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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 three case study questions. The candidates are required to answer any two case study questions out of three.

Case Study 1.

Fresh Vegetables Limited (FVL) was incorporated on 2nd April 2014 under the provisions of the Companies Act, 2013 to carry on the wholesale trading business in vegetables. As per the audited accounts of the financial year as at and for the year ended 31st March 2020 approved in its annual general meeting held on 31st August 2020 its net worth, for the first time since incorporation, exceeded ₹ 250.00 crores. The financial statements since inception till financial year ended 31st March 2019 were prepared in accordance with Companies (Accounting Standards) Rules 2006 (AS). It has been advised that henceforth it should prepare its financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015 (Ind AS).

The following additional information is provided by the Company:

– *FVL has in the financial year 2015-2016 entered into a 60:40 partnership with Logistics Limited and incorporated a partnership firm 'Vegetable Logistics Associates' (VLA) to carry on the logistics business of vegetables from farm to market;*

– *FVL also has an associate company Social Welfare Limited (SWL) that was incorporated in July 2018 as a charitable organization and registered under section 8 of the Companies Act, 2013. Social Welfare Limited has been the associate company of FVL since its incorporation;*

– *During the current financial year 2020-2021, FVL has decided to purchase vegetables from Vegetable Farms Limited (VFL) also. VFL has agreed to grant incentives to FVL on one of the following two bases:*

  - *A 10% prompt settlement discount on all purchases of vegetables settled within 30 days of purchase; or*
  - *Rebates based on the volume of merchandising purchased or sold.*

– *On 1st April 2020, FVL received a loan of ₹ 3.00 million from the Government. The loan is at 2% interest and is repayable in 5 years. The prevailing market interest rate is 10%.*

The Finance & Accounts department of FVL undertook an internal Ind AS diagnostic & impact. It came up with the following observations / queries:

– *FVL has decided to opt for exemption under paragraph D7AA of Ind AS 101 'First-time adoption of Indian Accounting Standards' and also elected the cost model under*

Ind AS 16 'Property, Plant and Equipment' for subsequent measurement. It has balance outstanding in the 'Revaluation Reserve' created as per AS;

- *FVL had acquired Hybrid Tomatoes Limited (HTL) as per the scheme of amalgamation sanctioned under the provisions of the Companies Act, 2013. The amalgamation was effective from 1st April, 2015 and was accounted for in the financial year 2015-2016 under Indian GAAP. As per the Scheme, the entire undertaking of HTL including all its assets, liabilities and reserves and surplus stood transferred in FVL. As a result, FVL has taken over assets / liabilities including certain financial instruments. Under Ind AS, FVL has opted for option under paragraph C1 of Ind AS 101 'First-time Adoption of Indian Accounting Standards', not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS);*
- *On 1st January 2019, FVL has classified a group of assets as 'Assets held for sale' in accordance with AS 10 'Property, Plant and Equipment' and stated it at lower of their net book value and net realisable value under previous GAAP. FVL has presented these assets separately from other fixed assets in the previous GAAP financial statements for the year ended 31st March 2019 and did not provide depreciation subsequently on the same. On transition to Ind AS, these assets could not fulfill the criteria for classifying as held for sale in accordance with Ind AS 105 'Non-current Assets held for Sale and Discontinued Operations'.*

You are an Ind AS Consultant. The Company has sought your advise on the following:

Select the correct option for Q. 1.1 - Q. 1.5

1.1. What is the date of transition to Ind AS?

(A) 1st April, 2019

(B) 31st March, 2019

(C) 1st April, 2020

(D) 31st March, 2020 *(2 Marks)*

1.2. How should FVL recognize prompt settlement discount?

(A) Deduct from the cost of vegetables;

(B) Present it as other operating revenue;

(C) Present it as other income;

(D) Defer it over usage. *(2 Marks)*

1.3. How should FVL recognize rebate based on volume of vegetables purchased?

(A) Deduct from the cost of vegetables;

(B) Present it as other operating revenue;

(C) *Present it as other income;*

(D) *Reduction from finance cost.* *(2 Marks)*

1.4. *FVL should recognize on the date of initial measurement government loan at:*

(A) *₹3,000,000*

(B) *₹2,090,211*

(C) *₹2,299,232*

(D) *₹2,940,000* *(2 Marks)*

1.5. *FVL should recognize the following amount as interest expense on the government loan in its fourth year at:*

(A) *₹240,000*

(B) *₹300,000*

(C) *₹258,347*

(D) *₹60,000* *(2 Marks)*

1.6. *Examine the applicability of Ind AS on VLA & SWL.* *(3 Marks)*

1.7. *FVL wants to assess its functional currency. The Company wants clarity on the date from which functional currency should be assessed. Should the assessment be from the date of transition to Ind AS or retrospectively as per paragraph 10 of Ind AS 101 'First-time adoption of Indian Accounting Standards'?* *(3 Marks)*

1.8. *What will be the accounting treatment of the balance outstanding in the "Revaluation Reserve" created as per previous GAAP? Will there be any impact on declaration of dividend? What will be the treatment of deferred tax on this transition revaluation reserve?* *(3 Marks)*

1.9. *Whether FVL would be required to apply Ind AS 109 'Financial Instruments' retrospectively (i.e. from the date of origination of the financial instrument by HTL) to such financial instruments acquired as part of the business combination?* *(3 Marks)*

1.10. *Should assets held for sales needs to be reclassified to 'Property, plant and equipment'. Whether deemed cost exemption under paragraph D7AA of Ind AS 101 will be available for these assets?* *(3 Marks)*

Answer to Case Study 1

1.1 Option (A) : 1st April, 2019

1.2 Option (A) : Deduct from the cost of vegetables

1.3 Option (A) : Deduct from the cost of vegetables

1.4 Option (B) : ₹ 20,90,211

1.5 Option (C) : ₹ 2,58,347

1.6 <u>Applicability of Ind AS in general:</u>

- Currently Ind AS is applicable to the following companies except for companies other than banks, NBFCs and Insurance Companies, on mandatory basis:
  (a) All companies which are listed or in process of listing in or outside India on Stock Exchanges.
  (b) Unlisted companies having net worth of ₹ 250 crore or more but less than rupees five hundred crore.
  (c) Holding, Subsidiary, Associate and Joint venture of above.
- Companies listed on SME exchange are not required to apply Ind AS on mandatory basis.
- Once a company starts following Ind AS either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow Ind AS for all the subsequent financial statements even if any of the criteria specified does not subsequently apply to it.
- Application of Ind AS is for both standalone as well as consolidated financial statements if threshold criteria met or adopted voluntarily.
- Companies meeting the thresholds for the first time at the end of an accounting year shall apply Ind AS from the immediate next accounting year with comparatives.
- Companies not covered by the above roadmap shall continue to apply existing Accounting Standards notified in the Companies (Accounting Standards) Rules, 2006.

Since the net worth of FVL in immediately preceding year exceeded ₹ 250 crores, Ind AS is applicable to it. The entity VLA and SWL have to be examined as they may fall in criteria (c) above.

<u>Applicability of Ind AS on VLA</u>

Since Joint arrangement can be either joint operation or joint venture. However, for the purpose of identifying the applicability of Ind AS, the Act defines Joint venture (as an explanation to section 2(6) of the Companies Act, 2013), as follows:

“the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement”.

Accordingly, if an entity is classified as joint operation and not joint venture, then Ind AS would not be applicable to such entity.

In the case of VLA, if partners conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. However, Ind AS would not be applicable on VLA in such a case since it is the case of joint operation (and not a joint venture).

Alternatively, if partners conclude that they have joint control of the arrangement and have rights to the net assets of the arrangement relating to the partnership firm, then this would be a joint venture. In such a case, Ind AS would be applicable to them.

Applicability of Ind AS on SWL

Social Welfare Limited (SWL) is the associate company of FVL. Accordingly, Ind AS would be applicable on SWL too.

1.7 Ind AS 101 'First-time Adoption of Indian Accounting Standards', provide 'Exceptions to the retrospective application of other Ind AS' and 'Exemptions for Business Combination' respectively.

But at the same time, Ind AS 101 is silent on the assessment of functional currency by an entity, i.e, from the date of transition or retrospectively. Since neither any exception nor any exemption has been specified for assessment of functional currency, an entity will have to assess its functional currency retrospectively as per paragraph 10 of Ind AS 101 stated as below:

Ind AS 101 states that except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities.

1.8 Ind AS 101 'First-time Adoption of Indian Accounting Standards' provides that except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities.

Further Ind AS 101 states that the accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind AS. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind AS.

Accordingly, as per the above requirements in the given case balance outstanding in the revaluation reserve should be transferred to retained earnings or if appropriate, another category of equity disclosing the description of the nature and purpose of such amount in accordance with the requirements of paragraph 79(b), Ind AS 1 'Presentation of Financial Statements'. This is because after transition, the Company is no longer applying the revaluation model of Ind AS 16, instead it has elected to apply the cost model approach.

It may be noted that the requirements of the Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

Further, it may also be noted that in accordance with Ind AS 12 'Income Taxes', deferred tax would need to be recognised on any difference between the carrying amount and tax base of assets and liabilities. No deferred tax is created on equity components. However, since the asset has been revalued, there will be difference for the amount between carrying value and tax base. Hence, deferred tax will have to be recognised on such asset.

1.9 Ind AS 101 'First-time Adoption of Indian Accounting Standards', states that a first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). If previous business combinations are not restated, the previous acquisition accounting remains unchanged. Carrying amount under previous GAAP of assets acquired and liabilities assumed in an un-restated business combination immediately after the business combination becomes their deemed cost at that date.

In preparing its opening Ind AS Balance Sheet, an entity applies the criteria in Ind AS 109 to classify financial instruments based on the facts and circumstances that exist at the date of transition to Ind AS. The resulting classifications are applied retrospectively.

For those financial assets and financial liabilities measured at amortised cost in the opening Ind AS balance sheet, an entity determines the cost of the financial assets and the financial liabilities on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in Ind AS 109. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount in accordance with previous GAAP immediately following the business combination is their deemed cost in accordance with Ind AS at that date.

In accordance with the above, unless there is a transitional relief under Ind AS 101 for financial instruments, the requirements of Ind AS 109 need to be applied retrospectively. It is pertinent to note that although Ind AS 101 does not provide for any transitional relief for financial instruments and requires applying requirements of Ind AS 109 retrospectively. However, Ind AS 101 specifically provides guidance regarding treatment to be done if entity elects to opt not to restate past business combinations.

Accordingly, for the financial instruments acquired as part of the business combination carrying amount as per the previous GAAP shall be their deemed cost at the date of business combination. Fair value or amortised cost (as required by Ind AS 109) shall be determined from the date of business combination and not from the date of origination of such financial instrument by Company B. If financial instruments are classified as FVTPL / FVOCI, then these should be measured at fair value at the date of transition to Ind AS. If these instruments are classified at amortised cost, then the entity determine the carrying amount on the transition date by taking the carrying amount of the loan at the date of business combination under previous GAAP and apply the effective interest rate which is determined after considering the amount and timing of expected settlement of such financial instrument.

1.10 In the given case, fixed assets are shown separately and are not derecognised from financial statements. These are eliminated from the financial statements only if they are disposed off or no future economic benefits are expected from its use or disposal.

Ind AS 101 'First-time Adoption of Indian Accounting Standards', provides that where there is no change in its functional currency on the date of transition to Ind AS, a first-time adopter to Ind AS may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments.

In accordance with above, the exemption as per paragraph D7AA is available to all property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS irrespective of whether these were disclosed separately. Under the previous GAAP, Company X has only presented the assets as held for sale separately. Accordingly, the Company X can avail the deemed cost exemption for such type of assets which were presented separately as held for sale as per previous GAAP but on transition did not meet the criteria of assets held for sale given under Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'.

Case Study 2.

Medicines India Limited (MIL) incorporated under the Indian Companies Act, 1956 is a pharmaceutical company. It has its manufacturing plant at Pune in Maharashtra. Besides domestic sales, it also exports the medicines to various countries. Its net worth exceeded ₹ 1,000 crores as per the audited accounts for the year ended 31st March 2014 & has remained above that since then. When preparing and finalizing the financial statements as at and for the year ended 31st March 2020, the following issues required attention:

- *MIL during the year ended 31st March 2020 had invested in a 12 year bond with a face value of ₹ 6,00,000 by paying ₹ 2,31,500. The effective rate of interest is 10%. MIL is recognizing proportionate interest income in its statement of profit and loss over the period of bond. MIL is not in the business of dealing in securities.*
- *MIL has a legal claim for damages filed by its customer of ₹ 2.50 million. There is a 40% chance that the entity will win the case and no cost will be involved. However, there is a 60% chance that decision will not be in the favour of the entity and it will have to pay for the damages.*
- *MIL entered into a contract to supply 10,00,000 million strips of a particular medicine for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non-performance of the contract is expected to be ₹ 0.25 million.*
- *The Finance & Accounts department had drawn the following calendar for finalization, approval & submission of financial statements for the year ended 31st March 2020:*

Completion of preparation of financial statements	*28th May, 2020*
Review & recommendation for approval by the Audit Committee	*15th June, 2020*
Review & approval for issue by the Board of Directors	*19th June, 2020*
Available to shareholders	*1st July, 2020*
Annual General Meeting	*15th September, 2020*
Filing with regulatory authority	*6th October, 2020*

The calendar was duly adhered.

- *As a part of its sales promotion activities, MIL distributes office utility articles along with its product catalogues to medical practitioners to familiarize & encourage them to prescribe medicines manufactured by it. No conditions are attached with the items distributed.*
- *MIL had in the earlier years developed, adopted & applied one of its accounting policies by considering a pronouncement of an overseas national standard - setting body in due accordance with Ind AS. The aforesaid body had made an amendment in that pronouncement effective 1st April, 2019.*
- *While preparing the annual financial statements for the year ended 31st March 2020, MIL discovered that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 2018 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 2019 and was recognised as an expense in the annual financial statements for the said year.*
- *During the year under consideration, MIL had to pay interest and penalties under the Income - Tax Act, 1961 in respect of one of its earlier financial year.*

Had you been the CFO of the Company, how would you have addressed the following:

Select the correct option for Q. 2.1 - Q. 2.5

2.1. With respect to investment in bonds, interest income during the currency of the bond, in the cash flow statement will be treated as:

(A) Financing activity

(B) Investing activity

(C) Either a or b with disclosure

(D) Non-Cash item *(2 Marks)*

2.2. How the maturity proceeds of bonds will be treated in the cash flow statement?

(A) Investing activity

(B) Financing activity

(C) Operating activity

(D) Any of the above with disclosure *(2 Marks)*

2.3. With respect to legal claim for damages filed by its customer, MIL should recognize a provision of:

(A) Nil

(B) ₹ 2.5 million

(C) ₹ 1.5 million

(D) ₹ 1 million (2 Marks)

2.4. The contract to supply 10,00,000 strips requires a provision of:

(A) Nil

(B) ₹ 0.25 million

(C) ₹ 0.50 million

(D) ₹ 0.125 million (2 Marks)

2.5. What is the date of approval for issue of-the financial statements?

(A) 15th June, 2020

(B) 19th June, 2020

(C) 1st July, 2020

(D) 15th September, 2020 (2 Marks)

2.6. Whether the distribution of office utility articles to medical practitioners is covered by Ind AS 115 'Revenue from Contracts with Customers'? If not, how should the same be accounted by MIL? Give reasons. (4 Marks)

2.7. Is it permissible for MIL to change the accounting policy based on a pronouncement of an overseas national standard - setting body due to a subsequent amendment in that pronouncement? (3 Marks)

2.8. Whether the situation relating to constructive obligation for payment of bonus is an error requiring retrospective restatement of comparatives considering the amount is material? Discuss. (3 Marks)

2.9. How should MIL account for the interest and penalties related to income taxes, in accordance with the principles of Ind AS? Is there any conflict between the treatment as per Ind AS vis-a-vis IFRS? (5 Marks)

Answer to Case Study 2

2.1 Option (D) : Non-cash item

2.2 Option (A) : Investing activity

2.3 Option (B) : ₹ 2.5 million

2.4 Option (B) : ₹ 0.25 million

2.5 Option (B) : 19th June, 2020

2.6 The term 'contract' is defined in Ind AS 115 as an agreement between two or more parties that creates enforceable rights and obligations.

In the given case:

- Gifts are distributed by MIL to doctors as a part of its sales promotion activities without there being an agreement between MIL and the doctors creating enforceable rights and obligations.
- The doctors to whom gifts are distributed are not 'customers' of MIL as they have not contracted with it to obtain goods or services in exchange for consideration.
- The items distributed as gifts are not an output of MIL ordinary activities.

In view of the above, the distribution of gifts to doctors does not fall under the scope of Ind AS 115.

As per Ind AS 38, sometimes expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods.

Examples of expenditure that is recognised as an expense when it is incurred include expenditure on advertising and promotional activities (including mail order catalogues).

Items acquired by MIL to be distributed as gifts as a part of sales promotion activities have no other purpose than to undertake those activities. In other words, the only benefit of those items for MIL is to develop or create brands or customer relationships, which in turn generate revenue. Ind AS 38 requires an entity to recognise expenditure on such items as an expense when the entity has a right to access those goods. Ind AS 38 states that an entity has a right to access goods when it owns them, or otherwise has a right to access them regardless of when it distributes the goods.

In view of the above, MIL should recognise the expenditure on items to be distributed as gifts as an expense when it owns those items, or otherwise has a right to access them, regardless of when it distributes the items to doctors.

2.7 In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management may apply an accounting policy from the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards.

If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy. As such a change is a voluntary change in accounting policy, it can be made only if it results in information that is reliable and more relevant and does not conflict with the sources in Ind AS 8.

2.8 As per 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.

As per Ind AS 1, an entity shall 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 retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 2018 and liabilities as at 31st March, 2018 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31st March, 2019, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 2020, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 2019) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 2018) wherein it should recognise the provision for bonus and restate the retained earnings.

2.9 Guidance Note on Division II-Ind AS Schedule III to the Companies Act, 2013 states that

'Any interest on shortfall in payment of advance income-tax is in the nature of finance cost and hence should not be clubbed with the current tax. The same should be classified as interest expense under finance costs. However, such amount should be separately disclosed.

Any penalties levied under Income-tax laws should not be classified as current tax. Penalties which are compensatory in nature should be treated as interest and disclosed in the manner explained above. Other tax penalties should be classified under 'Other Expenses'.

The above recommendations of the Guidance Note are based on the difference between the nature of current tax on the one hand and that of interest or penalties levied on an entity under the income-tax law on the other.

As per Ind AS 12, “current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.” Thus, an entity’s obligation for current tax arises because it earns taxable profit during a period. An entity’s obligation for interest or penalties, on the other hand, arises because of its failure to comply with one or more of the requirements of income-tax law (e.g. failure to deposit income-tax). Thus, obligations for current tax and those for interest or penalties arise due to reasons that are fundamentally different in nature.

Ind AS 1 ‘Presentation of Financial Statements’, requires, inter alia, that an entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law. It is with a view to properly reflect the difference in the nature of current tax and interest / penalties imposed under income-tax law that the Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013 requires interest or penalties to be not clubbed with current tax and to treat penalties that are compensatory in nature and interest as part of finance cost and to treat other penalties as part of other expenses.

There might be situations where an amount payable (or receivable) for interest or penalties may be in the nature of income-taxes and thus will be within the scope of IAS 12. In some situations, it might be difficult to identify whether an amount payable to (or receivable from) a tax authority includes interest or penalties. For example, this might be the case when the total amount payable to a tax authority is negotiated as a single amount and the tax authority often issues a single demand for unpaid taxes, which might also include interest and penalties. In such situations, since it may not be possible to segregate interest and penalty component, entire amount would qualify within meaning of IAS 12.

It is noted that the applicability of IFRS is across a large number of jurisdictions, each with its own income-tax law, therefore, an entity should determine whether a particular amount payable or receivable for interest and penalties is in the scope of IAS 12 (or Ind AS 12) considering the tax laws applicable in its individual jurisdiction.

In India, interest and penalty payable under section 234A/B/C will not qualify as income-taxes within the meaning of IAS 12 (or Ind AS 12). Thus, the related amount will be recognised as interest (similar to the approach under the guidance note). Other interest and penalties under the Indian income tax act are also generally not expected to qualify as income-taxes.

Case Study 3.

Sun Enterprise Limited (SEL), whose functional currency FC is engaged in the business of manufacturing various items from metals. It prepares its financial statements as per IFRS.

- *It is considering raising funds for the expansion of its production capacity. However, its debt-equity ratio is under pressure. It has the following options before it:*
  - *SEL issues 6% cumulative, non-redeemable preference shares (6% CNRPS) with discretionary dividends that are subject to availability of distributable reserves. The directors of SEL can decide at each period end whether and the extent to which a dividend will be paid on the preference share. The terms of the preference shares provide that if no dividend is paid on the preference shares, then no dividend is paid on SEL ordinary shares;*
  - *SEL issues 6% discretionary non-cumulative, non-redeemable preference shares (6% NCNRPS) that are subject to availability of distributable reserves. The directors of SEL can decide at each period end whether and the extent to which a dividend will be paid on the preference shares. The payment of dividends on SEL ordinary shares is also discretionary. The terms of the preference shares provide that if dividend is to be paid on SEL's ordinary shares, then a dividend must be paid on the preference shares;*
  - *SEL issues 6% non - redeemable, fixed cumulative mandatory dividend preference shares (6% NRCMP). If earnings are not sufficient in any given year, such dividends will be paid in future years. Additional dividends may be declared but only if dividends of the same amount are declared on the other classes of shares.*
  - *SEL issues 2000 convertible bonds with a 3 year term at a face value of FC 1,000 per bond resulting into a total proceed of FC 2.0 million. Interest is payable annually @ 6.00% per annum. Each bond is convertible, at the holder's discretion, at any time upto maturity into 250 shares. When the bonds are issued, the market interest rate for similar debt instrument without the conversion option is 9.00% per annum;*
  - *SEL issues a 2 year mandatorily convertible instruments for FC 1.0 million. The instrument requires SEL to make cash coupon payments of FC 50,000 each at the end of year 1 and year 2. At the end of year 2, the instrument will mandatorily convert into 5,000 ordinary shares.*
- *SEL has applied for a term loan from a bank for business purposes. As per the loan agreement, the loan required a personal guarantee of one of the directors of SEL to be executed. In case of default by SEL, the director will be required to compensate for the loss that bank incurs. Mr. Pure Joy, one of the director had given guarantee to the bank*

pursuant to which the loan was sanctioned to SEL. SEL does not pay premium or fees to its director for providing this financial guarantee.

– *SEL (parent company) has issued a comfort letter to its subsidiary company, Complete Surety Limited (CSL). CSL was able to obtain funds from the banker on the basis of comfort letter issued by SEL.*

– *SEL has given certain interest free refundable security deposits.*

– *SEL has issued compulsorily convertible debentures at 14.5% coupon rate which will be converted at the end of 10 years. The unsecured loan market rate of interest is 14.5% (Assuming this rate can be considered as the appropriate market rate for the given purpose). It may be noted that the coupon rate on debentures is same as that of the market rate of interest although coupon rate on instruments with conversion feature is generally lower than market rate of interest on unsecured loans.*

– *SEL shall be declaring dividend on a financial instrument (which has been classified as a liability in accordance with IAS 32, Financial Instruments: Presentation), after the end of the reporting period.*

You are the Chief Financial Officer of SEL. You have to resolve the following issues:

Select the correct option for Q. 3.1 - Q. 3.5

3.1. Whether 6% CNRPS can be classified as:

(A) Equity in its entirety;

(B) Liability in its entirety;

(C) Either of the above with disclosure;

(D) Compound Financial Instruments. *(2 Marks)*

3.2. Whether 6% NCNRPS can be classified as:

(A) Equity in its entirety;

(B) Liability in its entirety;

(C) Either of the above with disclosure;

(D) Compound Financial Instrument. *(2 Marks)*

3.3. Whether 6% NRCMP can be classified as:

(A) Compound financial instrument;

(B) Equity in its entirety;

(C) Liability in its entirety;

(D) Either (B) or (C) at the discretion of SEL. *(2 Marks)*

3.4. *If SEL issues 2000 convertible bonds of FC 1,000 per bond, assuming no transaction costs, on initial recognition:*

(A) There is no equity component;

(B) The equity component is FC 151,878

(C) The equity component is FC 200,000

(D) None of the above. *(2 Marks)*

3.5. *If SEL issues the 2 year mandatorily convertible instruments for FC 1.0 million, assuming no transaction costs and market interest rate for similar debt instrument without conversion option is 8% per annum, on initial recognition:*

(A) There is no equity component;

(B) There is no liability component

(C) The equity component is FC 910,837

(D) The equity component is FC 687,435. *(2 Marks)*

3.6. *Whether SEL is required to account for the financial guarantee received from its director? Will there be any disclosures under IAS 24?* *(4 Marks)*

3. 7. *Whether the comfort letter will be accounted for as a financial guarantee contract in accordance with IFRS 9, Financial Instruments?* *(2 Marks)*

3.8. *Whether Interest free refundable security deposits given by an entity are required to be discounted as per the principles of IFRS? If yes, at what rate should these be discounted?* *(3 Marks)*

3.9. *How the financial liability (debt portion) would be computed with respect to compulsorily convertible debentures of coupon rate 14.5% that will be converted at the end of 10 years. (It can be assumed that the equity conversion option requires the company to deliver a fixed number of its own shares for a fixed amount of another financial asset indicating that it meets the 'fixed for fixed' criterion under IAS 32).* *(3 Marks)*

3.10. *Whether SEL is required to accrue such dividends in the financial statements for the year even if it is declared after the end of the reporting period?* *(3 Marks)*

Answer to Case Study 3

3.1 Option (A) : Equity in its entirety

3.2 Option (A) : Equity in its entirety

3.3 Option (A) : Compound financial instrument

3.4 Option (B) : The equity component is FC 151,878

3.5 Option (C) : The equity component is FC 910,837

3.6 IFRS 9 'Financial Instruments', defines a financial guarantee contract as 'a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Based on this definition, an evaluation is required to be done to ascertain whether the contract between director and Bank qualifies as a financial guarantee contract as defined in Appendix A to IFRS 9. In the given case, it does qualify as a financial guarantee contract as:

- the reference obligation is a debt instrument (term loan);
- the holder i.e. Bank is compensated only for a loss that it incurs (arising on account of non-repayment); and
- the holder is not compensated for more than the actual loss incurred.

IFRS 9 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm's length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

It is also pertinent to note that the entity needs to exercise judgment in assessing the substance of the transaction taking into consideration relevant facts and circumstances, for example, whether the director is being compensated otherwise for providing guarantee. Based on such an assessment, an appropriate accounting treatment based on the principles of IFRS should be followed.

In the given case, SEL is the beneficiary of the financial guarantee and it does not pay a premium or fees to its director for providing this financial guarantee. Accordingly, SEL will not be required to account for such financial guarantee in its financial statements considering the unit of account as being the guaranteed loan, in which case the fair value would be expected to be the face value of the loan proceeds that SEL received.

In the given case based on the limited facts provided, SEL will be required to make necessary disclosures of such financial guarantee in accordance with IAS 24 as follows:

(a) the amount of the transactions;

(b) the amount of outstanding balances, including commitments, and:

  (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

  (ii) details of any guarantees given or received;

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

3.7 As per IFRS 9, a significant feature of a financial guarantee contract is the contractual obligation to make specified payment in case of default by the credit holder. As such, the contract may not necessarily be called as financial guarantee contract and it may take any name or legal form, however the treatment will be same as that of a financial guarantee contract. If a contract legally meets these requirements, then it would be accounted for as the financial guarantee contract as per IFRS 9.

Accordingly, in the given case, SEL will be required to evaluate as to whether it is contractually obliged to make good the loss in case CSL fails to make the payment. If yes, then such comfort letter would be a financial guarantee contract and will be accounted for in accordance with IFRS 9.

3.8 A refundable security deposits given by an entity is a financial instrument and should be classified as a financial asset in accordance with IFRS 9.

IFRS 9 states that the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.

If an entity determines that the fair value at initial recognition differs from the transaction price, the entity shall account for that instrument at that date adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

In accordance with the above, where the effect of time value of money is material, refundable security deposits should be discounted and should be shown at their present value at the time of its initial recognition.

Regarding the rate at which these should be discounted, entity needs to evaluate based on its own facts and circumstances, whether the effect of the time value of money is material or not on an overall consideration of total cash flows, etc. The difference between the transaction price and fair value should be accounted for.

The deposits which are contractually repayable on demand will be recognised at the transaction price on initial recognition similar to the initial recognition of demand deposit liabilities given under IFRS 13. For example, in case of an interest free security deposit paid, the difference may be deferred as prepaid expense to be recognised as an expense over the underlying term.

3.9 As per IAS 32 'Financial Instruments: Presentation', in case of compound financial instruments, it is required to separate it into two components, i.e., financial liability (debt) and equity component. When allocating the initial carrying amount of the compound instrument to the underlying financial liability and equity component, an entity first determines the fair value of the liability component (assuming there is no embedded derivative). The fair value of the liability component is determined with reference to the fair value of a similar stand-alone debt instrument. The amount allocated to the equity component is residual amount after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

The application guidance of IAS 32 provides additional guidance on compound financial instruments from issuers' point of view. It requires the issuer of such a financial instrument to present the liability component and the equity component separately in the balance sheet, as follows:

The fair value of the liability shall be the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

The amount allocated to the equity component will be the residual amount after deducting the fair value of the financial liability component as determined above from the fair value of the entire compound instrument (for purpose of this issue, transaction costs have been ignored).

3.10 SEL shall account for dividend on financial instrument classified as financial liability as per IAS 32 as follows:

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.

The payment of dividend / interest to financial instruments classified as liability accrues at the end of the reporting period even if it is paid or declared after the end of the reporting period. Accordingly, in the given case, SEL is required to account for the dividend, even if it is declared after the end of the reporting period.

Further, accounting for dividend on financial instrument which is classified as financial liability is governed by classification of such instrument under IFRS 9. If it is classified as subsequently measured at amortised cost, dividend will be accrued as part of interest expense recognised based on effective interest method.

Case Study 4.

Buildings & Co. Limited with a financial year end of 31st March, entered into a contract with its customer, Radar Company Limited, to build a manufacturing facility. Buildings & Co. Limited determines that the contract contains one performance obligation satisfied over time.

Construction is scheduled to be completed by the end of the 36th month for an agreed upon price of ₹ 25 crores. Buildings & Co. Limited has the opportunity to earn a performance bonus for early completion as follows:

- *15% bonus of the contract price if completed by the 30th months (25% likelihood).*
- *10% bonus of the contract price if completed by the 32nd months (40% likelihood).*
- *5% bonus of the contract price if completed by the 34th months (15% likelihood).*

In addition to the potential performance bonus for early completion, Buildings & Co. Limited is entitled to a quality bonus of ₹ 2 crores if a health and safety inspector assigns the facility a gold star rating as defined by Radar Company Limited in terms of the contract. Buildings & Co. Limited concludes that it is 60% likely that it will receive the quality bonus.

Buildings & Co. Limited has prepared interim financial statements for the third quarter ended 31st December, 2019 for the purposes of submission to banks. The interim financial statements show a net profit of ₹ 20 crores for the third quarter ended 31st December, 2019. Following adjustments have been made while computing the net profit:

- *Bad debts of ₹ 1 crores were incurred during the quarter ended 31st December, 2019. 50% of the bad debt have been deferred to next quarter.*
- *Additional depreciation of ₹ 45,00,000 resulting from change in the method of depreciation.*
- *₹ 5 crores expenditure on account of administrative expenses pertaining to the third quarter 31st December, 2019 is deferred on the argument that the fourth quarter will have more sales; therefore, fourth quarter should be debited by higher expenditure. The expenditures are uniform all throughout the quarters.*

While preparing the annual financial statements for the year ended 31st March 2019, Buildings & Co. Limited charged certain expenses as finance cost (assume the expenses to be material on overall level). While preparing the annual financial statements for the year ended 31st March 2020, management 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 management restated the comparative amount for the prior period presented i.e. for the year ended 31st March, 2019.

On 15th November, 2019, Buildings & Co. Limited acquired Concrete Mixers Private Limited for a purchase consideration of ₹ 10 crores. Concrete Mixers Private Limited is in the process of setting up a plant to make ready mix-concrete· and expects the plant to become operational by 30th April, 2020. Other than the plant in construction, there are no other operations in the Concrete Mixers Private Limited.

Buildings & Co. Limited has taken a loan of USD 15,00,000 as on 1 April 2019 taken for construction of its fabrication plant at an interest rate of 6% per annum payable on annual basis. On 1st April, 2019, the exchange rate between the currencies i.e. USD vs. Rupees was ₹ 72 per USD. The exchange rate on the reporting date i.e. 31st March, 2020 is ₹ 76 per USD. The corresponding amount could have been borrowed by Buildings & Co. Limited from and Indian bank in ₹ at an interest rate of 11% per annum as on 1st April, 2019.

Buildings & Co. Limited entered into a 10-year lease for 6,000 square meter of office space. The annual lease payments are ₹ 60,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Buildings & Co. Limited's incremental borrowing rate at the commencement date is 8% p.a. At the beginning of 6th year, Buildings & Co. Limited and lessor agree to amend the original lease to reduce the space to only 3000 square meters of the original space starting from the end of the first quarter of year 6. The annual fixed lease payments (from year 6 to year 10) are ₹ 35,000. Buildings & Co. Limited's incremental borrowing rate at the beginning of year 6 is 6% p.a.

Besides construction activity, Buildings & Co. Limited is also engaged in the trading of Copper. On 1st April, 2019, it had 100 kg of copper costing ₹ 70 per kg - totalling ₹ 7000. The Company has a scheduled delivery of these 100 kgs of copper to its customer on 30th September, 2019 at the rate of USD 100 on that date. To protect itself from decline in currency exchange rate (USD to ₹), the entity hedges its position by entering into currency futures contract for equivalent currency units at ₹ 76 / USD. The future contract mature on 30th September, 2019. The management performed an assessment of hedge effectiveness and concluded that the hedging relationship qualifies for cash flow hedge accounting. The entity determines and documents that changes in fair value of the currency futures contract will be highly effective in offsetting variability in cash flow of currency exchange. On 30th September, 2019, the entity closes out its currency futures contract. On the same day, it also sells its inventory of copper at USD 100 when the spot rate is ₹ 72 / USD.

Buildings & Co. Limited holds 40% of total equity shares of Highway Limited, an associate company. The value of investments in Highway Limited on 31st March, 2019 is ₹ 4 crores in the consolidated financial statements of Buildings & Co. Limited. During the year ended 31st March, 2020, Buildings & Co. Limited sold goods worth ₹ 3,50,000 to Highway Limited. The cost of goods sold is ₹ 3,00,000. Out of these, goods costing ₹ 1,00,000 to Highway Limited were in the closing stock of Highway Limited. During the period 31st March, 2020 the profit and loss statement of Highway Limited showed a loss of ₹ 2 crore. During the year ended 31st March, 2020, Highway Limited declared a dividend of ₹ 80,00,000 to its equity shareholders.

You have to resolve the following issues:

Select the correct option for Q. 4.1 - Q. 4.5

4.1. Determine the amount of variable consideration Building & Co. Limited should recognize in its contract with Radar Company Limited to build a manufacturing facility.

(A) ₹ 2.13 crores

(B) ₹ 4.13 crores

(C) ₹ 2 crores

(D) ₹ 3.94 crores. *(2 Marks)*

4.2. The CFO of the Company has requested you to review the interim financial statements of the third quarter ended 31st December, 2019 to ascertain the correct net profit to be presented to the Board of Directors. What is the correct amount of profit to be reported in the interim financial statements?

(A) ₹ 14.75 crores

(B) ₹ 18.25 crores

(C) ₹ 14.84 crores

(D) ₹ 14.50 crores. *(2 Marks)*

4.3. Would the error of classifying certain other expenses instead of finance costs in the comparative amounts (31st March, 2019) be considered to be correction of an error? Would the entity need to present a third balance sheet in its financial statements for the year ended 31st March, 2020?

(A) Reclassifications of previous year numbers is permissible in case of both balance sheet and statement of profit and loss and is not considered as an error.

(B) Reclassifications of previous year numbers shall be considered as an error and in case of an error it is mandatory to present a third balance sheet at the beginning of the period.

(C) Reclassifications of previous year numbers shall be considered as an error and since the retrospective restatement in statement of profit and loss has no impact on the information in balance sheet at the beginning of the preceding year i.e. 1st April, 2018, the entity is not required to present the third balance sheet.

(D) Reclassifications of previous year numbers is permissible in case of only statement of profit and loss and is not considered as an error. *(2 Marks)*

4.4. The CFO of the Company has requested you to evaluate whether the acquisition of Concrete Mixers Private Limited will be covered in Ind AS 103 'Business combinations' or whether the under-construction plant should be accounted for as an asset acquisition? What factors will you consider in your evaluation?

(A) Whether Concrete Mixers Private Limited has begun planned principal activities or is pursuing a plan to produce outputs.

(B) Will be able to obtain access to customers that will purchase the outputs.

(C) Whether Concrete Mixers Private Limited has employees, intellectual property and other inputs and processes that could be applied to those inputs.

(D) All of the above. *(2 Marks)*

4.5. In case of the foreign currency borrowing obtained by Buildings & Co. Limited, what is the amount of borrowing cost eligible for capitalization for the construction of the fabrication plant. (assume eligibility conditions related to capitalization of borrowing cost are met)?

(A) ₹ 1,18,80,000

(B) ₹ 68,40,000

(C) ₹ 1,25,40,000

(D) ₹ 1,28,40,000. *(2 Marks)*

4.6. The CFO of the Company has requested your suggestion on how to account for the modification in the lease of office space? Prepare the detailed working for the modification. *(6 Marks)*

4.7. You are required to prepare detailed working and pass necessary journal entries for the sale of copper and the corresponding hedge instrument taken by the company. Please prepare the journal entries as on the initial date (i.e. 1st April 2019), first quarter end reporting (i.e. 30th June 2019) and date of sale of copper and settlement of forward contract (i.e. 30th September 2019). *(5 Marks)*

Assume the exchange rates as follows and yield @ 6% per annum.

Date	Future price for 30th September 2019 delivery (₹/ USD)
1st April, 2019	76
30th June, 2019	74
30th September, 2019	71

4.8. What is the value of investment in Highway Limited as on 31st March, 2020 in the consolidated financial statements of Buildings & Co. Limited, if equity method is adopted for valuing the investments in associates? *(4 Marks)*

Answer to Case Study 4

4.1 Option (B) : ₹ 4.13 crores

4.2 Option (D) : ₹ 14.50 crores

4.3 Option (C) : Reclassifications of previous year numbers shall be considered as an error and since the retrospective restatement in statement of profit and loss has no impact on the information in balance sheet at the beginning of the preceding year i.e. 1st April, 2018, the entity is not required to present the third balance sheet.

4.4 Option (D) : All of the above

4.5 Option (A) : ₹ 1,18,80,000

4.6 In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation	Closing balance
	a	b	c = a x 8%	d = a-b + c	e	f	g
1	4,02,600*	60,000	32,208	3,74,808	4,02,600	40,260	3,62,340
2	3,74,808	60,000	29,985	3,44,793	3,62,340	40,260	3,22,080
3	3,44,793	60,000	27,583	3,12,376	3,22,080	40,260	2,81,820
4	3,12,376	60,000	24,990	2,77,366	2,81,820	40,260	2,41,560
5	2,77,366	60,000	22,189	2,39,555	2,41,560	40,260	2,01,300
6	2,39,555				2,01,300		

* Initial value of ROU asset and lease liability = Annual lease payment x annuity factor @ 8%

= 60,000 x 6.71 = ₹ 4,02,600

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

(a) a five-year remaining lease term,

(b) annual payments of ₹ 35,000 and

(c) Lessee's incremental borrowing rate of 6% p.a.

Present value of modified lease = Annual lease payment x annuity factor @ 6%

= 35,000 x 4.212 = 1,47,420

Lessee determines the proportionate decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 3,000 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (₹ 2,01,300) is ₹ 1,00,650

50% of the pre-modification lease liability (₹ 2,39,555) is ₹ 1,19,777.50.

Consequently, Lessee reduces the carrying amount of the ROU Asset by ₹ 1,00,650 and the carrying amount of the lease liability by ₹ 1,19,777.50. Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (₹ 1,19,777.50 – ₹ 1,00,650 = ₹ 19,127.50) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of ₹ 1,19,777.50 and the modified lease liability of ₹ 1,47,420 (which equals ₹ 27,642.50) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

4.7 Calculation of discounting factor based on yield @ 6% p.a. on quarter basis [ie 6% x (3/12)]

Date	Spot rate at indicated date	Forward rate for 30th September 2019	Discount factor @ 6% p.a. on quarter basis $(1/1.015)^n$
1st April, 2019		76	0.970951266
30th June 2019		74	0.985102019
30th September, 2019	72	71	1

Determination of fair value change

		1st April, 2019	30th June, 2019	30th September, 2019
a	Nominal ₹ @ ₹ 76 / USD	7,600	7,600	7,600
b	Nominal USD (100 kg for USD 100)	100	100	100
c	Forward rate for 30th September, 2019	76	74	71
d	Value in ₹ (b x c)	7,600	7,400	7,100
e	Difference (a-d)	0	200	500
f	Discount factor (as calculated in the above table)	0.971	0.985	1
g	Credit risk-free fair value (e x f)	0	197	500
h	CVA	0	0	0

i	Fair value	0	197	500
j	Fair value change for the period	0	197	303*

*500 – 197= 303

Journal Entries

Date	Particulars	Dr.	Cr.
1st April, 2019	No entry as initial fair value is zero		
30th June, 2019	Forward Contract Dr.	197	
	To Cash Flow Hedge Reserve (Other Equity) - OCI		197
	(Being Change in Fair Value of Hedging Instrument recognised in OCI accumulated in a separate component in Equity)		
30th September, 2019	Forward Contract Dr.	303	
	To Cash Flow Hedge Reserve (Other Equity) - OCI		303
	(Being change in fair value of the hedging instrument recognised in OCI)		
30th September, 2019	Bank/Cash/Trade Receivable Dr.	7,200	
	To Revenue from Contracts with Customers		7,200
	(Being sale of 100 kgs. of copper for USD 100 recognised at spot rate of ₹ 72 for USD 1)		
30th September, 2019	Cash Flow Hedge Reserve (Other Equity) - OCI Dr.	500	
	To Revenue from Contracts with Customers		500
	(Being fair value change in forward contract reclassified to profit and loss and recognised in the line item affected by the hedge item)		
30th September, 2019	Bank / Cash Dr.	500	
	To Forward Contract		500

4.8 Computation of investment in Associates as per Equity Method in CFS

Building & Co. Ltd.'s interest in Highway Ltd. at the end the year is calculated as follows:

		₹ in crore
Value of investment in Highway Ltd. as appearing in CFS		4.00
Less:	Building & Co. Ltd.'s share Highway Ltd.'s loss (40% x ₹ 2 crore)	(0.80)
Less:	Elimination of dividend received by Building & Co. Ltd. from Highway Ltd. (40% x ₹ 0.80 lakh)	(0.32)
Less:	Unrealised gain (no deduction required from Associate share of profit as it is a downstream transaction	Nil
Building & Co. Ltd.'s interest in Highway Ltd. at the end of the year under the equity method		(2.88)

Case Study 5.

New Age Technology Limited is an IT infrastructure Company which provides customize IT solutions to its customers.

During the current year ended 31st March, 2020, New Age Technology Limited has made investment in two entities namely ERP Solutions Limited engaged in the business of ERP solutions development and Cloud Equipments Limited engaged in the business of computer hardware related trading activities. New Age Technology Limited holds 45% of equity share capital of ERP solutions Limited and 60% of equity share capital of Cloud Equipments Limited.

The net aggregate value of identifiable assets and liabilities, as measured in accordance with Ind AS 103 for ERP solutions Limited and Cloud Equipments Limited is determined as ₹ 45 lakhs and ₹ 30 lakhs respectively.

During the year New Age Technology Limited issued additional shares on 31st March, 2020. Cost associated with the issue of equity were ₹ 50,00,000 and recorded directly in equity. Under Indian tax laws, deduction can be claimed over five year period from the date of share issue. Assuming a tax rate of 30%.

New Age Technology Limited acquired copyrights for certain patented software on 1st April, 2018 for ₹ 50,00,000. The software would assist the Company to develop an entire new range of IT solutions to its customers. Management basis its internal assessment, determined the useful life of the acquired software to be 10 years from the date of purchase. Further management performed a fair value assessment of the acquired software and determined it to be ₹ 48,00,000 as at 31st March, 2019 and ₹ 43,00,000 as at 31st March, 2020.

New Age Technology Limited is engaging with several investors to invest funds into the Company. As part of the negotiations several instruments are being considered depending on the yield each instrument would provide to the investor. New Age Technology Limited enters into a barter transaction to exchange its existing server for new high-end laptop with its vendor, Sunshine Limited. The server has a fair value of ₹ 2,00,000 and a carrying amount of ₹ 1,75,000. Whereas, the high-end laptop has a fair value of ₹ 2,50,000 and carrying amount of ₹ 2,10,000 in the books of Sunshine Limited.

The Company has taken a particular application software of a supplier namely, Crystal Systems Limited, which is available on a cloud infrastructure managed and controlled by the Crystal Systems Limited. The Company contracts to pay a fee of ₹ 5,00,000 per month in exchange for a right to receive access to the Crystal Systems Limited's application software for 2 years. The Company accesses the software on need basis over the internet. The contract does not convey any rights to New Age Technology Limited over the tangible assets of the Crystal Systems Limited.

New Age Technology Limited has entered into following Share Based payment transactions:

(i) On 1st April, 2019, New Age Technology Limited decided to grant share options to its employees. The scheme was approved by the employees on 30th June, 2019. New Age Technology Limited determined the fair value of the share options to be the value of the equity shares on 1st April, 2019.

(ii) On 1st April, 2019, New Age Technology Limited entered into a contract to purchase IT equipment from Bombay Software Limited and agreed that the contract will be settled by issuing equity instruments of New Age Technology Limited. New Age Technology Limited received the IT equipment on 30th July, 2019. The share-based payment transaction was measured based on the fair value of 'the equity instruments as on 1st April, 2019.

(iii) On 1st April, 2019, New Age Technology Limited decided to grant the share options to its employees. The scheme was approved by the employees on 30th June, 2019. The issue of the share options was however subject to the same being approved by the shareholders in a general meeting. The scheme was approved in the general meeting held on 30th September, 2019. The fair value of the equity instruments for measuring the share-based payment transaction was taken on 30th September, 2019.

You have to resolve the following issues:

Select the correct option for Q. 5.1 - Q. 5.5

5.1. The Chief Accountant of New Age Technology Limited wants to evaluate which of the investee entity of the Company will be eligible for consolidation. As per the requirements of Ind AS 110, which of the following is not a condition to determine whether an investor controls an investee?

(A) *Investor has right to participate in the operating and financial decisions of the investee.*

(B) *Investor has Power over the investee that gives him current ability to direct relevant activities.*

(C) *Investor has exposure, or rights, to variable returns from its involvement with the investee.*

(D) *Investor has ability to use its power over the investee to affect the amount of the investor's returns.* *(2 Marks)*

5.2. *What would be the amount of Deferred Tax Asset or Liability that the Company should recognize as on 31st March, 2020 on the cost incurred on the issue of equity shares during the year?*

(A) *No DTA or DTL should be recognized*

(B) *DTA of ₹ 15,00,000*

(C) *DTL of ₹ 15,00,000*

(D) *DTA of ₹ 50,00,000* *(2 Marks)*

5.3. *What would be carrying amount of the acquired software in the books of accounts of New Age Technology Limited as at 31st March, 2020?*

(A) *₹ 43,00,000*

(B) *₹ 45,00,000*

(C) *₹ 40,00,000*

(D) *₹ 48,00,000* *(2 Marks)*

5.4. *New Age Technology Limited has taken loan from a bank which as debt to equity ratio as one of its financial covenants. Any new fund raise could have a direct implication on the covenants of existing loans. Therefore, the CFO wants to understand which amongst the following instruments is an equity instrument as per Ind AS 32 'Financial Instruments: Presentation'?*

(A) *Non-redeemable preference shares with payment of dividend at market rates.*

(B) *Preference shares redeemable at the option of the issuer with payment of dividend at the discretion of the issuer.*

(C) *Preference shares redeemable at the option of the holder with payment of dividend at the discretion of the issuer.*

(D) *Preference shares redeemable at the option of the holder with payment of dividend at market rates.* *(2 Marks)*

5.5. *At what value should New Age Technology Limited record the high-end laptop purchased in exchange of its existing server in its books of accounts?*

(A) ₹ 2,00,000

(B) ₹ 1,75,000

(C) ₹ 2,50,000

(D) ₹ 2,10,000 *(2 Marks)*

5.6. *The Chief Accountant of the Company wants to understand what possible options are available to the Company in order to account for the Non controlling interest (NCI) in the acquisition of Cloud Equipments Limited. Assist him in making the journal along with amounts of resultant goodwill under the option available.* *(5 Marks)*

5.7. *The Chief Accountant of New Age Technology Limited has sought your advice, whether the IT should account for this transaction for use of software with Crystal Systems Limited in terms of Ind AS 116 leases for an intangible asset in terms of Ind AS 38 'Intangible Assets'. Help him to understand your assessment.* *(4 Marks)*

5.8. *Identify the grant date and measurement date in all the 3 cases of Share based payment transactions entered into by New Age Technology Limited, supported by appropriate rationale for the determination?* *(6 Marks)*

Answer to Case Study 5

5.1 Option (A) : Investor has right to participate in the operating and financial decisions of the investee

5.2 Option (B) : DTA of ₹ 15,00,000

5.3 Option (A) : ₹ 43,00,000

5.4 Option (B) : Preference shares redeemable at the option of the issuer with payment of dividend at the discretion of the issuer.

5.5 Option (A) : ₹ 2,00,000

5.6 For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest that give the holder ownership interest in the acquiree at either:

(a) Fair value or

(b) The present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets

The value of goodwill will be different under both the methods.

Journal Entries

Fair value method		₹ in crore	
		Dr.	Cr.
Net identifiable assets	Dr.	30	
Goodwill (balancing figure)	Dr.	?	
To Cash			?
To Non-controlling interest			?

Proportionate share method		₹ in crore	
		Dr.	Cr.
Net identifiable assets	Dr.	30	
Goodwill (balancing figure)	Dr.	?	
To Purchase consideration			?
To Non-controlling interest 40% (30 lakhs x 40%)			12

Alternatively, it can be assumed that value of net identifiable asset is equal to fair value. In such a case the amount in both the entries will be same.

5.7 Assessment of applicability of Ind AS 38 in the given scenario

As per Ind AS 38, to be an intangible asset the asset should meet following criteria:

- Identifiability;
- Control over a Resource (Asset); and
- Existence of Future Economic Benefits.

Since Crystal Systems Limited manages and controls the application software available on a cloud infrastructure and New Age Technology Limited has limited rights to use the same. Merely right to access the application of Crystal Systems Limited, does not give New Age Technology Limited power to obtain future economic benefits flowing from the software itself. Hence, the application software should not be recognised as an asset under Ind AS 38.

Assessment of applicability of Ind AS 116 in the given scenario

At the inception of a contract, an entity shall assess whether the contract is or contains a lease. For the purpose, a lease is defined as a contract, or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This right to control the asset throughout the period of use is emphasized ONLY if the customer has both (i) right to obtain substantially all he economic benefits from the use of the identified asset, and (ii) the right to direct the use of the identified asset.

In the given case, the contract gives the New Age Technology Limited only the right to access the Crystal Systems Limited's application software over the contract term, and hence the contract is not a lease contract within the meaning of Ind AS 116.

Conclusion

The right to access the Crystal Systems Limited's application software for a price over a specified period is a service contract. If the Crystal Systems Limited pays amounts for which the services are yet to be received, then the advance payment is a prepayment and an asset for the Crystal Systems Limited.

5.8 Ind AS 102 defines grant date and measurement dates as follows:

(a) **Grant date:** The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

(b) **Measurement date:** The date at which the fair value of the equity instruments granted is measured for the purposes of this Ind AS. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

Applying the above definitions in the given scenarios following would be the conclusion based on the assumption that the approvals have been received prospectively:

Scenario	Grant date	Measurement date	Base for grant date	Base for measurement date
(i)	30th June, 2019	30th June, 2019	The date on which the scheme was approved by the employees	For employees, the measurement date is grant date

(ii)	1st April, 2019	30th July, 2019	The date when the entity and the counterparty entered a contract and agreed for settlement by equity instruments	The date when the entity obtains the goods from the counterparty
(iii)	30th September, 2019	30th September, 2019	The date when the approval by shareholders was obtained	For employees, the measurement date is grant date