SUGGESTED SOLUTION

CA FINAL N'19

SUBJECT- GFRS

Test Code - FNJ 7293

BRANCH - () (Date :)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

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 liabilit y	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 To Warranty provision – current liabilities	Dr.	0.34	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	**INRm**
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**

CASE STUDY - 2

1. Option (c) : Rs. 9,500

   Hints

   The investment should be classified as Fair Value through other comprehensive income. As such, they will initially be valued inclusive of transaction costs.

   Therefore, the initial value is

   10,000 × Rs. 3.50 = Rs. 35,000 + Rs. 500 = Rs. 35,500.

   At year-end, these will be revalued to fair value of Rs. 4.50 each, therefore

   10,000 x Rs. 4.50 = Rs. 45,000.

   The gain is therefore Rs. 45,000 – Rs. 35,500 = Rs. 9,500.

2. Option (b) : Rs. 1,06,667

Hints

As the service is not sold separately, the discount cannot simply be applied to this element. Instead, the discount should be allocated to each part of the bundled sale. Applying the discount across each part gives revenue as follows:

Goods	Rs. 60,000	(Rs. 75,000 × Rs. 1,20,000/Rs. 1,50,000)
Installation	Rs. 20,000	(Rs. 25,000 × Rs. 1,20,000/Rs. 1,50,000)
Service	Rs. 40,000	(Rs. 50,000 × Rs. 1,20,000/Rs. 1,50,000)

The revenue in relation to the goods and installation should be recognised on 1st August, 2016. As 8 months of the service has been performed (from 1st August, 2016 to 31st March, 2017), then Rs. 26,667 should be recognised (Rs. 40,000 × 8/12).

This gives a total revenue for the year of 60,000 + 20,000 + 26,667 = Rs. 1,06,667.

3. Option (b) : Rs. 500,000 relating to a sale of specialised equipment on 31 March 2017. The full sales value was Rs. 700,000 but Rs. 200,000 relates to servicing that ABC will provide over the next 2 years, so ABC has not included that in revenue this year.

   Hints

   With item B, the sale of the goods has fulfilled a contractual obligation so the revenue in relation to this can be recognised. The service will be recognised over time, so the revenue should be deferred and recognised as the obligation is fulfilled.

   For item A, ABC acts as an agent, so only the commission should be included in revenue.

   For item C, any profit or loss on disposal should be taken to the statement of profit or loss. The proceeds should not be included within revenue.

   For item D, Rs. 1 million should be initially discounted to present value as there is a significant financing component within the transaction. The revenue would initially be recognised at Rs. 0.826 million, with an equivalent receivable. This would then be held at amortised cost with finance income of 10% being earned each year.

4. Option (d) : Rs. 55,800

   Hints

	Cost	*Net Realisable Value*	*Lower of cost and Net Realisable Value*
	(Rs.)	*(Rs.)*	*(Rs.)*

Item 1	24,000	See note 1	24,000
Item 2	33,600	31,800 (note 2)	31,800
			55,800

Notes:

The net realisable value is not known, but it must be above cost because the contract is expected to produce a high profit margin. The subsequent fall in the cost price to Rs. 20,000 is irrelevant for the inventory valuation as it is the replacement cost of the material.

The net realisable value is Rs. 31,800 (ie. Rs. 36,000 minus 50% of Rs. 8,400).

5. Option (c) : The receipt of cash from a claim on an insurance policy for damage caused by a fire in a warehouse on 1 January 2017. The claim was made in January 2017 and the amount of the claim had not been recognised at 31 March 2017 as it was uncertain whether the claim will be honoured. The insurance enterprise settled the claim by paying Rs. 1.5 million on 1 June 2017

Hints

The fire in the warehouse occurred before the reporting date and the claim was already made to the insurance company. Therefore, settlement of insurance claim should be included in the financial statements as receivable.

6. Option (c) : Rs. 8,000

Hints

Deferred tax asset	(30,000 × 30%) 9,000
Opening balance as per the trial balance	12,000
Reduction in Deferred tax liability	(3,000)
Tax expense:	
Current year estimate	15,000
Prior year overprovision	(4,000)
Deferred tax, as above	(3,000)
Charge for year	8,000

7. Option (b) : Owning 51%, but the constitution requires that decisions need the unanimous consent of shareholders

Hints
The fact that unanimous consent of all shareholders is required for decision making suggests that there is no control over the investee.

8. Option (b) : Rs. 91.57 million

Hints
The provision should be initially recognised at Rs. 91.57 million which is the present value of Rs. 100 million discounted at 4.5% for two years.

9. Option (b) : It will be apportioned between the parent company and the non-controlling interest (NCI) when the NCI is valued at fair value

Hints
Where the NCI is valued at fair value, impairment of goodwill splits between the parent and the NCI in proportion to their shareholdings.

10. Option (a) : Operating activities.

II. Answers to Descriptive Questions

1. (i) Development stage entity

Appendix B para B7 of IFRS 3, inter alia, provides that a business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

Further, para B 8 of IFRS 3 states that, —to be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

In the instant case the elements in the acquisition seems to contain both inputs and processes.

Inputs being the intellectual property used to design the customised software, fixed assets and employees. The processes being the strategic and operational process for developing the software.

Accordingly, given that Company PQR has access to inputs and processes necessary to manage and produce outputs, acquisition of Company PQR can be considered to be a business combination. The lack of outputs, such as revenue and a product, does not prevent the entity from being considered a business.

ii) Investment Property

As per IAS 40, Investment Property, judgment is required to decide whether the acquisition of set of investment properties meets the definition of a business (to be accounted for as per IFRS 3) or whether it is an acquisition of investment properties (to be accounted for under IAS 40). In applying judgment to determine whether an acquired set of investment properties qualifies as a business, reference should be made to IFRS 3. Factors that may be relevant in making the determination include whether property management services are acquired and the nature of those services, and the level and nature of ancillary services - e.g. security, cleaning and maintenance.

In the instant case, the acquired set of investment properties can be construed to be a business because it contains all of the inputs and processes necessary for it to be capable of creating outputs to provide a return to ABC Ltd.:

<u>Inputs:</u> Non-current assets (land and buildings) and contracts.

<u>Processes:</u> Management with unique knowledge related to investment properties in the area.

<u>Outputs:</u> The intended outputs include rental income

In contrast, if the property management contract is not taken over, then the group of assets might not be a business. The acquired set might not represent an integrated set of activities and assets because the key element of the infrastructure of the business, i.e. property management, is not taken over. If so, then ABC Ltd., would account for the transaction as the purchase of individual investment properties, and not as the purchase of a business.

2. Para 2 of IFRS 3 *inter alia* states that IFRS 3 is not applied to the acquisition of an asset or a group of assets that does not constitute a business. In such a case, the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

As per the illustrative example given in IFRS 3, a customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list does not usually arise from contractual or other legal rights. However, customer lists are often leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion.

Accordingly, both the items which the directors of ABC Ltd. have identified in the acquisition of MNO should be recognised as separate intangible assets on the acquisition of MNO. Both IFRS 3 Business Combinations and IAS 38 Intangible Assets require in-process research in a business combination to be separately recognised at its fair value provided this can be reliably measured i.e at Rs. 1.2 million. The recognition of customer list as an intangible asset should also be recognised at its fair value of Rs. 3 million.

3. Statement of cash flows (extract) for 2017

	Amount (Rs.)	Amount (Rs.)
Cash flows from opening activities		
Profit before taxation		
Adjustments for non-cash items:	70,000	
Depreciation	30,000	
Decrease in inventories (W.N. 1)	9,000	
Decrease in trade receivables (W.N. 2)	4,000	
Decrease in trade payables (W.N. 3)	(24,000)	
Interest paid to be included in financing activities (W.N.4)	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash inflow from operating activities		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents		3,000
Cash and cash equivalents, beginning of year		5,000

Cash and cash equivalents, end of year		8,000

Working Notes

1. **Decrease in inventories**

Total inventories of the Group at the end of the year	Rs. 30,000
Inventories acquired during the year from subsidiary	(Rs. 4,000)
	Rs. 26,000
Opening inventory	Rs. 35,000
Decrease in inventory	Rs. 9,000

2. **Decrease in trade receivables**

Total trade receivable of the Group at the end of the year	Rs. 54,000
Trade receivables acquired during the year from subsidiary	(Rs. 8,000)
	Rs. 46,000
Opening trade receivable	Rs. 50,000
Decrease in trade receivable	Rs. 4,000

3. **Decrease in trade payables**

Trade payables at the end of the year	Rs. 68,000
Trade payables of the subsidiary assumed during the year	(Rs. 32,000)
	Rs. 36,000
Opening trade payable	Rs. 60,000
Decrease in trade payables	Rs. 24,000

4. Alternatively, as per para 12 of IAS 7, the interest element may be classified as an operating activity. In such a situation, cash flow from operating activity will be Rs. 75,000 and there will be no cash outflow from financing activity.

4. The alterations to the leased property do not affect the lease itself and this should continue to be treated as an operating lease and charging profit or loss with the annual rental of Rs. 2.3 million.

The initial cost of the alterations should be capitalised and depreciated over the remaining useful life of the lease. In addition to this, IAS 37 *Provisions, Contingent Assets and Contingent Liabilities* requires that the cost of restoring the property to its original condition should be provided for on 1 April 2016 as this is when the obligation to incur the restoration cost arises (as the time taken to do the alterations is negligible). The present value of the restoration costs, given as Rs. 5 million, should be added to the initial cost of the alterations and depreciated over the remaining life of the lease. A corresponding provision should be created and a finance cost of 8% per annum should be charged to profit or loss as accrued on this provision.

Note:

1. IFRS are principles based standards. Different possible views may be taken by the user based on the emphasis laid to particular facts and evidences. Therefore, alternate answers may be possible for the above questions, depending upon the view taken.

2. Hints for MCQs are given only for understanding of the answer.

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 *reliably the expenditure attributable to the intangible asset during its development*	Nothing in the facts of the case showcase that A Ltd. is not 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 capitalization.

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.

<u>Power</u>

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 and key personnel	IFRS 10 includes rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to 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.	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 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.

	Other key management personnel: Head of Procurement and head of Retail shall also be appointed by Board by simple majority.	
(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.	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.
	Decisions related to ordinary	
	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.	None of the parties have removal or kick-out rights.

	As per the Shareholders' Agreement, neither party has any kick out rights in D Ltd.	
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.		

<u>Return</u>

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 Ltd. respectively; and accordingly has a right to receive variable return up to the extent of its shareholding in D Ltd.	A Ltd. is exposed to or has right to the variable return up to an extent of 66.93 percent.
(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.

   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.