SUGGESTED SOLUTION

FINAL Nov. 2019 EXAM

SUBJECT- FR

Test Code - FNJ 7097

BRANCH - () (Date :)

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Answer 1:

(A) As per Ind AS – 38 research cost of Rs. 8 and Rs. 10 crores to be expensed in respective years i.e. 2011 and 2012.

The **development expenses** can be capitalized from the date the internally generated assets (New distribution system in this case) meet the recognition criteria on and from 01.01.2013. Therefore cost of Rs. 30 + 36 + 40 = 106 crores is to be capitalized as an intangible assets.

However as per Ind AS – 38, the intangible should be carried at cost less accumulated amortization and accumulated impairment losses.

At the end of 2015 NDA Ltd. should recognize **impairment loss** of Rs. 7.46 crores (106.00 – 98.54) and carry the 'new distribution system' (intangible asset) at 98.54 crores in Balance sheet as per calculation given below.

Impairment loss is excess of carrying amount of asset over recoverable amount. **Recoverable amount** is higher of the two i.e. value in use (discounted future cash inflow) and market realizable value of asset. **(6 marks)**

The calculation of discounted future cash flow is as under assuming 10% discount rate.

Amt. (Rs. In crores)

Year	Cost Saving	Inflow by Marketing the System	Total Cash inflow	Discounted at 10%	Discounted cash flow
2016	16	10	26	0.909	23.634
2017	16	10	26	0.826	21.476
2018	16	10	26	0.751	19.526
2019	16	10	26	0.683	17.758
2020	16	10	26	0.621	16.146
					98.540

No amortization of asset shall be done in 2015 as amortization starts after use of asset, which is in 2016. **(4 marks)**

(B)

Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer,
(b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, *Financial Instruments: Presentation*. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

i) In the given case the amount of purchase consideration to be recognised on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	Rs. 25,00,000
Total purchase consideration	Rs. 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is:
  - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to Rs. 25,00,000 is recognised as a part of equity and therefore not re-measured subsequently or on issuance of shares.

ii) The amount of purchase consideration to be recognised on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	Rs. 25,00,000
Total purchase consideration	Rs. 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognised in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs. 15,00,000 (Rs. 40,00,000 - Rs. 25,00,000) should be recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (Rs. 40,00,000/ 25) shares at a premium of Rs. 15 per share. **(10 marks)**

Answer 2:
(A)

A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 2018 and therefore, would be treated as discontinued operation for the year ending 31st March 2019. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.

Accordingly, the results of G Ltd will be included on a line-by-line basis in the consolidated statement of comprehensive income as part of the profit from continuing operations of U Ltd for the year ending 31st March 2018.

As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:

(a) an entity has a detailed formal plan for the restructuring
(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 2018. They have made a formal announcement on 15th February 2018, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.

A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.

The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for Rs. 520 lakhs in this respect.

The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.

The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for Rs. 410 lakhs.

Further operating losses relate to future events and do not form a part of the closure provision.

Therefore, the total provision required = Rs. 520 lakhs + Rs. 410 lakhs = Rs. 930 lakhs. **(10 marks)**

Note:
Various issues related to the applicability of Ind AS / implementation under Companies (Indian Accounting Standards) Rules, 2015, are being raised by preparers, users and other stakeholders. Although many clarifications have been issued by way of ITFG Bulletins or EAC Opinion, still issues are arising on account of varying interpretations on several of its guidance. Therefore, alternate answers may be possible for the above questions based on standards, depending upon the view taken.

(B)

Assessment of the arrangement using the definition of derivative included under Ind AS 109.

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 foreign exchange rate (emphasis laid)

(b) it requires no initial net investment or an initial net investment is smaller than would be required for other types of contracts with similar response to changes in market factors.

(c) it is settled at a future date.

Upon evaluation of contract in question, on the basis of the definition of derivative, 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 40,000 on inception.

(c) the contract is settled in future

The derivative is a forward exchange contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

(3 MARKS)

Accounting in each Quarter

(i) Accounting on 1st January 2017

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.

(ii) Accounting on 31st March 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Profit and loss A/c Dr.	50,000	
To Derivative financial liability		50,000
(Being mark to market loss on forward contract recorded)		

(iii) Accounting on 30th June 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Derivative financial liability A/c Dr.	20,000	
To Profit and Loss A/c		20,000
(Being partial reversal of mark to market loss on forward contract recorded)		

(1*3 = 3 MARKS)

(iv) Accounting on 30th September 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Derivative financial liability A/c Dr.	30,000	
Derivative financial asset A/c Dr.	24,000	
To Profit and Loss A/c		54,000
(Being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)		

(v) Accounting on 31st December 2017

The settlement of the derivative forward contract by actual purchase of USD 40,000

Particulars	Dr. (Rs.)	Cr. (Rs.)
Cash (USD Account) (USD 40,000 x Rs.62)Dr.	24,80,000	
Profit and loss A/c Dr.	1,44,000	
To Cash (USD 40,000 x Rs. 65)		26,00,000
To Derivative financial asset A/c		24,000
(Being loss on settlement of forward contract booked on actual purchase of USD)		

(2*2 = 4 MARKS)

Answer 3:
(A)

Paragraph 27 of Ind AS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.

If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

(4 MARKS)

Accordingly, the amounts recognised in years 1 and 2 are as follows:

Year	Calculation	Compensation expense for period	Cumulative compensation expense
		Rs.	Rs.
1	[1,850 employees× 1,000 options × Rs. 1.20] × 1/3	7,40,000	7,40,000
2	(1,840 employees× 1,000 options × [(Rs.1.20× 2/3)+ {(Rs.1.05 - 0.90) ×0.5/1.5}] – 7,40,000	8,24,000	15,64,000

Note: Year 3 calculations have not been provided as it was not required in the question.

(2 MARKS)

(B)

In effect, this contract results in an initial net investment of Rs. 36 crores which yields a cash inflow of Rs. 10 crores every year, for five years. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non- derivative contract that has a similar response to changes in market conditions.

For this reason, the instrument fails the condition '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'. Therefore, the contract is not accounted for as a derivative contract. **(5 marks)**

(C)

(i) The land and government grant should be recognized by A Ltd. at fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income. (Refer footnote [1])

(ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.

(iii) Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.

(iv) Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh / 10 years] should be credited to profit and loss each year over period of 10 years. (Refer footnote [2])

(v) As per para 12 of Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

Foot note .

1. As per the amendment made by MCA in Ind AS 20 on 21st September, 2018, alternatively if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. Land will be shown in the financial statements at Rs. 1.

2 As per the amendment made by MCA in Ind AS 20 on 21st September, 2018, alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. The machinery will be recognised at Rs. 70 lakh (Rs. 80 lakh - Rs. 10 lakh). Reduced depreciation will be charged to the Statement of Profit or Loss.

(5 marks)

(D)

Once a company has fulfilled the net worth / turnover / net profit criterion for one year it has to fulfill its CSR obligations for the subsequent three financial years, even if it does not fulfill any of these criteria in those years.

In the given case XYZ Ltd. falls in the ambit of CSR obligations by fulfilling the criteria of net profit exceeding Rs. 5 crores in the year 20X1. So it has to discharge its CSR obligations by spending two percent of its average profit every year starting from 20X2 till 20X4. It cannot stop spending on CSR activities as per the Act after 20X2. **(4 marks)**

Answer 4:

(I) Consolidated balance sheet

A Ltd. and its subsidiaries Consolidated balance sheet as at 31st December, 2016

	(Rs. in '000)
Asset	
Non-current assets	
Land	200
Other assets	1,600
	1,800
Liabilities	
Share capital	400
Retained profit Non-current liabilities	800
Liabilities	600
	1,800

(5 marks)

(II) Consolidation worksheet **(Rs. in '000)**

	A Ltd.	B Ltd.	Adjustments		Consolidated Balances (Dr./Cr.)
			Dr.	Cr.	
Profit before tax	150	180	-	90 (note-1)	420 Cr.
Share of profit	-	-	-	9 (note-2)	9 Cr.
before tax					
Tax	50	60	30	-	140 Dr.
Share of tax	-	-	3	-	3 Dr.
Profit after tax	**100**	**120**			**286 Cr.**
Extraordinary item	50	-	50	-	-
	-	-	62 (note-3)	-	62 Dr.
Retained profit	**150**	**120**			**224 Cr.**
Beginning	400	300	-	70	
Retained profit	-	-	-	30	800 Cr.
Ending retained	**550**	**420**			**1,024 Cr.**
Investment in B Ltd.	100	-		100	-
Investment in C Ltd.					
(300@30%)	90		54		144 Dr.
Other assets	970	800			1,770 Dr.
Share capital	400	100	100		400 Cr.
Retained profit	550	420			1,024 Cr.
Liabilities	210	280			490 Cr.

(7 marks)

(III) Consolidated accounts

A Ltd. and its subsidiaries Consolidated Statement of Profit and Loss for the year ending 31st December, 2017

	(Rs. in '000)
Profit before tax [150+180+90(120*9/12)] (Note 1)	420
Share of associated company's (9-3) (Note 2)	6
	426
Tax [50+60+30(40x9/12)]	140
Profit after tax	286
Extraordinary item : Loss on disposal of shares (See Note 3)	62
Retained profit for the year	224
Beginning retained profit	800
Ending retained profit	1,024

(3 marks)

A Ltd. and its subsidiaries Consolidated balance sheet as at 31st December, 2017

	(Rs. in '000)
Asset	
Non-current assets	
Investment in associated company (Note 4)	144
Other assets	1,770
	1,914
Liabilities	
Share capital	400
Retained profit	1,024
Non-current liabilities	
Liabilities	490
	1,914

(3 marks)

Note 1. C Ltd. Profit and Loss Account to be consolidated up to 30-9-2017 as per Ind AS-110.

Note 2. From 1 -10-2017 C Ltd. become associates therefore accounting for investment in associates have to be done as per Ind AS-28.

Note 3. Calculation of profit or loss on disposal of share of subsidiary in consolidated Profit and Loss Account as per Ind AS-28.

Loss Account as per Ind AS-28 Proceeds from disposal	Rs. 260,000
Less : Proportionate net asset value of C on the date of disposal (30-9-2017)	Rs. 3,22,000
Loss	***Rs. 62,000***

[As on 1 -1 -2016 the net asset value of C was Rs. 4,00,000 (Rs. 3,00,000 book value + Rs.1,00,000 revaluation profit).From 1 -1 -2017 to 30-9-2017 'C' Ltd. net asset increased by Rs. 60,000 (after tax) profit for 9 months (80x3/4). Which makes net asset as on 30-9-2017 of Rs. 4,60,000, 70% of 460,000 = Rs. 3,22,000]

Note 4. Investment in associates (as per Ind AS-28) 30% of net asset

As on i.e. 4,60,000*30% on 30-9-2017	Rs. 1,38,000
Share of profit in associates for 1 -10-2017 to 31 -12-2017	Rs. 6,000
	Rs. 1,44,000

(2 marks)

Answer 5:
(A)

(i) The Lessee company should record the asset as a finance lease since the risk and reward is transferred. Lessee has guaranteed to the lessor, the residual value of Rs. 20,000, in spite of the fact that the estimated residual value of the asset will be Rs. 2,000.

Further the lease payments substantially cover the fair value of leased asset as per calculation given below.

Calculation of Present value of Minimum Lease Payments (MLP) at implicit rate of 10%

Year	Discount Factor	Minimum Lease payments (see note below)	Present Value of MLP
Annual Lease Rentals			
31st March, 2015	0.909	1,00,000	90,900
31st March, 2016	0.826	1,00,000	82,600
31st March, 2017	0.751	1,00,000	75,100
Guaranteed Residual Value			
31st March, 2017	0.751	20,000	15,020
		Total	2,63,620

Note: The contingent rent, taxes, insurance, maintenance expenses etc. if paid by the lessee to the lessor, then it does not form part of the minimum lease payments and will be expensed when incurred. Insurance expense is a kind of reimbursement from lessee to lessor. Hence in the above case, for calculation of present value of minimum lease payments only lease rental of Rs. 1,00,000 has been considered.

At the time of initial recognition, the lessee will recognise the leasehold asset at lower of below:

Present value of MLP	2,63,620

Fair value of leased asset 2,64,000

Hence, leasehold asset will be recognised at 2,63,620

Accounting entry for initial recognition would be :

Leasehold equipment Dr. 2,63,620

To Leasehold obligation 2,63,620

(4 marks)

(ii) Lease rentals should split between principal portion of leasehold obligation and finance costs as follows:

Year	Opening balance	Payments	Finance costs @ 10%	Reduction in liability	Closing obligation
	(a)	(b)	(a) x 10% = (c)	(b)-(c)=(d)	(a)-(d) = (e)
1st April, 2014	-				2,63,620
31st March, 2015	2,63,620	1,00,000	26,362	73,638	1,89,982
31st March, 2016	1,89,982	1,00,000	18,998	81,002	1,08,980
31st March, 2017	1,08,980	1,00,000	11,020*	88,980	20,000

* Difference is due to approximation.

(1.5 marks)

In the books of Lessee

Journal Entries (at the time of subsequent measurement)

Date	Particulars		Dr. Rs.	Cr. Rs.
31st March 2015	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	73,638	
	Interest Expenses	Dr.	26,362	
	Depreciation	Dr.	87,207	
	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2016	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	81,002	
	Interest Expenses	Dr.	18,998	
	Depreciation	Dr.	87,207	

	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2017	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	88,980	
	Interest Expenses	Dr.	11,020	
	Depreciation	Dr.	87,206	
	To Cash			1,02,000
	To Accumulated Depreciation			87,206

(3 marks)

(iii) Entries at the end of lease period

Leasehold Obligation Account	Dr.	20,000	
Accumulated Depreciation Account	Dr.	2,61,620	
To Cash Account			18,000
To Leasehold Equipment Account			2,63,620

(1 mark)

(iv) The Current and Non-current Classification at the end of year 1 in the books of Lessee

Balance Sheet (An extract)

	Rs.
ASSETS	
Non-current Asset	
Leasehold Asset	
Gross Block	2,63,620
Accumulated Depreciation	(87,207)
LIABILITIES	
Non-current Liability	
Leasehold Obligation (payable after 12 months from the reporting date)	1,08,980
Current Liability	
Leasehold Obligation (payable within 12 months from the reporting date)	81,002

(2.5 marks)

(B)

(i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs.30,00,000.

However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

(ii) The provision creates a potential deferred tax asset for the group since its carrying value is Rs. 20,00,000 and its tax base is nil.

This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of Rs. 20,00,000 in the year to 31st March, 2019.

The amount of the deferred tax asset will be Rs. 4,00,000 (Rs. 20,00,000 x 20%).

This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.

(iii) The development costs have a carrying value of Rs. 15,20,000 (Rs. 16,00,000 – (Rs. 16,00,000 x 1/5 x 3/12)).

The tax base of the development costs is nil since the relevant tax deduction has already been claimed.

The deferred tax liability will be Rs. 3,04,000 (Rs. 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.

(iv) The carrying value of the loan at 31st March, 2018 is Rs. 1,07,80,000 (Rs. 1,00,00,000 – Rs. 2,00,000 + (Rs.98,00,000 x 10%)).

The tax base of the loan is Rs.1,00,00,000.

This creates a deductible temporary difference of Rs. 7,80,000 (Rs. 1,07,80,000 –Rs. 1,00,00,000) and a potential deferred tax asset of Rs. 1,56,000 (Rs. 7,80,000 x 20%).

Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities. **(4 x 2 marks = 8 marks)**

Answer 6:

(A)

Ind AS 10 defines 'Events after the Reporting Period' as follows:

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)

In the instant case, the demand notice has been received on 15th June, 2017, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, condition exists on 31st March, 2017, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 2016-17, at best estimate of the expenditure to be incurred, i.e., Rs.15,00,000.

(5 marks)

(B)

As per paragraph 5 of Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

(a) It incurs expenditures for the asset.
(b) It incurs borrowing costs.
(c) It undertakes activities that are necessary to prepare the asset for its intended use or sale. The ship is a qualifying asset as it takes substantial period of time for its construction. Thus the related borrowing costs should be capitalized.

Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on April 1, 20X0. Thus condition (a) and (b) are met. However, condition (c) is met only on March 1, 20X1, and that too only with respect to one ship. Thus there is no capitalisation of borrowing costs during the financial year ended March 31, 20X1. Even during the financial year ended March 31, 20X2, borrowing costs relating to the 'one' ship whose construction had commenced from March 1, 20X2 will be capitalised from March 1, 20X2 to March 31, 20X2. All other borrowing costs are expensed. **(5 marks)**

(C)

(i) For classification of assets

As per Ind AS 16 'Property, Plant and Equipment' states that Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per Ind AS 40 'Investment property', investment property is a property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business.

According, to the facts given in the questions, since Property 1 and 2 are used as factory buildings, their classification as PPE is correct. However, Property 3 is held to earn rentals; hence, it should be classified as Investment Property. Thus, its classification as PPE is not correct. Property 3 shall be presented as separate line item as Investment Property as per Ind AS 1.

(2 marks)

(ii) For valuation of assets

Ind AS 16 states that an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. Also, Ind AS 16 states that If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of investment property.

Since property 1 and 2 is used as factory building, they should be classified under same category or class ie. 'factory building'. Therefore, both the properties should be valued either at cost model or revaluation model. Hence, the valuation model adopted by Stars Ltd. is not consistent and correct as per Ind AS 16.

In respect to property 3 being classified as Investment Property, there is no alternative of revaluation model i.e. only cost model is permitted for subsequent measurement. However, Stars Ltd. is required to disclose the fair value of the investment property in the Notes to Accounts.

(2 marks)

(iii) **For changes in value on account of revaluation and treatment thereof**

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

(1 mark)

(iv) **For treatment of depreciation**

Ind AS 16 states that depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Accordingly, Stars Ltd. is required to depreciate these properties irrespective of that their fair value exceeds the carrying amount. **(1 mark)**

(v) **Rectified presentation in the balance sheet**

As per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet should be as follows:

Case 1: If Stars Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 2017 Rs.

Assets **Non-Current Assets**	

Property, Plant and Equipment		
Property 1 (30,000-3,000)	27,000	
Property 2 (20,000 – 2,000)	18,000	
		45,000

Investment Property Property 3 (Fair value being Rs. 27,000) (Cost = 24,000-2,400)	21,600

(2 marks)

Case 2: If Stars Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 2017 Rs.

Assets		
Non-current Assets		
Property, Plant and Equipment		
Property 1	32,000	
Property 2	22,000	54,000
Investment Properties		
Property 3 (Fair value being 27,000) (Cost = 24,000-2,400)		21,600
Equity and Liabilities		
Other Equity		
Revaluation Reserve *		
Property 1 (32,000 – 27,000)	5,000	
Property 2 (22,000 –18,000)	4,000	9,000

* Revaluation reserve should be routed through Other Comprehensive Income (OCI) (subsequently not reclassified to Profit and Loss) in the Statement of Profit and Loss and shown as a separate column in the Statement of Changes in Equity.

(2 marks)