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FINAL MAY 2019 EXAM

SUBJECT- GFRS

Test Code – FNJ 7156

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Case Study 1:

I. Answers to Multiple Choice Questions (MCQs)

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.:

Inputs: Non-current assets (land and buildings) and contracts.

Processes: Management with unique knowledge related to investment properties in the area.

Outputs: 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.

5. 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.

Case Study 2:

I. <u>Answers to Descriptive Questions</u>

Answer 1

(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.

Answer 2

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

<u>Scenario (a)</u>

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 recognize 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 recognise 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*

Answer 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
Interest charges paid to supplier of plant for deferred credit (since there is no qualifying asset)	-
Present value of estimated dismantling costs to be incurred after 10 years	INR 1,00,000
Operating losses before commercial production	-
Cost of machinery	INR 27,00,000

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

Capitalization 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 authorization 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 authorization 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.

Case Study 3:

I. Answers to descriptive questions

Answer 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 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.	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 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.

Answer 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

I. 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

Answer 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.