J.K. SHAH®
TEST SERIES
Evaluate Learn Succeed

SUGGESTEDANSWERS

CA FINAL

Test Code – JK-GFR-21

Date – 06-09-2020

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

Tel: (022) 26836666

Answers

Case Study 1

1.1 (c)

1.2 (a)

1.3 (b)

1.4 (c)

1.5 (b)

1.6 On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payment s (USD)	Present Value factor *@ 5%	Present Value of Lease Payment	Conversion rate (spot rate)	INR value
1	10,000	0.95	9,524	68	6,47,618
2	10,000	0.91	9,070	68	6,16,780
3	10,000	0.86	8,638	68	5,87,410
4	10,000	0.82	8,227	68	5,59,438
5	10,000	0.78	7,834	68	5,32,798
Total			**43,295**		**29,44,044**
For simplicity the Present value factor is rounded of up to two places, however the calculation is done as per exact value.					

As per Ind AS 21, The Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.

At the end of Year 1, the lease liability will be measured in terms of USD as under:

Lease Liability:

Year	Initial Value (USD)	Lease Payment	Interest @5%	Closing Value (USD)
1	43,295	10,000	2,165	35,460

Interest at the rate of 5% will be accounted for in profit and loss at average rate of INR 69 (i.e., USD 2,165 *69) = INR 1,49,385

Interest Expense………………Dr. INR1,49,385
To Lease liability (INR 1,49,385)

Lease payment would be accounted for at the reporting date exchange rate, i.e. INR 70/- at the end of year 1

Lease liability………………………..Dr INR 700,000
To Cash INR 700,000

As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., INR 70/- at the end of Year 1. Accordingly, the lease liability will be measured at INR 24,82,165 with the corresponding impact due to exchange rate movement of INR 88,736 (24,82,165 – (29,44,044 + 1,49,385 – 700,000) will be taken to profitand loss.

ROU asset will be measured during year 1 as follows:

Year	Opening Balance	Depreciation	Closing Balance
1	29,44,044	5,88,809	23,55,235

1.7 Classification

The investment property will be bifurcated for developing of units which will be sold in the ordinary course of business. Hence, the investment property will be reclassified as inventory on 1st January, 2019.

However, as per para 59 of Ind AS 40, transfers between investment property, owner- occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. Hence, the carrying value of the reclassified property as inventory will be₹ 40 crore only.

Measurement

The additional costs of ₹ 12 crore for developing the units which were incurred up to and including 31st March, 2019 would be added to the cost of inventory to give a closing cost of ₹ 52 crore.

The total selling price of the units is expected to be ₹ 100 crore (10 units x ₹ 10 crore). Since the further costs to develop the units total ₹ 8 crore, the net realisable value of inventory (consisting of 10 units) would be ₹ 92 crore (₹ 100 crore - ₹ 8 crore). The inventory (consisting of 10 units) will be measured at a cost of ₹ 52 crore (cost ₹ 52 crore or NRV ₹ 92 crore whichever is less).

Disclosure

"During the year, the operating lease has been cancelled with respect to investment property. On the date of cancellation of the operating lease, the company has started the process of bifurcating the property into 10 identical units of equal size to sell in the ordinary course of business. Hence, Rainbow Limited has reclassified as the property as inventory on the date of cancellation and measured it at the reporting date on cost or NRV whichever is less. The units are shown as inventory under current assets in the Balance Sheet."

1.8 Scenario A

Since the loan is repayable on demand, it has fair value equal to cash consideration given. Rainbow Ltd. and Canyons Ltd. should recognize financial asset and liability, respectively, at the amount of loan given (assuming that loan is repayable within a year). Upon, repayment, both the entities should reverse the entries that were made at the origination.

Journal entries in the books of Rainbow Ltd.

At origination		
BankA/c Dr. To Loan From CanyonsLtd A/c	₹ 20,00,000	₹ 20,00,000
On repayment		
Loan From CanyonsLtdA/c Dr. To Bank A/c	₹ 20,00,000	₹ 20,00,000

Journal entries in the books of Canyons Ltd.

At origination		
Loan to Rainbow Ltd A/c Dr. To Bank A/c	₹ 20,00,000	₹ 20,00,000
On repayment		
BankA/c Dr. To Loan to Rainbow Ltd Bank A/c	₹ 20,00,000	₹ 20,00,000

Scenario B

Applying the guidance in Ind AS 109 'Financial Instruments', a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, if a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears.

Both Rainbow Ltd. and Canyons Ltd. should recognise financial liability and Asset, respectively, at fair value on initial recognition, i.e., the present value of ₹ 20,00,000 payable at the end of 5 years using discounting factor of 12%. The difference between the loan amount and its fair value is treated as an Dividend Income from the subsidiary.

Journal entries in the books of Rainbow Ltd. (for one year)

At origination		
Bank A/c Dr. To Loan FromCanyonsLtd A/c (20,00,000 x 0.5674) To Dividend Income A/c	₹ 20,00,000	 11,34,800 8,65,200
During periods to repayment- to recognise interest Year 1 – For Interest		
Interest Expense. A/c (₹ 11,34,800 x 12%) Dr. To Loan FromCanyons A/c	₹ 1,36,176	₹ 1,36,176
Transferring of interest to Profit and Loss		
Profit and LossA/c Dr. To Interest Expense. A/c	₹ 1,36,176	₹ 1,36,176
Note: Interest needs to be recognised in Statement of profit and loss.		

Journal entries in the books of Canyons Ltd. (for one year)

At origination			
Loan to Rainbow Ltd. A/c	Dr.	₹ 11,34,800	
Dividend Distribution to Rainbow Ltd	Dr.	8,65,200	
To Bank A/c			20,00,000
During periods to repayment- to recognise interest			
Year 1			
Loan to Rainbow Ltd. A/c	Dr.	₹ 1,36,176	
To Interest Income A/c			₹ 1,36,176
Note: Further, there may be variation in figures on account of discounting factor taken.			

Case Study 2

2.1 (b)

2.2 (a)

2.3 (d)

2.4 (d)

2.5 (b)

2.6 Since the deposit is paid at the commencement of the lease, the difference between the present value of deposit and the amount of deposit paid will form the part of right of use asset and will be depreciated over the lease term.
Entity Makers Ltd. accounts for the deposit as follows:
On the date of lease commencement:

Security Deposit	Dr.	6,20,000	
ROU asset	Dr.	3,80,000	
To Bank			(10,00,000)
Years 1 to Year 5			
Depreciation	Dr.	76,000	
To ROU asset			(76,000)

Years 1

Security Deposit	Dr.	62,092	
To Interest Income			(62,092)

Years 2

Security Deposit	Dr.	68,301	
To Interest Income			(68,301)

Years 3

Security Deposit	Dr.	75,131	
To Interest Income			(75,131)

Years 4

Security Deposit	Dr.	82,644	
To Interest Income			(82,644)

Years 5

Security Deposit	Dr.	90,909	
To Interest Income			(90,909)

At the end of 5 years

Bank	Dr.	10,00,000	
To Security Deposit			(10,00,000)

2.7 "A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease".

In accordance with above paragraph, Makers Ltd shall account for the modification in the lease contract as follows:

(i) Determine if the lease modification is to be accounted for a separate new lease

Because the change in pricing of the lease is not commensurate with the stand-alone price for the additional right-of-use asset, Makers Ltd does not account for the modification as a new lease, separate from the original 10-year lease.

(ii) Account for the modified lease

Makers Ltd accounts for the modified lease prospectively from the effective date of the modification, recognising the lease payments to be recd. under the modified lease of INR 750,000 (INR 150,000 × 5 years), net of Makers Ltd 's accrued rent asset of INR 76,331 (refer note 1), on a straight-line basis over the remaining 5-year lease term, i.e.

INR 673,669 ÷ 5 years = INR 134,734 per year

At the end of the lease, Makers Ltd will have recognised as lease income the INR 13,02,564 in lease payments it receives from lessee during the 10-year lease term.

Note 1

At the effective date of the modification (the beginning of Year 6), Makers Ltd has an accrued lease rental asset of INR 76,331 as follows:

Rental income recognised on a straight-line basis for the first 5 years of the lease [see (a) below]	628,895
Less: Lease payments received for the first 5 years [see (b) below]	552,564
	76,331

(a) INR 1,257,789 ÷ 10 years = INR 125,779 per year * 5

(b) Lease payments for the first 5 years

(i) Year 1- INR 1,00,000

(ii) Year 2- INR 1,05,000

(iii) Year 3- INR 1,10,250

(iv) Year 4- INR 1,15,763

(v) Year 5- INR 1,21,551 Total INR 5,52,564

Year	Annual rental payment (A)	Straight lining of rent income (B)	Accrued lease rental asset recognised during the year (C=B–A)
Year 1	100,000	1,25,779	25,779
Year 2	105,000	1,25,779	20,779
Year 3	110,250	1,25,779	15,529
Year 4	115,763	1,25,779	10,016
Year 5	121,551	1,25,779	4,228
Year 6	127,628	1,25,779	-1,849
Year 7	134,010	1,25,779	-8,231
Year 8	140,710	1,25,779	-14,931
Year 9	147,746	1,25,779	-21,967

Year 10	155,132	1,25,779	-29,354
Total	**1,257,789**	**12,57,790**	**-**

Accrued lease rental at the beginning of 6th year is INR 76,331 (25,779 + 20,779 + 15,529 + 10,016 + 4,228).

2.8

Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	**INR**
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	75,00,000
Contingent consideration	10,,00,000
Consideration transferred at date of acquisition [A]	97,50,000
Fair value of non-controlling interest at date of acquisition (1,00,000 x 35% x 12) [B]	4,20,000
Total [C] = [A] + [B]	1,01,70,000
Net assets acquired at date of acquisition [D]	(1,05,20,000)
Gain on Bargain Purchase [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, ₹ 1,50,000 incurred by D Ltd. in relation to acquisition, will be ignored by Makers Ltd.

Journal entry at the date of acquisition by Makers Limited as per Ind AS 103

	₹	₹
Identifiable net assets Dr.	1,05,20,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		75,00,000
To Provision for contingent consideration to D Ltd.		10,00,000
To Non-controlling Interest		4,20,000
To Capital Reserve		3,50,000

Note: Since ₹ 1,50,000 is incurred by D Ltd., no entry is passed for it in the books of Makers Ltd.

Case Study 3

3.1 (a)

3.2 (d)

3.3 (d)

Note: Since the question specifically asks for treatment of policy on return of Products and options mentioned are on the basis of Ind AS 37, the above answer has been given strictly on the basis of the options provided. However, after issuance of Ind AS 115, sales revenue shall be recognised after adjusting estimate of refund as per company's past practice (considering it as a variable element). In such a case, no question of creating a provision shall arise.

3.4 (c)

3.5 (a)

3.6 Basic EPS as on 31.3.2015 = ₹ 600 million/500 = ₹1.20
Diluted EPS as on 31.3.2015 = ₹623.10 million/525 = ₹1.19
Basic EPS as on 31.3.2016 = ₹800 million/500 = ₹1.60
Diluted EPS as on 31.3.2016 = ₹892.40 million/600 = ₹1.49
Notes:

₹in million

(1) Adjustment to earnings available to equity holders	**31.3.2016**	**31.3.2015**
PAT	800.00	600.00
Add Interest	120.00	30.00
Deduct Tax effect (5)23% an interest	–27.60	–6.90
Adjusted earnings	**892.40**	**623.10**
(2) Adjustment to weighted average No. of shares	**31.3.2016**	**31.3.2015**
Outstanding shares at the beginning of the year	500	500
Outstanding shares at the end of the year	500	500
Weighted average number of shares	500	500
Adjustments for shares to be issued on conversion of convertible debentures assuming all convertible debentures are converted into equity shares	100	25
Weighted average number of shares plus potential shares	**600**	**525 [(500 x 9 + 600 x 3)]/**

3.7

Balance Sheet (Extract)

Financial assets	Amt. (₹)
Interest rate options (WN 1)	15,250
6% Debentures in Y Ltd. (WN2)	1,53,000
Shares in X Ltd.	1,87,500

Profit and loss account (Extract)

Finance income:	Amt. (₹)
Gain on interest rate option (WN I)	5,250
Effective interest on 6% debentures (WN2)	12,000
OCI	
Fair Value Gain (Without Recycling)	12,500

(2) **Debentures:** On the basis of the information provided, this can he treated as a held to-maturity investment.

Initial measurement (at fair value)

Financial assets	Dr.	₹ 1,50,000	
To Cash			₹ 1,50,000

At 31st Mar-2020 (amortized cost)

Financial assets (₹ 1,50,000 x 8%)	Dr.	₹ 12,000	
To Finance Income			₹ 12,000
Cash (₹ 1,50,000x 6%)	Dr.	₹ 9,000	
To Finance asset			₹ 9,000

Amortized cost at 31st Mar- 2020

(1,50,000 +12,000-9,000)= ₹ 1,53,000

(3) **Shares:** These are treated as FVTPL (share cannot normally be held to maturity and they are clearly not loans or receivables)

Initial measurement (at fair value)

Financial asset (50,000 x ₹ 3.5)	Dr.	₹ 1,75,000	
To Cash			₹1,75,000

31st Mar-2020 (re-measured to fair value)

Financial asset (50,000 x₹ 3.75) -₹ 1,75,000	Dr.	₹ 12,500	
TO OCI			₹ 12,500

3.8 As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequentperiod.

Issue 1

In accordance with para 41, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31stMarch, 2020, the comparative amounts as at 31stMarch 2019 would be restated to reflect the correctclassification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatementhas a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1stApril, 2018 in addition to the comparatives for the financial year2017-2018.

Issue 2

In accordance with para41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, inthe financial statements for the year ended 31stMarch, 2020, the comparative amounts for theyearended31stMarch,2019wouldberestatedtoreflectthecorrectclassification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the precedingperiod.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1stApril, 2018). Therefore, the entity is not required to present a third balance sheet.

Case Study 4

4.1 (b)

4.2 (d)

4.3 (a)

4.4 (a)

4.5 (c)

4.6 Ind AS 115, inter alia states that, "if an entity has anobligation or a right (a forward or a call option), to repurchase theasset, the customer does not obtain control of the asset because thecustomer is limited in its ability to direct the use of, and obtainsubstantially all of the remaining benefits from, the asset even thoughthe customer may have physical possession of the asset.

Consequently, the entity shall account for the contract as either of the following:

(i) a lease in accordance with Ind AS 116, Leases, if the entity canor must repurchase the asset for an amount that is less than theoriginal selling price of the asset, unless the contract is part of asale and leaseback transaction; or

(ii) a financing arrangement in accordance with paragraph B68 ifthe entity can or must repurchase the asset for an amount thatis equal to or more than the original selling price of the asset".

Accordingly,if the repurchase price of theasset is greater than the original selling price of the asset, itconstitutes a financing arrangement.

Thus, the entity should continue to recognise the asset and also recognise a financial liability for any consideration received from thecustomer. The difference between the amount received from thecustomer and the amount of consideration to be paid to the customer(i.e., ₹30,00,000 in this case) shall be treated as interest expense.

Ind AS 115 states that, "If an entity has an obligationto repurchase the asset at the customer's request (a put option) at aprice that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has asignificant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying theentity consideration for the right to use a specified asset for a period oftime. Therefore, if the customer has a significant economic incentive toexercise that right, the entity shall account for the agreement as alease in accordance with Ind AS 116, unless the contract is part of asale and leaseback transaction."

In accordance at the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine theaccounting for the transfer of the asset. In the given case, as the repurchase price is significantly greater than the expected market value, the entity concludes that the customer has a significanteconomic incentive to exercise its right, i.e., the put option. The entity determines there are no other relevant factors to consider whenassessing whether the customer has a significant economic incentiveto exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer, because thecustomer is limited in its ability to direct the use of, and obtainsubstantially all of the remaining benefits from, the asset.
Accordingly, the entity accounts for the transaction as a lease in accordance with Ind AS 116, Leases.

4.7 In this case, the carrying amount of the investment immediately prior to theadditional investment is ₹2,00,000.
Upon acquisition of additional 15% the equity-accounted amount for theassociate increases by ₹1,80,000. The notional goodwill applicable to thesecond tranche of the acquisition is ₹ 30,000 [₹ 1,80,000 – (15% × ₹10,00,000)].
The impact of the additional investment on Entity A's equity-accountedamount for Entity B is summarised as follows:

Particulars	% held	Carrying amount	Share of net assets	Goodwill included in investment
Existinginvestment	20%	2,00,000	1,90,000	10,000
Additionalinvestment	15%	1,80,000	1,50,000	30,000
Total investment	**35%**	**380,000**	**340,000**	**40,000**

4.8 Ind AS 103 provides that if the initial accounting for abusiness combination is incomplete by the end of the reporting period inwhich the combination occurs, the acquirer should report in its financialstatements provisional amounts for the items for which the accounting isincomplete. During the measurement period, the acquirer shouldretrospectively adjust the provisional amounts recognised at the acquisitiondate to reflect new information obtained about facts and circumstances thatexisted as of the acquisition date and, if known, would have affected themeasurement of the amounts recognised as of that date.
In accordance with above, the acquirer should revise comparativeinformation for prior periods presented in financial statements as required,including making any change in depreciation, amortisation or other incomeeffects recognised in completing the initial accounting.

Based on above, the comparative information presented in the financialstatements for the year 2019-20 needs to be restated for the measurementperiod adjustment as follows:

	31 March 2019	
	As stated originally	**Revised**
Profit or loss (patent amortisation)	83,333(1)	125,000 (2)
Goodwill	1,20,00,000	70,00,000 (3)
Patent	99,16,667 (4)	1,48,75,000 (5)

Notes:

1. 1,00,00,000 x 1 /10 x 1 / 12

2. 1,50,00,000 x 1 / 10 x 1 / 12

3. 1,20,00,000 – 50,00,000

4. 1,00,00,000 – 83,333

5. 1,50,00,000 – 125,000

Case Study 5

5.1 (a)

5.2 (b)

5.3 (d)

5.4 (a)

5.5 (c)

5.6 In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attached to the share to determine whether it exhibits the fundamental characteristic of a financial liability or an equity instrument.

(A) Redeemable preference shares at a specified date:

This contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. Hence, classified as ‘financial liability’.

(B) Distributions on preference shares

Another important point for consideration is whether the company has an obligation to make payments of dividend ie, whether dividend on such preference shares are cumulative or non-cumulative.

Where dividends are cumulative, one needs to assess the key terms of the instrument to check if the entity has a contractual obligation. In cases where the preference shares entitled to dividend which is payable such that entity does not have an unconditional right to defer payment, then this provides the shareholders with a lender's return on the amount invested. This obligation is also not negated if the entity is unable to pay such dividend for lack of funds or insufficient distributable profits. Therefore, the obligation to pay dividend meets the definition of financial liability.

Conclusion: In the given case, 9% Cumulative Preference shares redeemable after10 years provides for mandatory fixed dividend payments and redemption of preference shares by Power India Ltd. for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment ofprincipal) to the preference shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

Treatment of dividend paid to preference shareholders under IFRS

The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss.

Since the preference shares are classified as financial liability, the dividend thereon will be considered in the nature of interest and accordingly be charged to Profit and Loss as part of finance cost.

5.7 Accordingly, in the given case, the equity method earlier followed by the entity needs to be discontinued from the date of transfer of 15% interest in B Limited (that is, the date on which B Limited ceases to be an associate of ECL Limited) and the retained interest will be accounted for as a financial asset. The retained financial interest will be classified and measured as per the principals of Ind AS 109. At inception (date of transfer of 15% interest in B Limited), the retained interest will be measured at fair value, i.e. ₹ 65,000

Any difference in fair value of any retained interest plus proceeds fromdisposal of 15% interest and the carrying amount of the investment at thedate the equity method was discontinued will be recognised in profit and lossi.e. ₹25,000 (₹65,000 + ₹ 80,000 - ₹120,000).

Furthermore, the entire share of associate's other comprehensive income of₹20,000 representing exchange difference relating to a foreign operationwill be reclassified to profit or loss.

The accounting entry shall be as follows:

(i) Derecognition of investment in associate and recognition of retained interest at fair value **(₹)**

Particulars	**Dr / Cr Amount**	
Investment in financial asset (10% stake) Dr.		65,000
Cash on sale of investment Dr.		80,000
To Investment in associate (carrying value) Cr.	120,000	
To Profit and loss Cr.	25,000	

(ii) Reclassifying from other comprehensive income to the statementof profit and loss

Particulars	**Dr / Cr Amount**
OCI (Equity) Dr.	20,000
To Profit and loss (reclassified as part of gain on partial disposal) Cr.	20,000

5.8 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

Estimating variable consideration

An entity is required to estimate variable consideration using either the 'expected value' or the 'most likely amount' method, as described in the standard: An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

An entity is required to choose between the expected value method and the most likely amount method based on which method better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a 'free choice'. Rather, an entity selects the method that is best suited, based on the specific facts and circumstances of the contract.

Conclusion: In the given case, the contract includes both a fixed and a variable price as consideration. Hence the transaction price is equal to fixed consideration plus variable consideration.

The fixed consideration agreed is ₹ 15 crore.

The completion bonus of ₹ 50 lacs and performance bonus of ₹ Nil to 50 lacs would beconsidered as variable elements present in the contract while determining the transaction price.

The entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in IFRS 15 as below:

(a) The entity should use the most likely amount to estimate the variable consideration associated with the completion bonus. This is because there are only two possible outcomes (₹ 50 lacs or nothing) and it is the method that the entity would expect to better predict the amount of consideration to which it will be entitled. The company can estimate the time of completion of constructing the jet.

(b) The entity should use the expected value method to estimate the variable consideration associated with the broad range of performance bonus (ie based on number of flights taken up during the first year of operation). This is because it is the method that the entity would expect to better predict the amount of consideration to which it will be entitled.