as per IFRS 10.

This constitutes "joint control" under IFRS 11, which is defined as:

"The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control."

Accordingly, A-ONE Ltd. will be consolidated as a joint venture using the equity method prescribed under IAS 28.

3. (a) In respect of the infrastructure business, ABC Limited is first required to determine its contractual performance obligations. Those obligations are:

- Construction services during Year 1 and 2
- Operation services during Years 3 to 10
- Road surfacing in Year 8

As a consideration of the aforementioned services, ABC Limited is paid a consideration of Rs. 200 crores per annum. Since this represents an unconditional contractual right to receive cash, it is a financial asset recognised and measured as per IFRS 9.

Measurement of revenue

Contract to render construction services and carry out road resurfacing are construction contracts in accordance with IAS 11. The contract to render operation services is accounted for in accordance with IAS 18.

In accordance with paragraph 12 of IAS 11 and paragraph 9 of IAS 18, revenue is measured at the fair value of consideration received or receivable.

(b) Accordingly, revenue to be recognised in respect of these performance obligations are as below:

Particulars	**Year**	**Cost (Rs. crores)**	**Margin**	**Revenue (Rs. crores)**
Construction services	1	500	5%	525
	2	500	5%	525
Operation services (per year)	3-10	80 (10 x 8)	20%	96 [(10x120%) x 8]
Road resurfacing	8	100	10%	110
Total		**1,180**		**1,256**

Revenue is recognised at the contract cost plus margin, with a corresponding debit to financial asset in each of the years mentioned above. The same is tabulated in column (A) below.

As the consideration for these performance obligations is received over a period of time, as tabulated in column (B) below, there is an inherent finance income element included in the consideration. In order to determine the same, the formula of IRR is applied on column (C) which represents the net cash flow i.e. creation of financial asset and its realisation.

In the present case, IRR is determined as 6.18%.

Applying the computed IRR of 6.18% on the financial asset balance as at the beginning of the year (i.e. previous year's column (E)), finance income for each of the years is determined.

The table after the next table summarises the net effect of accounting for these transactions as per IFRIC 12.

Rs. crores

Year	Financial asset	Cash inflow	Net cash flow	Finance income @ IRR = 6.18%	Adjusted financial asset
	(A)	(B)	(C) = (A) + (B)	(D) = previous year's (E) X 6.18%	(E)= E of previous year + C+D
1	525		525	-	525.0
2	525		525	32.4	1,082.4
3	12	(200)	(188)	66.9	961.3
4	12	(200)	(188)	59.4	832.7
5	12	(200)	(188)	51.5	696.2
6	12	(200)	(188)	43.0	551.2
7	12	(200)	(188)	34.1	397.3
8	122	(200)	(78)	24.6	343.9
9	12	(200)	(188)	21.3	177.2
10	12	(200)	(188)	10.8	0
	1,256	**(1,600)**	**(344)**	**344**	

*Different is due to approximation.

Net effect of accounting under IFRIC 12:

Rs. crores

Year	Contract cost	Revenue					Net profit
		Construction services	Operation services	Road resurfacing	Finance income	Total	
1	500	525			-	525.0	25.0
2	500	525			32.4	557.4	57.4
3	10		12		66.9	78.9	68.9
4	10		12		59.4	71.4	61.4
5	10		12		51.5	63.5	53.5
6	10		12		43.0	55.0	45.0
7	10		12		34.1	46.1	36.1
8	110		12	110	24.6	146.6	36.6
9	10		12		21.3	33.3	23.3
10	10		12		10.8	22.8	12.8
	1,180	**1,050**	**96**	**110**	**344**	**1,599.9***	**420**

* Difference is due to approximation.

(b) The extract of IFRS balance sheet of ABC Limited is as below:

Particulars	**As at 31 March 2017**	**As at 31 March 2016**	**As at 1 April 2015**
Assets			
Non-current assets			
(a) Property, plant and equipment - Power plant given on operating lease (carried at original cost less depreciation) - Spare parts for power plant with useful life of more than one year			
(b) Investment property – Land with undetermined use (carried at cost)			
(e) Investments - In equity shares of subsidiary (carried at cost as per IAS 27) - In equity shares of unrelated unlisted company (carried at fair value through other comprehensive income) - Equity contribution in respect of interest free loan to B-ONE Ltd.			
(f) Other financial assets - Interest free loan to B-ONE Ltd. (carried at amortised cost) - Loan to employees at discounted rate of interest - Consideration receivable under service concession arrangement			
Sub –total (A)			
Current assets			
(a) Investments - Investments in mutual funds carried at fair value through profit or loss			
(b) Financial assets - Consideration receivable under service concession arrangement			
Sub total (B)			
Total assets (A) + (B)			

Particulars	As at 31 March 2017	As at 31 March 2016	As at 1 April 2015
EQUITY AND LIABILITIES			
Equity			
- Class A equity shares - Equity component of Class B equity shares - Compulsorily convertible preference shares			
Total equity			
Liabilities			
Non-current liabilities			
(a) Financial liabilities			
(i) Borrowings – Loan from Yep Bank Ltd., net of processing fee of 1%			
(ii) Other financial liabilities - Liability component of Class B equity shares - Corporate guarantee contract			
(b) Provisions – Mine restoration provision			
Total			
Current liabilities			
Total			
Total liabilities			
Total equity and liabilities			

Answers to Objective Type Questions:

1. **Option c.** The date of transition to IFRS is 1 April 2015.

2. **Option d.**

As at the balance sheet date, in the consolidated financial statements of ABC Limited, the assets and liabilities of financial services business undertaken by B-ONE Ltd. shall be measured as below:

- the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of IFRS 5, shall be measured in accordance with applicable IFRSs the carrying amounts of any assets and liabilities that are within the scope of the measurement requirements of IFRS 5, shall be measured at lower of carrying amount and fair value less costs to sell.

The aggregate of the above shall be compared with the fair value less costs to sell of the financial services business as a whole.

3. Option d.

Class A equity share is classified as "Equity". This is because Class A equity shareholders are entitled to dividend at the discretion of the Board of Directors which implies that they are only entitled to residual interest in the net assets of ABC Limited.

4. Option d.

Class B equity shareholders are entitled to a fixed dividend of 10% subject to availability of profits in that year and distributable cash as on balance sheet date of relevant year. Therefore, it is a financial liability. (Refer paragraph 25 of IAS 32)

5. Option (a)

Class A equity shares are classified as equity instruments of ABC Limited. Accordingly, the journal entry will be as below:

Bank	Dr.	Rs. 400 crores	
To Class A equity shares			Rs. 400 crores
(Being issuance of Class A equity shares to CeeDee)			

6. Option (c)

The fair value of liability component of financial instrument is determined as the present value of cash outflow obligations of ABC Limited. In order to determine that, the cash flows are laid out below:

												Rs. in crores
	Particulars	**For the year ending 31 March**										
		2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**Total**
(a)	Opening cash and cash equivalents	100	85	16	8	2	8	26	48	74	104	
(b)	Profit / (loss) as per IGAAP financial statements	(20)	(75)	(15)	(13)	(2)	10	13	18	23	28	
(c)	Depreciation as per IGAAP	5	6	7	7	8	8	9	8	7	7	
(d)	Impact on profit / loss due to IFRS conversion	8	10	(4)	5	7	(12)	6	1	0	(2)	
(e)	Dividend @ 10%	100	100	100	100	100	100	100	100	100	100	
	Dividend (w,e,less (a), (b) or (e))	Nil	Nil	Nil	Nil	Nil	8	13	18	23	25	
	Present value @ 13% p.a.	Nil	Nil	Nil	Nil	Nil	3.8	5.5	6.8	7.7	7.4	31.2

As computed above, the present value of dividend obligation is Rs. 31.2 crores. Accordingly, the liability component is Rs. 31.2 crores and the equity component of Class B equity shares is determined as Rs. 568.8 crores.

7. Option (c) i.e. The PPA with GOP contains an embedded lease arrangement

As per paragraph 6 of IFRIC 4, "Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

(a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and

(b) the arrangement conveys a right to use the asset."

In the present case, the PPA with GOP can be fulfilled by the use of the power plant which is a specific asset. Accordingly, condition (a) above is satisfied.

Since

- The entire output of power plant is consumed by the purchaser i.e. GOP
- The price paid by GOP includes an element of capacity charge which makes the price for the output variable.

the PPA with GOP contains an embedded lease arrangement.

8. Option (b)

Continuing the rationale to the above MCQ i.e. the PPA with GOP contains an embedded lease arrangement, next, in order to determine if the lease arrangement is an operating lease or a finance lease, one can refer to paragraph 10 of IAS 17. On assessing the situations given therein, it may be concluded that situations

(a) Not fulfilled, as the ownership is not transferred to GOP.

(b) Not fulfilled, as GOP doesn't have an option to purchase the power plant.

(c) Not fulfilled, as the PPA is for 10 years whereas the useful life of the power plant is 15 years

(d) Not fulfilled. Refer computation below.

(e) Not fulfilled, as the asset is not specialised in nature.

The computation required for the purpose of (d) above is given below:

Contract year	Capacity charges	Total capacity charges	Present value @ 12%
	Rs. / kwh	**Rs. Crores**	
1	1.10	491.4	438.8
2	1.10	491.4	391.7
3	1.10	491.4	349.8
4	1.10	491.4	312.3

5	1.10	491.4	278.8
6	0.78	348.5	176.6
7	0.78	348.5	157.6
8	0.78	348.5	140.7
9	0.78	348.5	125.7
10	0.78	348.5	112.2
			2,484.30

[Total capacity charges above have been calculated as: 85% availability X 600 MW X 1,000 kw/MW X 24 hours X 365 days/year X Rate in Rs. per kwh]

Hence, present value of the minimum lease payments (Rs. 2,484.30 crores) amounts to only 62% of the fair value (Rs. 4,000 crores) of the leased asset.

Based on the evaluation above, the answer to this question is Option b i.e. “Property, plant and equipment under an operating lease arrangement”.

9. Option (d)

ABC Limited needs to recognise a provision for site restoration in accordance with the terms of the mining license granted to it. The provision is determined based on the best estimate of outflow of economic benefits to satisfy the contractual obligation, discounted to its present value using an appropriate rate determined in accordance with IAS 37.

10. Option (a)

In accordance with paragraphs 3.2.3, 3.2.4 and 3.2.5 of IFRS 9, the financial asset is not derecognised by ABC Limited as it does not constitute a transfer

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