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Further, in the Elective Papers which are Case Study based, the solutions have been worked out on the basis of certain assumptions/views derived from the facts given in the question or language used in the question. It may be possible to work out the solution to the case studies in a different manner based on the assumption made or view taken.

PAPER – 6E: GLOBAL FINANCIAL REPORTING STANDARDS

The question paper comprises five case study questions. The candidates are required to answer any four case study questions out of five.

Case Study 1.

Rainbow Limited is a large manufacturing company that has already adopted Ind AS. during the financial year 2017-18. The company is in the process of preparing its financial statements as per Ind AS for the financial year 2018-19. Some new developments have taken place during the year and the company is keen that the appropriate accounting treatment and disclosures under Ind AS are determined and highlighted to the Board of Directors. Rainbow Limited's CFO has sought your assistance and shared the following details with you. Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ₹1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clear River Project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow Limited to commence this research as at 31st March, 2019.

(ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident of the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 2020.

In September 2018, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 2019 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May 2019, and thus the claim form would not have been filed with the State Government.

Four years ago, Rainbow Limited had acquired a commercial property for ₹40 crores and immediately leased out the same to Turquoise Limited on an operating lease basis. The annual rental as per the agreement was determined to be ₹4 crores. As per the terms of the lease agreement, the lessee can cancel the lease by giving three months' notice in writing to the company. Turquoise Limited gave a notice on 1st October 2018 to vacate the property from 1st January, 2019. The fair value of such property was ₹ 58 crores as on 1st January, 2019.

On receiving such notice, Rainbow Limited has started the process of bifurcating the property into 10 identical units of equal size and sell it in the ordinary course of business. The company has incurred ₹12 crores as the expenses towards such conversion 31st March, 2019. The *bifurcation process is still in progress as at that date and the company estimates that they need to spend a further of ₹ 8 crores to complete the project, after which each of these units could fetch ₹ 10 crores.*

Rainbow Ltd. has a wholly owned subsidiary Canyons Ltd. which has recently been going through a lot of financial difficulties. Canyons Ltd. has approached Rainbow Ltd for assistance and seeing the long term potential, the parent company has funded ₹ 20 lakhs to Canyons Ltd. as interest-free loan. The loan shall either be repayable on demand or after a fixed term which will be mutually agreed upon by the parent and the subsidiary. The market rate of interest for similar loan is 12% p.a.

On 1st April, 2018, the company issued a convertible bond that matures in five years. The bond can be converted into ordinary shares at any time. Rainbow Limited has calculated that the liability and equity components of the bond are ₹ 80 lakhs for the liability component and ₹20 lakhs for the equity component, giving a total amount of the bond of ₹ 1 crore. The interest rate on the bond is 8% and local tax legislation allows a tax deduction for the interest paid in cash. The local tax rate is 30%.

In order to fund an upcoming project, Rainbow Limited borrowed ₹ 5 crores from a scheduled bank during 2018-19. The loan carries market interest rate and is repayable in 3 years. Given that the company invested a significant amount of time preparing the loan documentation and obtaining necessary approvals, Rainbow Limited has requested the bank to include an extension option. Accordingly, if the company so requires, it will have the option to extend the period of the loan at market rates prevailing at that date.

On 1st January, 2019, Rainbow Limited acquired a 60% stake in Shadow Limited. The cash consideration payable was ₹ 1 crore to be paid immediately, and ₹1.21 crores after two years. The fair value of net assets of Shadow Limited at acquisition date was ₹ 3 crores. Rainbow Limited has calculated that its cost of capital is 10%. Non-controlling interest is measured at the proportionate share of identifiable net assets.

Rainbow Limited had purchased equipment P on 1st April, 2017 for ₹ 1 lakh and this had an estimated useful life of 10 years, with a residual value of zero. The asset is depreciated on a straight line basis. On 31st March, 2019, Rainbow Limited has revalued equipment P to ₹ 1.04 lakhs.

Questions:

1.1 Calculate the deferred tax liability arising on the convertible bond as at the 2 year ending 31st March, 2019.

(A) ₹ 30,00,000.

(B) ₹ 2,40,000.

(C) ₹ 6,00,000.

(D) ₹ 24,00,000.

1.2 Calculate the amount of goodwill/capital reserve arising upon acquisition of Shadow Limited.

(A) ₹ 1 crore capital reserve.

(B) ₹ 80 lakhs of capital reserve.

(C) ₹ 20 lakhs goodwill.

(D) ₹ 41 lakhs of goodwill.

1.3 The three year term loan obtained from the bank contains an option to extend the period of the loan at market rates prevailing at that date. State which of the following is correct:

(A) It is not an embedded derivative.

(B) It is an embedded derivative closely related to the loan.

(C) It is an embedded derivative but not closely related to the loan, so it needs to be separately accounted for.

(D) It is an embedded derivative but not closely related to the loan, so no further accounting is required.

1.4 What is the annual depreciation charge on equipment P for years 3 to 10 and what is the amount of revaluation surplus that can be transferred to retained earnings annually?

(A) Annual depreciation charge will be ₹10,000 and an annual transfer of ₹ 3,000 can be made from revaluation surplus to retained earnings.

(B) Annual depreciation charge, will be ₹10,000, however, annual transfer from revaluation surplus to retained earnings is not permitted.

(C) Annual depreciation charge will be ₹13,000 and an annual transfer of ₹ 3,000 may be made from revaluation surplus to retained earnings.

(D) Annual depreciation charge will be ₹ 13,000, however, annual transfer from revaluation surplus to retained earnings is not permitted.

1.5 The CFO of Rainbow Limited is concerned that there may be an impairment of goodwill in one of the subsidiary companies. Clarify how impairment, if any, will be accounted for by the Parent company:

(A) It will always be deducted in full from the parent company retained earnings.

(B) It will be apportioned between the parent company and the Non-Controlling Interest (NCI) when the NCI is valued at fair value.

(C) It will never be apportioned between the parent company and the NCI

(D) It will be apportioned between the parent company and the NCI where the NCI is valued using the proportionate method. ***(2 x 5 = 10 Marks)***

1.6 Suggest the suitable accounting treatment, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 2019. ***(6 Marks)***

1.7 In regards to the property previously leased to Turquoise Limited, analyse the accounting implications of the bifurcation currently in progress under the relevant Ind AS and prepare a note on the classification, measurement and disclosure as at 31st March, 2019.

(4 Marks)

1.8 How should Rainbow Limited account for the interest-free loan given to Canyons Limited, under the following scenarios:

Scenario A: The loan is repayable on demand.

Scenario B: The loan is repayable after 5 years.

Provide necessary journal entries under both scenarios, in the books of Rainbow Limited and Canyons Limited. ***(5 Marks)***

Answer to Case Study 1

1.1 : (C) ₹ 6,00,000

1.2 : (C) ₹ 20,00,000 goodwill

1.3 : (B) It is an embedded derivative closely related to the loan.

1.4 : (C) Annual depreciation charge will be ₹ 13,000 and an annual transfer of ₹ 3,000 may be made from revaluation surplus to retained earnings.

1.5 : (D) It will be apportioned between the parent company and the NCI where the NCI is valued using the proportionate method

1.6 Accounting treatment for

1. First Grant

The first grant for 'Clear River Project' involving research into effects of various chemicals waste from the industrial area in Madhya Pradesh, seems to be unconditional as no details regarding its refund has been mentioned in the question. Even though the research has not been started nor any major steps have been completed by Rainbow Limited to commence the research, the grant will be recognised immediately in profit or loss for the year ended 31st March, 2019.

Alternatively, in case, the grant is conditional as to expenditure on research, the grant will be recognised over the year the expenditure is being incurred and recognised in the books of Rainbow Limited.

2. Second Grant

The second grant related to commercial development of a new equipment is a grant related to depreciable asset. As per the information given in the question, the equipment will be available for sale in the market from April, 2020. Hence, by that time, grant relates to the construction of an asset and should be initially recognised as deferred income.

The deferred income should be recognised as income on a systematic and rational basis over the asset's useful life.

The entity should recognise a liability on the balance sheet for the years ending 31st March, 2019 and 31st March, 2020. Once the equipment starts being used in the manufacturing process, the deferred grant income of ₹ 100,000 should be recognised over the asset's useful life to compensate for depreciation costs.

Alternatively, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of ₹ 100,000 against the cost of the equipment as on 1st April, 2020.

3. **For flood related compensation**

Rainbow Limited will be able to submit an application form only after 31st May, 2019 ie in the year 2019-2020. Although flood happened in September, 2018 and loss was incurred due to flood related to the year 2018-2019, the entity should recognise the income from the government grant in the year when the application form related to it is submitted and approved by the government for compensation.

Since, in the year 2018-2019, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited could not recognise the grant income as it has not become receivable as on 31st March, 2019

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		
Loan to Canyons Ltd. A/c Dr.	₹ 20,00,000	
To Bank A/c		₹ 20,00,000
On repayment		
Bank A/c Dr.	₹ 20,00,000	
To Loan to Canyons Ltd. A/c		₹ 20,00,000

Journal entries in the books of Canyons Ltd.

At origination		
Bank A/c Dr.	₹ 20,00,000	
To Loan from Rainbow Ltd. A/c		₹ 20,00,000
On repayment		
Loan from Rainbow Ltd. A/c Dr.	₹ 20,00,000	
To Bank A/c		₹ 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. The difference in fair value and transaction cost will treated as investment in Subsidiary Canyons Ltd.

Both Rainbow Ltd. and Canyons Ltd. should recognise financial asset and liability, 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 equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

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

At origination			
Loan to Canyons Ltd. A/c (20,00,000 x 0.5674)	Dr.	₹ 11,34,800	
Investment in Canyons Ltd. A/c	Dr.	₹ 8,65,200	
To Bank A/c			₹ 20,00,000
During periods to repayment- to recognise interest			
Year 1 – Charging of Interest			
Loan to Canyons Ltd. A/c (₹ 11,34,800 x 12%)	Dr.	₹ 1,36,176	
To Interest income A/c			₹ 1,36,176
Transferring of interest to Profit and Loss			
Interest income A/c	Dr.	₹ 1,36,176	
To Profit and Loss A/c			₹ 1,36,176
Note : Interest needs to be recognised in Statement of profit and loss. The same cannot be adjusted against capital contribution recognised at origination.			

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

At origination			
Bank A/c	Dr.	₹ 20,00,000	
To Loan from Rainbow Ltd. A/c			₹ 11,34,800
To Equity Contribution in Rainbow Ltd. A/c			₹ 8,65,200
During periods to repayment- to recognise interest			
Year 1			
Interest expense A/c	Dr.	₹ 1,36,176	
To Loan from Rainbow Ltd. A/c			₹ 1,36,176

Note: Further, there may be variation in figures on account of discounting factor taken.

Case Study 2.

Makers Ltd. is engaged in the business of manufacturing a number of products including moulds, dies and machinery. They have a wide customer base in automobile, infrastructure, construction and other sectors both within India and abroad.

Typically, a contract is entered into for sale of each product and consideration is received on the event of delivery of goods to the customer place. The cost of each mould is ₹ 400 and the selling price .is ₹ 450. The terms of the contract entitle the customer to return any unused moulds within 30 days and receive a full refund. The Company estimates that the costs of recovering the mould· will be immaterial and expects that the returned moulds can be resold at a profit. The company has sold a total of 10,000 moulds during the month ended 31st March, 2019. From past experience, Makers Ltd expects that 3% of the moulds will be returned during the current year.

On 1st April, 2018, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. Makers Ltd. incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 2019. The loan is repayable in FCY on 31st March, 2024 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 2018 - FCY 1 = ₹ 2.50.

- 31st March, 2019 – FCY 1 = ₹ 2.75.

- Average rate for the year ended 31st Match, 2019 – FCY 1 = ₹ 2.42. The functional currency of the group is Indian Rupee,

Makers Ltd. acquired 65% of shares on 1st June, 2018 in D Limited which is engaged in production of components of machinery. D Limited has 1,00,000 equity shares of ₹ 10 each. The quoted market price of shares of D Limited was ₹12 on the date of acquisition. The fair value of D Limited's identifiable net assets as on 1st June, 2018 was ₹ 80,00,000.

Makers Limited wired ₹50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of Makers Limited on the date of issue is ₹ 25 per share.

Makers Limited also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by D Limited exceeds ₹ 1 crore over the next three years. On the date of acquisition, D Limited assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000. D Limited incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

Additional information:

Makers Ltd. has identified five segments (denoted as A to E below, for ease of reference)

Segment	Sales		Total Sales	Profit	Assets
	Exports	Domestic			
A	1,20,00,000	-	1,20,00,000	10,00,000	20,00,00,000
B	2,50,00,000	80,00,000	3,30,00,000	30,00,000	5,00,00,000
C	4,50,00,000	-	4,50,00,000	50,00,000	7,00,00,000
D	2,70,00,000	60,00,000	3,30,00,000	30,00,000	10,00,00,000
E	40,00,000	50,00,000	90,00,000	20,00,000	15,00,00,000
		TOTAL	13,20,00,000	1,40,00,000	57,00,00,000

Makers Ltd. has entered into an operating lease for new office space for a period of 10 years from October 1, 2018. The escalation clause of the lease agreement states that the lease rent shall be escalated by 12% after completion of every 3 years. The general inflation rate in the economy is 5%. The initial lease rent agreed per month is ₹85,000.

The company has an identifiable asset QR with a carrying amount of ₹ 10,00,000. Its recoverable amount is ₹ 6,50,000. The tax base of QR is ₹ 8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Makers Ltd. expects to continue to earn profits in future.

Makers Ltd. acquired the trademark for a product from ABC Ltd. in 2008-09 for ₹ 8,00,000. The trademark is expected to have an indefinite useful life. The carrying amount as on 1st April, 2018 is ₹ 8,00,000. Now due to competition, the sales of the product have declined by 25%. The management has made assessment and has ascertained that the trademark will continue to have indefinite useful life. The recoverable amount is ascertained as ₹ 6,00,000.

Questions:

2.1 Based on the quantitative threshold, which of the above segments A to E would be considered as reportable segments?

(A) Segment C.

(B) Segments C, D and B.

(C) Segments B, C, D and E

(D) All are reportable segments.

2.2 What is the amount to be charged to the statement of profit and loss towards lease rent for the new office space for the year ended March 31, 2019?

(A) ₹ 8,57,935.

(B) ₹ 9,97,989.

(C) ₹ 5,87,935.

(D) ₹ 11,75,869.

2.3 For the identifiable asset QR, what would be the impact on the deferred tax asset/ liability at the end of the period?

(A) Nil impact.

(B) Deferred tax asset will have a closing balance of ₹1,05,000.

(C) Deferred Tax asset will have a balance of ₹60,000.

(D) Deferred tax asset will have a balance of ₹45,000.

2.4 In respect of the trademark with indefinite life, Makers Ltd. seeks your advice on the appropriate treatment from following:

(A) The entity can continue with the same carrying amount of ₹8,00,000.

(B) The entity can adopt amortisation for the amount of ₹6,00,000.

(C) The entity has to test the asset for impairment, as an external unfavourable event had occurred and reduce the carrying amount to ₹6,00,000.

(D) The entity is required to test the trademark for impairment every year and accordingly, the carrying amount will be reduced to ₹6,00,000.

2.5 Makers Ltd. is evaluating a proposal to acquire the shares of C Ltd., a competitor. The company will proceed only if they will have a controlling stake, in accordance with the applicable accounting standards. Help them identify which one of the following situations will fail their objective, i.e., they are unlikely to have control over C Ltd.?

(A) Acquiring 56% of total shares of C Ltd and being able to elect 3 out of 5 directors on its Board.

(B) Acquiring 65% of total shares with decisions requiring unanimous consent of all shareholders.

(C) Owning 40% of the total shares and having the majority of voting rights in C Ltd.

(D) Having currently exercisable options which would effectively result in 60% ownership of total shareholding. ***(2 x 5 = 10 Marks)***

2.6 Analyse the terms of the revenue contracts with customers for sale of moulds as per applicable Ind AS. Determine the amount of revenue, refund liability and the asset to be recognized by Makers Ltd. for the said contracts explaining the reasons for your answers.

(4 Marks)

2.7 What would be the appropriate accounting treatment for the Foreign Currency loan in the books of Makers Ltd. for the FY 2018-19? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain/loss. ***(5 Marks)***

2.8 How will the acquisition of D Ltd. be accounted by Makers Limited, under Ind AS 103? Prepare detailed workings and pass the necessary journal entries. ***(6 Marks)***

Answer to Case Study 2

2.1 : (D) All are reportable segments

2.2 : (C) INR 5,87,935

2.3 : (D) Deferred tax assets will have a balance of INR 45,000

2.4 : (D) The entity is required to test the trademark for impairment every year and accordingly, the carrying amount will be reduced to ₹ 6,00,000.

2.5 : (B) Acquiring 65% of total shares with decisions requiring unanimous consent of all shareholders.

2.6 The entity applies the requirements in Ind AS 115 to the portfolio of 10,000 moulds because it reasonably expects that the effects on the financial statements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable.

The entity considers on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of ₹ 43,65,000 (₹ 450 x 9700 moulds not expected to be returned) can be included in the transaction price. The entity determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 43,65,000) will not occur as the uncertainty is resolved (i.e. over the return period).

The entity estimates that the costs of recovering the moulds will be immaterial and expects that the returned moulds can be resold at a profit.

Upon transfer of control of the 10,000 moulds, the entity does not recognise revenue for the 300 moulds that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of Ind AS 115, the entity recognises the following:

(a) Revenue of ₹ 43,65,000 (₹ 450 × 9700 moulds not expected to be returned);

(b) A refund liability of ₹ 1,35,000 (₹ 450 refund × 300 moulds expected to be returned); and

(c) An asset of ₹ 1,20,000 (₹ 400 × 300 moulds for its right to recover products from customers on settling the refund liability).

2.7 Initial carrying amount of loan in books

Loan amount received	=	60,00,000 FCY
Less: Incremental issue costs	=	(2,00,000) FCY
		58,00,000 FCY

Ind AS 21 "The Effect of Changes in Foreign Exchange Rates" states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in ₹ = 58,00,000 FCY x ₹ 2.50/FCY

= ₹ 1,45,00,000

Therefore, the loan would initially be recorded at ₹ 1,45,00,000

Calculation of amortized cost of loan (in FCY) at the year end:

Period	Opening Financial Liability (FCY) A	Interest at 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
2018-2019	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FC is 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 2018-2019 in ₹ is ₹ 16,84,320 (6,96,000 FC x ₹ 2.42/FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = ₹ 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So, the closing loan balance in ₹ is 58,96,000 FC x ₹ 2.75/FC = ₹ 1,62,14,000

The exchange differences that are created by this treatment are recognized in profit or loss.

In this case, the exchange difference is

₹ [1,62,14,000 - (1,45,00,000 + 16,84,320 – 16,50,000)] = ₹ 16,79,680

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	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000

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]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [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.	80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to D Ltd.		9,80,000
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.

Your advisory client Gamma Limited is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

- *Gamma Limited holds 100% Investment in G Limited and D Limited;*
- *G Limited and D Limited hold 60% and 40% in GD Limited respectively.*
- *Delta Limited is a 100% subsidiary of GD Limited*

Gamma Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 2019 and the extract of the same is as follows:

Particulars	*Attributable to Gamma Limited*	*Non-controlling interest*	*Total (₹ in '000)*
Profit for the year	*39,000*	*3,000*	*42,000*
Other Comprehensive Income	*5,000*	*Nil*	*5,000*
Total Comprehensive Income	*44,000*	*3,000*	*47,000*

The long-term finance of the company comprises of the following:

(i) 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 2018 at full market value.

(ii) 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 2019. The dividend on these preference shares is discretionary.

(iii) ₹18 crores of 6% Convertible Debentures issued on 1st April, 2017 and repayable on 31st March, 2021 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their Convertible Debentures for 10 crores ordinary shares in the company. On 1st April, 2017, the prevailing market interest rate for five-year Convertible Debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in five years is 0.68 and the cumulative present value of ₹1 payable at the end of years one to five is 3·99.

In the year ended 31st March, 2019, Gamma Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

While preparing the financial statements for the year ended 31st March, 2019, Gamma Limited has observed two issues in the previous year Ind AS financial statements (i.e. 31st March, 2018) which are as follows:

Issue 1:

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 2018. While preparing annual financial statements for the year ended 31st March, 2019, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 2018).

Issue 2:

The company had charged off certain expenses as finance costs in the year ended 31st March, 2018. While preparing annual financial statements for the year ended 31st March, 2019, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 2018).

Additional information:

Gamma Ltd. granted share options to one of its technical directors on the condition that he will not work with a competitor (i.e., non-compete clause) for a period of three years. The fair value of the award at the date of the grant is ₹ 2,00,000, including the effect of the non-compete clause.

Gamma Ltd. has inventory of raw material Y of 10,000 units as at 31st March, 2019 with a carrying amount of ₹100 each. The current market value of that raw material is ₹95 each. Gamma Ltd. intends to use the raw material to manufacture a component to be used by a customer. Gamma Ltd. estimates costs to completion and sale of ₹50 each and a selling price for the component is estimated to be ₹ 160 each.

Gamma Limited sold a machinery Z for ₹9,00,000, to a new customer. To get into long term relationship with the customer, the terms of sale also include after sales service to be provided for next three years free of cost. The company also sells the sales service contract separately where the customer buys it after the initial warranty period at ₹1,00,000.

The company has stores across India. It deals mainly with three products A. B, and C. The company has a policy of refunding the entire purchase money provided the buyer returns the product without any damage within a period of 15 days in respect of Product A and B, and 6 months in respect of Product C. This policy has not been mentioned in any their written documents nor has been communicated in any other media. However, it is widely known. The company has duly complied with this policy in the past. The accountant has made an estimate, based upon past experience and the average probability that the cost involved in relation to the product return policy for each of the product is as follows:

	₹
Product A	*1,50,000*
Product B	*2,50,000*
Product C	*5,00,000*
Total	*9,00,000*

The management is of the view that no provision for returns needs to be created as there is no legal obligation on the part of the company.

Questions:

3.1 What is the value of raw material Y of Gamma Ltd. as per applicable Ind AS?

(A) ₹9,50,000.

(B) ₹11,00,000.

(C) ₹10,00,000.

(D) ₹16,00,000. '

3.2 How should the revenue be recognised in the books of account for the sale of machinery Z?

(A) ₹9,00,000 is to be recognised as revenue in the year of sale.

(B) ₹9,00,000 is to be recognised at the end of three years after sale.

(C) ₹9,00,000 is to be recognised in the year of sale and ₹1,00,000 to be spread over next three years.

(D) ₹8,10,000 is to be recognised in the year of sale and ₹ 90,000 to be spread over next three years.

3.3 Your advice is sought on the correct approach for Gamma Ltd.'s policy on return of Products A, B and C.

(A) The provision has to be created as conservative policy has to be followed in accounting.

(B) The provision need not be created as the company is not under any legal obligation to return the purchase money.

(C) Provision has to be created for ₹ 9,00,000 (after adjustment of the time duration remaining) as there exists a possibility of a future liability.

(D) The entity has to create a liability for ₹9,00,000 (or such amount as may be determined after adjustment of the time duration remaining) as there exists a present obligation as a result of past event.

3.4 What is the correct accounting treatment under Ind AS for the share options granted to Gamma Ltd.'s technical director?

(A) Gamma Ltd. should recognise an expense of ₹ 2,00,000 over the period of three years and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

(B) Gamma Ltd. should recognise an expense of ₹2,00,000 over the period of three years and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.

(C) Gamma Ltd, should recognise an expense of ₹ 2,00,000 immediately and cannot reverse the expense recognised even if the director goes to work for competitor and loses the share options.

(D) Gamma Ltd. should recognise an expense of ₹ 2,00,000 immediately and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.

3.5 The CFO of Gamma Ltd. is trying her best to understand the high level differences between IFRS and US GAAP. Which of the following is the correct hierarchy under US GAAP hierarchy for determining the selling price of a deliverable?

(A) First, the Vendor-Specific Objective Evidence must be used, if available. If not, then Third Party Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.

(B) First, the Best Estimate of Selling Price must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must obtain Third Party Evidence.

(C) First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.

(D) First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must use Cost plus a Reasonable Margin. ***(2 x 5 = 10 Marks)***

3.6 Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?

Secondly, consider this alternative scenario. All other facts remain the same as above, but G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited. Explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements. ***(4 Marks)***

3.7 Based on the details of long term finance provided above, help Gamma Limited compute the following:

- *the finance cost of convertible debentures and closing balance as on 31st March, 2019 to be presented in the consolidated financial statements.*
- *the basic and diluted earnings per share for the year ended 31st March, 2019.*

Assume that income tax is applicable to Gamma Limited and its subsidiaries at 25%.

(7 Marks)

3.8 What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 2018?

(4 Marks)

Answer to Case Study 3

3.1: (C) ₹ 10,00,000

3.2: (D) ₹ 8,10,000 is to be recognised in the year of sale and ₹ 90,000 to be spread over next three years.

3.3: Both (C) Provision has to be created for ₹ 9,00,000 (after adjustment of the time duration remaining) as there exists a possibility of a future liability

and (D) The entity has to create a liability for ₹ 9,00,000 (or such amount as may be determined after adjustment of the time duration remaining) as there exists a present obligation as a result of past event.

> **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.
>
> In case Ind AS 37 is applied, then both options (C) and (D) are same in substance with difference in language.

3.4: (C) Gamma should recognise an expense of ₹ 2,00,000 immediately and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

3.5: (A) First, the Vendor-Specific Objective Evidence must be used, if available. If not, then Third Party Evidence is used. If neither prices are available, then the entity must make its best estimate of selling price.

3.6 As per paragraph 4(a) of Ind AS 110, an entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

A parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind AS, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

- wholly-owned subsidiary; or

- is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Although GD Limited is a partly-owned subsidiary of G Limited, it is the wholly-owned subsidiary of Gamma Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. G Limited and D Limited). Thus, GD Limited being the wholly owned subsidiary fulfils the conditions as mentioned under paragraph 4(a)(i) and is not required to inform its other owner D Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, GD Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

In Alternative Scenario, where both G Limited and D Limited are owned by an individual Mr. X, then GD Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, GD Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, GD Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, D Limited should be informed about and do not object to GD Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of G Limited and D Limited, GD Limited will be required to provide relevant financial information as per Ind AS.

3.7 Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (1,80,000 crore x 0.74)

= ₹ 1,33,200 crore

Present value of interest payable annually for 4 years (1,80,000 thousand x 6% x 3.31)

= ₹ 35,748 thousand

Total liability component = ₹ 1,68,948 thousand

Therefore, equity component = 1,80,000 thousand – 1,68,948 thousand = 11,052 thousand

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance of loan	Finance cost @ 8%	Interest paid @ 6%	Closing balance of loan
	A	b = a x 8%	c	d = a + b - c
31.3.2018	1,68,948	13,515.84	10,800	1,71,663.84
31.3.2019	1,71,663.84	13,733.11	10,800	1,74,596.95

Finance cost of convertible debentures for the year ended 31.3.2019 is ₹ 13,733.11 thousand and closing balance as on 31.3.2019 is ₹ 1,74,596.95 thousand.

Note: The question provides annuity factor for 5 years and also discount factor of 5th year. However, the term of convertible debentures is 4 years. Therefore, the above solution has been given on the basis of the annuity factor for 4 years and the discount factor for the 4th year.

Calculation of Basic EPS **₹ in 000**

Profit for the year	39,000
Less: Dividend on preference shares (80,000 x 0.05)	(4,000)
	35,000

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)}

= 23,75,00,000 shares or 2,37,500 thousand shares

Basic EPS = ₹ 35,000 thousand / 2,37,500 thousand shares

= ₹ 0.147

Calculation of Diluted EPS **₹ in 000**

Profit for the year		39,000
Less: Dividend on preference shares (80,000 x 0.05)		(4,000)
		35,000
Add: Finance cost (as given in the above table)	13,733.11	
Less: Tax @ 25%	(3,433.28)	10,299.83
		45,299.83

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)} + 10,00,00,000

= 33,75,00,000 shares or 3,37,500 thousand shares

Diluted EPS = ₹ 45,299.83 thousand / 3,37,500 thousand shares

= ₹ 0.134

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 subsequent period.

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 31st March, 2019, the comparative amounts as at 31st March 2018 would be restated to reflect the correct classification.

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 preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1st April, 2017 in addition to the comparatives for the financial year 2017-2018.

Issue 2

In accordance with para 41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 2019, the comparative amounts for the year ended 31st March, 2018 would be restated to reflect the correct classification.

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 preceding period.

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 (1st April, 2017). Therefore, the entity is not required to present a third balance sheet.

Case Study 4.

Global Ltd. is a highly reputed private company that has been in the infrastructure and power business for three generations. The company's CFO has approached your advisory firm for assistance in applying Ind AS for the first time in 2018-19. The following brief details are provided to you.

Global Ltd. has two units (Unit 1and Unit 2) of 600 MW each in its power plant. The plant was set up in the year 2010 and it is expected that it will be able to supply power till 2025. Global has entered into a Power Purchase Agreement with the State Government. The construction of the plant was funded using a debt-equity ratio of 70:30. The term loan carried an interest rate of 12% p.a. The total outlay on the plant was ₹4,000 crores which is also considered as its fair value. Some important features of the PPA are:

- *The State Government has agreed to purchase 600 MW power generated by Unit 1.*
- *The term of the agreement is fixed as 10 years.*
- *The tariff for power supply agreed with the State Government is as follows:*

Contract year	Capacity charges (₹/kWh)	Energy charges (₹/kWh)
1	1.10	2.00
2	1.10	2.10
3	1.10	2.30
4	1.10	2.50
5	1.10	2.60
6	0.78	2.80
7	0.78	3.00
8	0.78	3.20
9	0.78	3.40
10	0.78	3.70

(1 MW = 1000 KW and the plant operates 24 hours a day, 365 days in the year).

Capacity charges are payable based on 85% capacity, irrespective of the actual units consumed. An incentive is payable for availability of plant beyond 85% capacity and a penalty is recoverable for availability of plant below 85% (for this case study, assume that exactly 85% was available).

Global Ltd. has been granted a 15-year license to extract coal from a mine situated at a remote location R. At the end of this term, Global is obligated to carry out certain prescribed activities in order to restore the ecological balance in location R.

The CFO has informed you that the company is in talks with specific target companies/ individuals in order to complement their operations. One of the key areas of focus is to bring in fresh thinking by buying out startups and research organisations in the infrastructure and power sectors. Global Ltd. has identified New Start Ltd. which is primarily into research and development of alternative energy sources. New Start Ltd. has not yet sold to any customers and therefore has not generated any revenues to date. However, Global Ltd. believes that New Start Ltd. has the right technology and a dedicated workforce that is well qualified in this field.

Global Ltd. owns 25% of the voting rights in Local Ltd. and is entitled to appoint one director to the Board, which consists of five members. The remaining 75% of the voting rights are held by two entities who are entitled to appoint two directors each. Decisions can be made by a quorum of four directors and a majority of those present at the Board meeting. Quite often, the other shareholders call Board meetings at short notice and make decisions in the absence of Global's representative. Although Global Ltd., has requested financial information from Local Ltd., but no information has been received. On the rare occasion that Global's representative attends the Board meeting of Local Ltd., his suggestions for agenda items are ignored and any concerns raised are vehemently opposed by the other directors.

Additional information:

Global Ltd had the following borrowings in place during 2018-2019. Loan A of ₹ 5 crores at 8% and Loan B of ₹ 10 crores at 9%. The company constructed a new factory which cost ₹12 crores and was funded out of the existing borrowings. The factory took 7 months to complete-.

The company purchased 1,000 equity shares in K Ltd. on 1st April, 2018. Since the investment was of a strategic nature, with no immediate plans to sell (or buy further), the management of Global decided to use the irrevocable election under Ind AS 109 to designate these investments at FVOCI.

Questions:

4.1 Global Ltd., has invested in debt oriented mutual funds. The investment should be subsequently measured as:

(A) FVOCI.

(B) FVTPL

(C) Amortised cost.

(D) Cost.

4.2 What is the cost of borrowings to be capitalised with the cost of constructing the new factory?

(A) ₹66.67 lakhs.

(B) ₹1.04 crores.

(C) ₹1.67 crores.

(D) ₹ 60.66 lakhs.

4.3 For the equity investment in K Ltd., designated at FVOCI, the fair value gains and losses:

(A) Will always be recorded through equity and never realised in profit and loss, even when it is sold.

(B) Will be recorded through equity when .it is held by the company, but realised in profit and loss when it is sold.

(C) Will be recognised in profit and loss when it is held and when it is sold.

(D) Will be recorded through profit and loss when it is held by the company, but in equity when it is sold.

4.4 The junior accountant at Global Ltd. needs clarifications on the various new terminology relating to fair value. What source should he refer to first, when measuring fair value of an asset/liability?

(A) Principal market.

(B) Most advantageous market.

(C) Foreign market.

(D) Participant specific market.

4.5 Global Ltd. is in talks with a target company based in the US and the CFO has messaged you for a quick clarification on certain differences between IFRS and US GAAP. Which of these sentences would be the correct response to your client?

(A) If certain criteria are met, US GAAP permits reversal of impairments of long lived assets held for use, whereas IFRS prohibits such reversals. IFRS requires the use of component approach for depreciation whereas US GAAP does not.

(B) If certain criteria are met, US GAAP permits reversal of impairments of long lived assets held for use, whereas IFRS prohibits such reversals. US GAAP requires the use of component approach for depreciation whereas IFRS does not.

(C) If certain criteria are met, IFRS permits reversal of impairments of long lived assets held for use, whereas US GAAP prohibits such reversals. IFRS requires the use of component approach for depreciation whereas US GAAP does not.

(D) If certain criteria are met, IFRS permits reversal of impairments of. long lived assets held for use, whereas US GAAP prohibits such reversals. US GAAP requires the use of component approach for depreciation whereas IFRS does not. ***(2 x 5 = 10 Marks)***

4.6 Evaluate the Power Purchase Agreement under the requirements of Ind AS. How should the construction of power plant be classified in the financial statements of Global Ltd.? Support your answer with the necessary workings. Briefly comment on the site restoration costs for the mine at location R. ***(6 Marks)***

4.7 Analyse the relationship between Global Ltd. and Local Ltd. Also comment on the relationship between Local Ltd. and the other two shareholders. ***(4 Marks)***

4.8 Since Global Ltd. is considering the acquisition of New Start Ltd., they need your advice on whether this fulfils the criteria under business combinations, or should it be treated as an asset acquisition? ***(5 Marks)***

Answer to Case Study 4

4.1: (B) FVTPL

4.2: (D) ₹ 60.66 lakhs

4.3: (A) Will always be recorded through equity and never realised in profit and loss, even when it is sold.

4.4: (A) Principal Market

4.5: (C) If certain criteria are met, IFRS permits reversal of impairments of long-lived assets held for use, whereas US GAAP prohibits such reversals. IFRS requires the use of component approach for depreciation whereas US GAAP does not.

4.6: Global Limited may determine whether the power purchase agreement with the State government contains a lease.

Power purchase agreement with the State government contains an embedded lease arrangement which needs to be evaluated under Appendix C of Ind AS 17, Leases.

As per paragraph 6 of Appendix C of Ind AS 17, "Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

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

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

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

With respect to condition (b), paragraph 9 of Appendix C of Ind AS 17 provides as below:

"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:

(a) 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.

(b) 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.

(c) 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."

In the present case, criteria (c) above is fulfilled since:

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

Accordingly, the power purchase agreement with the State government contains an embedded lease arrangement.

<u>Analysis of activity of construction of power plant which needs to be classified in the financial statements of Global Limited</u>

Continuing the rationale to the above i.e. the power purchase agreement with the State government contains an embedded lease arrangement, next, in order to determine if the lease arrangement is an operating lease or a finance lease, one can refer to paragraph 10 of Ind AS 17 which provides as below:

"Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications."

The evaluation of these situations is given below:

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

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

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

(d) Not fulfilled. Refer computation below.

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

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

Contract year	Capacity charges	Total capacity charges	Present value @ 12%
	₹ / kwh	₹ Crores	
1	1.10	491.4	438.8
2	1.10	491.4	391.7
3	1.10	491.4	349.8
4	1.10	491.4	312.3
5	1.10	491.4	278.8
6	0.78	348.5	176.6
7	0.78	348.5	157.6
8	0.78	348.5	140.7
9	0.78	348.5	125.7
10	0.78	348.5	112.2
			2,484.30

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

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

Based on the evaluation above, it can be concluded that "Power Plant" is under an operating lease arrangement" and accordingly, it should be classified in the financial statements.

Site restoration costs for the mine at Location R

Global Limited needs to recognise a provision for site restoration in accordance with the terms of the mining license granted to it. The provision is determined based on the best estimate of outflow of economic benefits to satisfy the contractual obligation, discounted to its present value using an appropriate rate determined in accordance with Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets".

4.7: Despite the fact that the Global Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent Global Ltd. from exerting significant influence. This is clear from the following facts given in the question:

- The other shareholders frequently call board meeting at the short notice and make decisions in the absence of Global Ltd.'s representative.
- Global Ltd has requested financial information from Local Ltd, but this information has not been provided.
- On rare occasions, Global Ltd's representative attends the board meeting, but suggestions for agenda items are ignored and any concerns raised are vehemently opposed by the other directors

Whilst it appears the Global Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent Global Ltd's efforts and stop Global Ltd from actually having any influence.

Considering the substance over form, these all facts clearly indicate that Global Ltd. does not have any influence on Local Ltd.

In this situation, Local Ltd would not be an associate of Global Ltd.

4.8: Paragraph B7 of Ind AS 103, 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 B8 of Ind AS 103 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 this case, the skilled workforce, right technology, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.

When the said inputs and processes are applied as an integrated set, the Company will be capable of producing outputs; the fact that the Company currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Hence, in the given scenario, the acquisition of shares in Company New Start Ltd. represents a business combination.

Case Study 5.

Main Bank Ltd. holds certain loans of ₹ 10,000 that yield 18% interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield is estimated at ₹ 11,000. Main Bank securitizes the principal component of the loan plus the right to receive the interest at 14% to Beta Ltd., a special purpose entity, for ₹ 10,000.

Out of the balance interest of 4% it is stipulated that half of such balance interest namely, 2% will be due to Main Bank Ltd. as a fee for continuing to service the loans. The fair value of the servicing asset so created is estimated at ₹ 350. The remaining half of the interest is due to Main Bank Ltd. as an interest strip receivable, the fair value of which is estimated at ₹ 650.

During 2018-2019, Main Bank Ltd.'s subsidiary Sub Bank Ltd. originates 2,000 bullet loans with a gross carrying amount of ₹ 50 Lakhs. It has decided that the portfolio would be segregated between Individual Housing Loans and Non-Individual Housing Loans, on the basis of shared credit risk characteristics at initial recognition. Individual housing loans portfolio comprises 1,000 loans with a gross carrying amount of ₹ 2,000 per client on average, and a total gross carrying amount of ₹ 20 Lakhs. The Non-Individual housing loans comprise 1,000 loans with a gross carrying amount of ₹ 3,000 per client. The historical default rate for next 12 months is 4 borrowers in Individual Housing Loan and 2 borrowers in Non-Individual Housing Loans. Assume that there are no transaction costs or fees, and that the loan contracts do not include any option for prepayment or call. Consider that the EIR is 10%.

Main Bank has a number of corporate clients who regularly enter into derivatives (mainly forward contracts and options) to manage the volatility on their forecast cash inflows/outflows arising from sales and purchases. There are also some large companies that enter into External Commercial Borrowings (ECB loans) which are typically structured as a variable rate loan with a floating-to-fixed interest rate swap. Main Bank is frequently posed with questions by these clients on whether they should adopt hedge accounting. They also periodically request valuation statements that are inclusive of Credit Valuation Adjustment and Debit Valuation Adjustment (CVA and DVA) for derivatives.

Additional information:

Main Bank has a debt factoring arrangement for its customer A. Main Bank agreed to pay ₹91.5 lakhs, less a servicing charge of ₹1.5 lakhs (net proceeds ₹90 lakhs), in exchange for 100% of the cash flows from short term receivables of customer A. According to customer A, the receivables have a face value of ₹ 100 lakhs and carrying amount of ₹ 95 lakhs. The customers will be instructed to pay the amounts to Main Bank. Customer A also writes a *guarantee to Main Bank that it will reimburse any credit losses upto ₹ 5 lakhs, over and above the expected credit losses of ₹ 5 lakhs and losses of up to ₹ 15 lakhs are considered reasonable. The guarantee is estimated to have a fair value of ₹ 0.5 lakhs.*

Questions:

5.1 The middle office of Main Bank Ltd. is examining the financial statements of its customers (i.e., borrowers) in order to ensure that loan covenants are being met, especially with respect to debt-equity ratios. Assist them in determining which of the instruments will qualify as equity in their entirety under Ind AS:

(A) Redeemable debentures with discretionary dividend.

(B) Optionally convertible redeemable preference shares.

(C) Debentures convertible into a fixed number of instruments, at the option of the issuer.

(D) Debentures convertible into a fixed number of instruments, at the option of the holder.

5.2 Some of Main Bank's customers are in troubled times and they are going through Strategic Debt Restructuring i.e. renegotiating with Main Bank the terms of their debt. Help them understand the requirements of Ind AS 109 so they can assess the accounting implications for the loan in their books:

(A) A qualitative assessment is sufficient, as the counterparty for the modified loan is the same as before.

(B) Although the counterparty is the same since the two loans are considered as separate financial instruments, the old loan must be mandatorily derecognised and the renegotiated loan has to be recognised.

(C) A qualitative assessment may not be sufficient and a quantitative assessment may be required. If there is substantial modification, the old loan need not be derecognised.

(D) A qualitative and quantitative assessment may be needed. If there is substantial modification, the old loan must be derecognized and the renegotiated loan has to be recognised.

5.3 Disclosures of fair value are not required when:

(A) Fair value cannot be estimated.

(B) Fair value assumptions are described in accounting policies.

(C) The carrying amount is a reasonable approximation of fair value.

(D) Three level fair value hierarchy is provided in the notes to accounts.

5.4 Which of the following instruments is not an example of a derivative contract?

(A) Total return swap.

(B) LIBOR linked debentures.

(C) Credit Default Swap.

(D) Written treasury bond option.

5.5 In respect of Main Bank's debt factoring arrangement for its customer A, which of the following statements is correct?

(A) Continuing involvement asset must be recognised along with the associated liability.

(B) Continuing involvement asset must be recognised but there is no associated liability.

(C) There is continuing involvement asset but the associated liability must be recognized.

(D) There is no continuing involvement in the receivables of customer A.

(2 x 5 = 10 Marks)

5.6 You are required to assist Main Bank in analyzing the securitisation transaction. Compute the fair value of the securitised component of the loan and the amortisation of the carrying amount based on related fair values. ***(6 Marks)***

Pass journal entries in the books of Main Bank upon securitisation of these loans.

5.7 Calculate the loss rate approach in the books of Sub-Bank for both Individual Housing Loans and Non-Individual Housing Loans. ***(4 Marks)***

5.8 Explain why hedge accounting may be helpful to Main Bank's corporate clients. Briefly outline the need and requirements of CVA and DVA for derivative contracts. ***(5 Marks)***

Answer to Case Study 5

5.1: (C) Debentures convertible into a fixed number of instruments, at the option of the issuer.

5.2: (D) A qualitative and quantitative assessment may be needed. If there is substantial modification, the old loan must be derecognized and the renegotiated loan has to be recognized.

5.3: (C) The carrying amount is a reasonable approximation of fair value.

5.4: (B) LIBOR linked debentures

5.5: (A) Continuing involvement asset must be recognized along with the associated liability.

5.6 Fair Value of securitised component of the loan

	₹	₹
Fair value of loan		11,000
Less: Fair value of servicing asset	350	
Fair value of interest strip	650	1,000
Fair value of securitised component of loan		10,000

Apportionment of carrying amount based on relative fair values			
Particulars	**Fair Values**	**% age based on Total Fair Value**	**Carrying Amount / Cost**
Securitised component of loan	10,000	90.91	9,091
Servicing Asset	350	3.18	318
Interest Strip Receivable	650	5.91	591
	11,000	100	10,000

3.	**The profit arising on securitisation should be computed as follows:**	₹
	Net proceeds of securitisation	10,000
	Less: Cost (apportioned carrying amount) of securitised component of loan	9,091
	Profit on securitisation	909

4.	**Based on the above, the following journal entries would be passed in the books of the Originator:**			
			₹	₹
(a)	*To record securitisation of principal plus right to 14% interest*			
	Cash A/c	Dr.	10,000	
	To Loans A/c (cost of securitised component)			9,091
	To Profit on Securitisation			909
(b)	*To record the creation of servicing asset and interest strip receivable*			
	Servicing asset A/c	Dr.	318	
	Interest strip A/c	Dr.	591	
	To Loans A/c			909

5.7 Calculation of loss rate approach

Group	Number of loans	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average defaults	Estimated total gross carrying amount at default	Present value of observed loss*	Loss rate
	A	B	C = A x B	D	E = B x D	F	G = F / C
Individual	1,000	2,000	20,00,000	4	8,000	7,272	0.36%
Non-Individual	1,000	3,000	30,00,000	2	6,000	5,454	0.18%

* Expected credit losses have been discounted using the effective interest rate at 10%.

5.8 Hedge accounting may be helpful to Main Bank's corporate clients:

Corporates regularly enter into derivatives (mainly forward contracts and options) to manage the volatility on their cash inflows / outflows which may arise typically from forecast sale or purchase transactions. A purchase order placed for import of materials or assets (or, purchase order received for export transactions), is typically a trigger for a company to enter into a foreign exchange derivative (such as a forward or option). This helps the company to protect any ups and downs in the currency markets and lock in the value of sale or purchase and thereby protect the revenues and limit the costs. This is commonly known as economic hedging.

While these purchase and sale transactions will happen in future and are (rightly) not yet accounted for in the books of account, the derivative contract must be measured at fair value through profit and loss account. Any gains and losses must be recognized. However, the offsetting purchase or sale is yet to happen and there is no matching loss or gain. Therefore, there is a misconception that derivatives cause volatility.

In order to mitigate this, may entities choose to reflect their economic hedging activity in the books of account by adopting hedge account. In order to defer the gains and losses arising from the fair value movement of a derivative and match the timing of gains and losses to the appropriate asset / liability or receivable / payable, entities need to comply with the requirements of hedge accounting as described in Ind AS 109. These include detailed risk management policies, hedge documentation with the qualifying criteria, effectiveness testing and measurement of ineffectiveness.

In respect of External Commercial Borrowings (ECB loans), the variable rate loan and the floating-to-fixed interest rate swap are often structured with the same contract. In line with the offsetting requirements of Ind AS 109, these would be considered as two separate instruments – i.e. the borrowing separately and the interest rate swap separately and accounted for at amortised cost and FVTPL respectively. Once again, in order to mitigate the mismatch in the measurement basis of the two instruments, it would be beneficial for a company to adopt hedge accounting. This would also mean that the finance cost line item in the company's profit and loss would effectively comprise the variable rate interest expense and the fair value gains / losses from the interest rate swap.

Requirements of CVA and DVA for derivative contracts:

Assets and liabilities managed by an entity would be affected by its market risk i.e., interest rate risk, currency risk and credit risk relating to its respective counterparties. In respect of derivatives, as provided by Ind AS 113, entities need to consider the non-performance risk and credit risk of both counterparties involved. Valuation techniques include the use of credit valuation adjustment and other internal / external information in order to arrive at the credit valuation adjustment and debit valuation adjustment (CVA and DVA) for derivatives. Accordingly, the fair value of a derivative in accordance with Ind AS 113 is determined after considering CVA and DVA.