

ANSWERS OF MODEL TEST PAPER 1
FINAL COURSE GROUP I
PAPER 1: FINANCIAL REPORTING
PART – I CASE SCENARIO BASED MCQS

1. **Option (b) :** 38%
2. **Option (c) :** ₹ 2,48,000; ₹ 2,28,000
3. **Option (d) :** ₹ 1,30,000
4. **Option (a) :** ₹ 2,05,00,000
5. **Option (c) :** ₹ 1,70,83,333
6. **Option (d) :** ₹ 34,16,667
7. **Option (c) :** 1.4 million EURO
8. **Option (a) :** ₹ 117.6 million
9. **Option (b) :** ₹ 4,32,573
10. **Option (b) :** ₹ 68,091
11. **Option (d) :** Since A Ltd. is not a listed entity and if X Ltd. does not object to A Ltd. for not preparing consolidated financial statements, A Ltd. will not be required to prepare CFS.
12. **Option (b) :** Since X Ltd. is not preparing CFS under Ind AS, A Ltd. is mandatorily required to prepare CFS under Ind AS
13. **Option (d) :** Even if A Ltd. is an unlisted entity, it is mandatorily required to prepare CFS
14. **Option (a) :** S Pvt. Ltd. has to mandatorily prepare its financial statements as per Ind AS
15. **Option (d) :** Automation requires ongoing training and education to keep up with the latest technology

PART – II DESCRIPTIVE QUESTIONS

1. Statement showing Cost of production line:

Particulars	Amount ₹'000
Purchase cost	10,000
Goods and services tax – recoverable goods and services tax not included	-
Employment costs during the period of getting the production line ready for use (1,200 x 2 months / 3 months)	800
Other overheads – abnormal costs	600
Payment to external advisors – directly attributable cost	500
Dismantling costs – recognized at present value where an obligation exists (2,000 x 0.68)	1,360
Total	13,260

Carrying value of production line as on 31st March, 20X2:

Particulars	Amount ₹ '000
Cost of Production line	13,260
Less: Depreciation (W.N.1)	(1,694)
Net carrying value carried to Balance Sheet	11,566

Provision for dismantling cost:

Particulars	Amount ₹ '000
Non-current liabilities	1,360
Add: Finance cost (WN3)	57
Net book value carried to Balance Sheet	1,417

Extract of Statement of Profit & Loss

Particulars	Amount ₹ '000
Depreciation (W.N.1)	1,694
Finance cost (W.N.2)	57
Amounts carried to Statement of Profit & Loss	1,751

Extract of Balance Sheet

Particulars	Amount ₹ '000
Assets	
Non-current assets	
Property, plant and equipment	11,566
Equity and liabilities	
Non-current liabilities	
Other liabilities	
Provision for dismantling cost	1417

Working Notes:**1. Calculation of depreciation charge**

Particulars	Amount ₹ '000
In accordance with Ind AS 16 the asset is split into two depreciable components: Out of the total capitalization amount of 13,260, Depreciation for 3,000 with a useful economic life (UEL) of four years ($3,000 \times \frac{1}{4} \times 10/12$). This is related to a major overhaul to ensure that it generates economic benefits for the second half of its useful life	625
For balance amount, depreciation for 10,260 with an useful economic life (UEL) of eight years will be: $10,260 \times \frac{1}{8} \times 10/12$	1,069
Total (To Statement of Profit & Loss for the year ended 31 st March 20X2)	1,694

2. Finance costs

Particulars	Amount ₹ '000
Unwinding of discount (Statement of	57

Profit and Loss – finance cost) 1,360 x 5% x 10/12	
To Statement of Profit & Loss for the year ended 31 st March 20X2	57

2. Consolidated Balance Sheet of PN Ltd. and its subsidiary SR Ltd.

as at 31 March 20X2

Particulars	Note No.	₹
I. Assets		
1. Non-current assets		
(i) Property, Plant & Equipment	1	26,83,200
(ii) Goodwill	2	89,402
2. Current Assets		
(i) Inventories	3	5,34,800
(ii) Financial Assets		
(a) Trade Receivables	4	3,11,300
(b) Cash & Cash equivalents	5	<u>70,100</u>
Total Assets		<u>36,88,802</u>
II. Equity and Liabilities		
1. Equity		
(i) Equity Share Capital	6	15,60,000
(ii) Other Equity	7	11,39,502
2. Non-controlling Interest (W.N.3)		5,07,300
3. Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	2,12,400
(b) Short term borrowings	9	<u>2,69,600</u>
Total Equity & Liabilities		<u>36,88,802</u>

Notes to accounts

			₹
1.	Property, Plant & Equipment		
	Land & Building	13,41,600	
	(4,68,000+5,61,600+3,12,000)	<u>13,41,600</u>	26,83,200
2.	Plant & Machinery (W.N.5)		89,402
3.	Goodwill (W.N.4)		
	Inventories	3,74,400	
	PN Ltd.	<u>1,60,400</u>	5,34,800
4.	SR Ltd. (1,13,600 +46,800)		
	Trade Receivables	1,86,500	
	PN Ltd.	<u>1,24,800</u>	3,11,300
5.	SR Ltd.		
	Cash & Cash equivalents	45,200	
	PN Ltd.	<u>24,900</u>	70,100
8.	SR Ltd.		
	Trade Payables	1,46,900	
	PN Ltd.	<u>65,500</u>	2,12,400
9.	SR Ltd. (34,300 + 31,200)		
	Short-term borrowings	2,49,600	
	PN Ltd.	<u>20,000</u>	2,69,600
	SR Ltd.		

Statement of Changes in Equity:

6. Equity share Capital

Balance at the beginning of the reporting period ₹	Changes in Equity share capital during the year ₹	Balance at the end of the reporting period ₹
15,60,000	0	15,60,000

7. Other Equity

	Reserves & Surplus			Total ₹
	Capital reserve ₹	Retained Earnings ₹	Other Reserves ₹	
Balance at the beginning of the reporting period	0	0	9,36,000	9,36,000
Total comprehensive income for the year	0	1,78,400	0	1,78,400
Dividends	0	(52,416)	0	(52,416)
Total comprehensive income attributable to parent (W.N.2)	0	77,518	0	77,518
Gain on Bargain purchase	0	<u>0</u>	<u>0</u>	<u>0</u>
Balance at the end of reporting period	0	<u>2,03,502</u>	<u>9,36,000</u>	<u>11,39,502</u>

Working Notes:

1. Adjustments of Fair Value

The Plant & Machinery of SR Ltd. would stand in the books at ₹ 4,44,600 on 1 October 20X1, considering only six months' depreciation on ₹ $\left(\frac{4,21,200}{90\%}\right) = 4,68,000$;

total depreciation being ₹ $4,68,000 \times 10\% \times \frac{6}{12} = 23,400$.

Being the fair value of the asset ₹ 6,24,000, there is an appreciation to the extent of ₹ 1,79,400 (₹ 6,24,000 – ₹ 4,44,600).

Acquisition date profits of SR Ltd.

₹

Reserves on 1.4.20X1	3,12,000
Profit & Loss Account Balance on 1.4.20X1	93,600
Profit for 20X1-20X2: Total [₹2,55,800 - (93,600 - 74,880)] x 6/12 i.e. ₹ 1,18,540 upto 1.10.20X1	1,18,540
Total Appreciation	<u>5,07,000*</u>
Total	<u>10,31,140</u>
Holding Co. Share (70%)	7,21,798
NCI	3,09,342

*Appreciation = Land & Building ₹ 3,12,000 + Inventories ₹ 46,800 + Plant & Machinery ₹ 1,79,400 – Trade Payables (₹ 31,200) = ₹ 5,07,000

2. Post-acquisition profits of SR Ltd.

₹

Profit after 1.10.20X1 [2,55,800 - (93,600-74,880)] x 6/12	1,18,540
Less: 10% depreciation on ₹6,24,000 for 6 months less depreciation already charged for 2 nd half of 20X1-20X2 on ₹4,68,800 (ie 31,200-23,400)	<u>(7,800)</u>
Total	<u>1,10,740</u>
Share of holding Co. (70%)	77,518
Share of NCI (30%)	33,222

3. Non-controlling Interest

₹

Par value of 1872 shares	1,87,200
Add: 30% Acquisition date profits [(10,31,140 – 74,880) x 30%]	2,86,878
	<u>33,222</u>
30% Post-acquisition profits [W.N.2]	<u>5,07,300</u>

4. Goodwill

₹

Amount paid for 4,368 shares		12,48,000
Less : Par value of shares	4,36,800	
Acquisition date profits-share of PN Ltd. (W.N.1)	<u>7,21,798</u>	<u>(11,58,598)</u>
Goodwill		<u>89,402</u>

5. Value of Plant & Machinery:

₹

PN Ltd.		7,48,800
SR Ltd.	4,21,200	
Add: Appreciation on 1.10.20X1	<u>1,79,400</u>	
	6,00,600	
Add: Depreciation for 2nd half charged on pre-revalued value	23,400	
Less: Depreciation on ₹ 6,24,000 for 6 months	<u>(31,200)</u>	<u>5,92,800</u>
		<u>13,41,600</u>

6. Consolidated Profit & Loss account

₹

PN Ltd. (as given)	1,78,400	
Less: Dividend	<u>(52,416)</u>	1,25,984
Share of PN Ltd. in post-acquisition profits (W.N.2)		<u>77,518</u>
		<u>2,03,502</u>

3. (a) Balance Sheet as at 31st March, 20X2 (Extracts)

Financial Assets:

₹

Interest rate option (W.N.1)	15,250
6% Debentures in Fox Ltd. (W.N.2)	1,53,000
Shares in Cox Ltd. (W.N.3)	1,87,500

Statement of Profit and Loss (Extracts)

Finance Income:

Gain on interest rate option (W.N.1)	5,250
Effective interest on 6% Debentures (W.N.2)	12,000

Working Notes:

1. Interest rate option

This is a derivative and so it must be treated as at fair value through profit or loss

Particulars	₹	₹
<i>Initial measurement (at cost)</i>		
Financial Asset Dr.	10,000	
To Cash A/c		10,000

At 31st March, 20X2

Particulars	₹	₹
<i>(Re-measured to fair value)</i>		
Financial Asset (₹ 15,250 - ₹10,000) Dr.	5,250	
To Profit and loss A/c		5,250

Financial Assets (₹10,000 + ₹5,250) = ₹ 15,250 (Balance Sheet)

Gain on interest option = ₹ 5,250 (Statement of Profit and Loss)

2. Debentures

On the basis of information provided, this can be treated as a held-to-maturity investment

Particulars	₹	₹
<i>Initial measurement (at cost)</i>		
Financial Asset Dr.	1,50,000	
To Cash A/c		1,50,000

At 31st March, 20X2 (Amortized cost)

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

Amortized cost at 31st March, 20X2

(₹ 150,000 + ₹ 12,000 – ₹ 9,000) = ₹ 153,000 (Balance Sheet)

Effective interest on 6% debenture = ₹ 12,000 (Statement of Profit and Loss)

3. Shares in Cox Ltd.

These are treated as an available for sale financial asset (shares cannot normally be held to maturity and they are clearly not loans or receivables)

Particulars	₹	₹
<i>Initial measurement (at cost)</i>		
Financial Asset (₹ 50,000 x ₹3.50) Dr.	1,75,000	
To Cash A/c		1,75,000

At 31st March, 20X2 (Re-measured at fair value)

Particulars	₹	₹
Financial Asset Dr.	12,500	
[(₹ 50,000 x 3.75) – 1,75,000]		
To Equity A/c		12,500

Shares in Cox Ltd (₹ 1,75,000 + ₹ 12,500) = ₹ 1,87,500 (Balance Sheet)

- (b) As per Ind AS 36, the revised carrying amount of asset ASSOTA would be ₹ 6,50,000.

The tax base of asset ASSOTA is given as ₹ 8,00,000.

Carrying base of asset = ₹ 6,50,000

Tax base of asset = ₹ 8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of ₹1,50,000 (₹8,00,000 – ₹6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be ₹1,50,000 x 30% = ₹45,000.

4. (a) (i) Points earned on ₹ 10,00,000 @ 10 points on every ₹ 500
= [(10,00,000 / 500) x 10] = 20,000 points.

Value of points = 20,000 points x ₹ 0.5 each point = ₹ 10,000

Revenue recognized for sale of goods	₹ 9,90,099	[10,00,000 x (10,00,000/10,10,000)]
Revenue for points deferred	₹ 9,901	[10,00,000 x (10,000/10,10,000)]

Journal Entry

		₹	₹
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,90,099
To Liability under Customer Loyalty programme			9,901

- (ii) Points earned on ₹ 50,00,00,000 @ 10 points on every ₹ 500 = [(50,00,00,000/500) x 10] = 1,00,00,000 points.

Value of points

= 1,00,00,000 points x ₹ 0.5 each point = ₹ 50,00,000

Revenue recognized for sale of goods

= ₹ 49,50,49,505 [50,00,00,000 x (50,00,00,000/ 50,50,00,000)]

Revenue for points

= ₹ 49,50,495 [50,00,00,000 x (50,00,000/ 50,50,00,000)]

Journal Entry in the year 20X1

		₹	₹
Bank A/c	Dr.	50,00,00,000	
To Sales A/c			49,50,49,505
To Liability under Customer Loyalty programme			49,50,495
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	42,11,002	
To Sales A/c			42,11,002
(On redemption of (100 lakhs -18 lakhs) points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year

= 18,00,000 x 80% = 14,40,000 points

Total points to be redeemed within 2 years

= [(1,00,00,000-18,00,000) + 14,40,000] = 96,40,000

Revenue to be recognised with respect to discounted point

= 49,50,495 x (82,00,000/96,40,000) = 42,11,002

(iii) Revenue to be deferred with respect to undiscounted point in 20X1-20X2 = 49,50,495 – 42,11,002 = 7,39,493

(iv) In 20X2-20X3, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 60% = 10,80,000 points

Total points discounted till date

= 82,00,000 + 10,80,000 = 92,80,000 points

Revenue to be recognized in the year 20X2-20X3 = $[(49,50,495 \times (92,80,000 / 96,40,000)) - 42,11,002] = ₹ 5,54,620$.

Liability under Customer Loyalty Programme To Sales A/c (On redemption of further 10,80,000 points)	Dr. ₹ 5,54,620	₹ 5,54,620
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The Liability under Customer Loyalty programme at the end of the year 20X2-20X3 will be ₹ 7,39,493 – ₹ 5,54,620 = ₹ 1,84,873.

(v) In the year 20X3-20X4, the merchant will recognize the balance revenue of ₹ 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Liability under Customer Loyalty programme To Sales A/c (On redemption of balance points)	Dr. ₹ 1,84,873	₹ 1,84,873
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(b)

Either

As per paragraph 9 of Ind AS 24, Related Party Disclosures, “Key management personnel are those persons having authority and

responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.”

Accordingly, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per paragraph 7 and 9 of Ind AS 19, ‘Employee Benefits’, an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.

Paragraph 17 of Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity shall disclose key management personnel compensation in total i.e. disclosure of directors’ fee of (₹ 10,00,000 + ₹ 7,50,000) ₹ 17,50,000 is to be made as employees benefits (under various categories).

Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

Or

- (i) The land and government grant should be recognized by A Ltd. at fair value of ₹ 12,00,000 and this government grant

should be presented in the books as deferred income. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. Land will be shown in the financial statements at ₹ 1)

- (ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.
- (iii) ₹ 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.
- (iv) ₹ 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 1,00,000 [₹ 10 lakh/10 years] should be credited to profit and loss each year over period of 10 years. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. The machinery will be recognised at ₹ 70 lakh (₹ 80 lakh - ₹ 10 lakh). Reduced depreciation will be charged to the Statement of Profit or Loss.
- (v) As per para 12 of Ind AS 20, the entire grant of ₹ 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance

that U Ltd. will comply with the conditions attached to the grant.

5. (a) Allocation of proceeds of the bond issue:

Liability component (W.N.1)	₹ 18,47,720
Equity component	<u>₹ 1,52,280</u>
	<u>₹ 20,00,000</u>

The liability and equity components would be determined in accordance with Ind AS 32. These amounts are recognised as the initial carrying amounts of the liability and equity components. The amount assigned to the issuer conversion option equity element is an addition to equity and is not adjusted.

Basic earnings per share Year 1:

$$\frac{\text{₹ 10,00,000}}{12,00,000} = \text{₹ 0.83 per ordinary share}$$

Diluted earnings per share Year 1:

It is presumed that the issuer will settle the contract by the issue of ordinary shares. The dilutive effect is therefore calculated in accordance with the Standard.

$$\frac{\text{₹ 10,00,000} + \text{₹ 1,66,295 (W.N.2)}}{12,00,000 + 5,00,000 \text{ (W.N.3)}} = \text{₹ 0.69 per ordinary share}$$

Working Notes:

- This represents the present value of the principal and interest discounted at 9%

$$1,20,000 \times 2.531 = \text{₹ 3,03,720}$$

$$20,00,000 \times 0.772 = \text{₹ 15,44,000}$$

$$\underline{\text{₹ 18,47,720}}$$

2. Profit is adjusted for the accretion of ₹ 1,66,295 (₹ 18,47,720 × 9%) of the liability because of the passage of time. However, it is assumed that interest @ 6% for the year has already been adjusted.
 3. 5,00,000 ordinary shares = 250 ordinary shares x 2,000 convertible bonds
- (b) This information will be incorporated into the consolidated statement of cash flows as follows:

Statement of cash flows for 20X2 (extract)	Amount	Amount
	(₹)	(₹)
Cash flows from opening activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (Note 1)	9,000	
Decrease in trade receivables (Note 2)	4,000	
Decrease in trade payables (Note 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
<i>Net cash inflow from operating activities</i>		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
<i>Net cash outflow from investing activities</i>		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	

<i>Net cash outflow from financing activities</i>	<u>(4,000)</u>
Increase in cash and cash equivalents	3,000
Cash and cash equivalents at the beginning of the year	<u>5,000</u>
Cash and cash equivalents at the end of the year	<u>8,000</u>

Working Notes:

1. Inventories

Total inventories of the Group at the end of the year	₹ 30,000
Inventories acquired during the year from subsidiary	<u>(₹ 4,000)</u>
	₹ 26,000
Opening inventory	<u>(₹ 35,000)</u>
Decrease in inventory	<u>₹ 9,000</u>

2. Trade Receivables

Total trade receivables of the Group at the end of the year	₹54,000
Trade receivables acquired during the year from subsidiary	<u>(₹8,000)</u>
	₹46,000
Opening trade receivables	<u>(₹50,000)</u>
Decrease in trade receivables	<u>₹ 4,000</u>

3. Trade Payables

Trade payables at the end of the year	₹ 68,000
Trade payables of the subsidiary assumed during the year	<u>(₹32,000)</u>
	₹ 36,000
Opening Trade payable	<u>(₹ 60,000)</u>
Decrease in Trade payables	<u>₹ 24,000</u>

6. (a) Presentation of Revenue numbers:

Ind AS 115 requires revenue to be recognized only on satisfaction of the performance obligations under the contract. It is crucial that the performance obligations be identified at the commencement of the contract, so that the trigger points for revenue recognition become identifiable.

Management would always have an incentive to present higher revenue numbers. In the given case, the fact that the COO is given an incentive for revenues and EBITDA indicates that revenue is a potential area for material misstatement, given the personal interest of the COO in the same.

The sale of fibre optic cable cannot be recognized on 31st March 20X2 as the goods are not yet transferred to the customer Ethernet Bullet Ltd.'s factory premises, which is one of the critical obligations of Astra Ltd. The contention of the COO that it takes merely a few minutes to shift the goods, and hence the sale can be recognized does not hold true. One can always cross-question as to why the movement of goods did not happen if it was merely a few minutes job. It could be a possibility that the goods may not be packed, or there may still be some pending inspection of the goods before transferring the same etc. In view of this, the performance obligation under this contract has not been completed, and hence booking the revenue has resulted in an overstatement of revenue by ₹ 2 crores, and a consequent inflation of profits, assuming that Astra Ltd. is making profit on this sale transaction. Additionally, booking this sale has resulted in an understatement of inventory as at the reporting date of 31st March 20X2.

In view of the above, multiple conflicts of interest arise for Ms. Suparna Dasgupta:

- Pressure to present favourable revenue figures and chartered accountant's personal circumstances.

- The chartered accountant is under pressure to present favourable numbers, notably in favour of the COO, thereby increasing the incentives to the COO, and in turn benefiting with the continued job prospects. Thus, the ethical and professional standards required of the accountant are at odds with the pressures of her personal circumstances.

Duty to stakeholders

The directors have a duty to act in the best interests of the company's stakeholders. While higher revenue numbers do indicate a good growth trajectory of the company, recognizing the revenue before fulfilling the performance obligations, or incorrectly booking grant income as revenue, results in misleading the stakeholders about the actual performance of the entity, thereby actually becoming detrimental to the stakeholders.

Ethical principles guiding the chartered accountant's response

By exhibiting bias in reporting higher revenue figures due to the risk of losing the job, objectivity stands compromised. Knowingly disclosing incorrect information compromises integrity, and erring in complying with Ind AS requirements, though continuing to report so in the financial statements, results in displaying absence of professional competence.

Appropriate action

In the given case, the chartered accountant faces an ethical dilemma, and must apply her moral and ethical judgment. As a professional, she is responsible for presenting the truth, and to avoid indulging in 'creative accounting practices' due to pressure.

The chartered accountant accordingly must put the interests of the company and professional ethics first and insist that the financial statements represent correct revenue numbers, in compliance with the relevant Ind AS. Being an advisor to the directors, she must prevent deliberate misrepresentation / fraudulent financial reporting, regardless of the personal consequences. The accountant should not allow any undue

influence from the directors to override her professional judgment or integrity. This is in the long-term interests of the company,

Further, knowingly providing incorrect information is regarded as professional misconduct. To prevent such misconduct, the chartered accountant should not sign off on the financial statements containing incorrect financial information. By adhering to the ethical principles, the chartered accountant will maintain her professional integrity and contribute to the trust and reliability placed in the work expected from her.

However, if she signs the financial statements containing the inflated revenue numbers, Ms. Suparna Dasgupta would be guilty of professional misconduct under Clause I of Part II of Second Schedule to the Chartered Accountants Act, 1949. The Clause states that a member of the Institute, whether in practice or not, shall be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder, or any guidelines issued by the Council. As per the Council guidelines, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

(b) For 80,000 share-based options vested before transition date:

Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments **that vested before the date of transition to Ind AS**. Hence, Nuogen Ltd. may opt for the exemption given in Ind AS 101 for 80,000 share options vested before the transition date. However, since no earlier accounting was done for these share-based options under previous GAAP too, therefore this led to an error on the transition date, as detected on the reporting date i.e. 31st March, 20X4. Hence, being an error, no exemption could be availed by Nuogen Ltd. on transition date with respect to Ind AS 102.

While preparing the financial statements for the financial year 20X3-20X4, an error has been discovered which occurred in the year 20X1-20X2, i.e., for the period which was earlier than earliest prior period presented. The error should be corrected by restating the opening balances of relevant assets and/or liabilities

and relevant component of equity for the year 20X2-20X3. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2).

Accordingly, on retrospective calculation of Share based options with respect to 80,000 options, Nuogen Ltd. will create 'Share based payment reserve (equity)' by ₹ 16,00,000 and correspondingly adjust the same through Retained earnings.

For 40,000 share-based options to be vested on 31st March, 20X5:

Since share-based options have not been vested before transition date, no option as per Ind AS 101 is available to Nuogen Ltd. The entity will apply Ind AS 102 retrospectively. However, Nuogen Ltd. did not account for the same at the grant date. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2). Adjustment is to be made by recognising the 'Share based payment reserve (equity)' and adjusting the retained earnings by ₹ 2,00,000.

Further, expenses for the year ended 31st March, 20X3 and share based payment reserve (equity) as at 31st March, 20X3 were understated because of non-recognition of 'employee benefits expense' and related reserve. To correct the above errors in the annual financial statements for the year ended 31st March, 20X4, the entity should restate the comparative amounts (i.e., those for the year ended 31st March, 20X3) in the statement of profit and loss. In the given case, 'Share based payment reserve (equity)' would be credited by ₹ 2,00,000 and 'employee benefits expense' would be debited by ₹ 2,00,000

For the year ending 31st March, 20X4, 'Share based payment reserve (equity)' would be credited by ₹ 2,00,000 and 'employee benefits expense' would be debited by ₹ 2,00,000.

Working Note:

Period	Lot	Proportion	Fair value	Cumulative expenses	Expenses
		a	b	d= b x a	e = d-previous period d
20X1-20X2	1 (1-year vesting period)	1/1	16,00,000	16,00,000	16,00,000
20X1-20X2	2 (4-year vesting period)	1/4	8,00,000	2,00,000	2,00,000
20X2-20X3	2 (4-year vesting period)	2/4	8,00,000	4,00,000	2,00,000
20X3-20X4	2 (4-year vesting period)	3/4	8,00,000	6,00,000	2,00,000

ANSWERS OF MODEL TEST PAPER 2

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

ANSWER TO PART – I CASE SCENARIO BASED MCQS

1. **Option (d)** : Provision for ₹ 50 crores
2. **Option (a)** : ₹ 48,753
3. **Option (b)** : ₹ 1.75 crores
4. **Option (c)** : ₹ 0.03 crores
5. **Option (c)** : ₹ 20,00,000 goodwill
6. **Option (d)** : The first Ind AS financial statements shall distinguish the correction of errors from changes in accounting policies and reported as part of the reconciliations as at 1st April, 20X2.
7. **Option (a)** : 4 performance obligations
8. **Option (d)** : ₹ 40 lakhs
9. **Option (d)** : Issuance of equity shares ₹ 40 lakhs; dividends paid ₹ 10 lakhs
10. **Option (d)** : Advertising costs ₹ 40 lakhs; staff bonuses ₹ 60 lakhs
11. **Option (c)** : Annual depreciation charge will be ₹ 13,000 and an annual transfer of ₹ 3,000 may be made from revaluation surplus to retained earnings.
12. **Option (d)** : ₹ Nil
13. **Option (b)** : Interest expense ₹ 12,000
14. **Option (d)** : ₹ 36 lakhs
15. **Option (d)** : All of the above

ANSWERS OF PART – II DESCRIPTIVE QUESTIONS

1. **Calculation of purchase consideration:**

Particulars	₹ in million
Market value of shares issued (150 million x 4/3 x ₹ 10)	2,000

Initial estimate of market value of shares to be issued (150 million x 1/5 x ₹ 10)	300
Incremental acquisition costs other than the issue cost of shares	<u>1</u>
Total consideration	<u>2,331</u>

Contingent consideration is recognized in full if payment is probable. Incremental costs associated with the acquisition, other than the issue costs of financial instruments, can be included in the cost of the investment. Where material, future consideration is measured at the present value of the amount payable. In the case of shares to be issued, this is represented by the share price.

Statement of fair value of identifiable net assets at the date of acquisition

Particulars	₹ in million
As per B Ltd.'s Balance Sheet	1,200
Fair value of customer relationships	100
Fair value of research and development project	<u>50</u>
Total net assets acquired	<u>1,350</u>

As per *Ind AS 38 'Intangible assets'*, intangible assets can be recognized separately from goodwill provided they are identifiable, are under the control of the acquiring entity, and their fair value can be measured reliably.

Customer relationships that are similar in nature to those previously traded, pass these tests but employee expertise fails the 'control' test. Both the research and development phases in process project can be capitalised provided their fair value can be measured reliably.

Statement of computation of goodwill

Particulars	₹ in million
Fair value of consideration given	2,331
Fair value of net assets acquired	<u>(1,350)</u>
Goodwill on acquisition	<u>981</u>

As per para 58 of Ind AS 103, changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date are

measurement period adjustments to be dealt with in accordance with paragraphs 45–49.

As per para 48 of Ind AS 103, the acquirer recognises an increase (decrease) in the amount by means of a decrease (increase) in goodwill.

Accordingly, the changes in the fair value of contingent consideration is recorded as an adjustment to goodwill as follows:

Goodwill	Dr.	₹ 30 million
To Contingent consideration		₹ 30 million

2. (a) The USD contract for purchase of machinery entered into by company A includes an embedded foreign currency derivative due to the following reasons:
 - The host contract is a purchase contract (non-financial in nature) that is not classified as or measured at FVTPL.
 - The embedded foreign currency feature (requirement to settle the contract by payment of USD at a future date) meets the definition of a stand-alone derivative – it is akin to a USD-₹ forward contract maturing on 31 December 20X1.
 - USD is not the functional currency of either of the substantial parties to the contract (i.e., neither company A nor company B).
 - Machinery is not routinely denominated in USD in commercial transactions around the world. In this context, an item or a commodity may be considered ‘routinely denominated’ in a particular currency only if such currency was used in a large majority of similar commercial transactions around the world. For example, transactions in crude oil are generally considered routinely denominated in USD. A transaction for acquiring machinery in this illustration would generally not qualify for this exemption.
 - USD is not a commonly used currency for domestic commercial transactions in the economic environment in which either company A or B operate. This exemption generally applies when the business practice in a particular economic environment is to use a more stable or liquid foreign currency (such as the USD), rather than the local currency, for a majority of internal or cross-border transactions, or both. In the illustration above, companies

A and B are companies operating in India and the purchase contract is an internal/domestic transaction. USD is not a commonly used currency for internal trade within this economic environment and therefore the contract would not qualify for this exemption.

Accordingly, company A is required to separate the embedded foreign currency derivative from the host purchase contract and recognise it separately as a derivative.

The separated embedded derivative is a forward contract entered into on 9th September 20X1, to exchange USD 10,00,000 for ₹ at the USD/₹ forward rate of 67.8 on 31st December 20X1. Since the forward exchange rate has been deemed to be the market rate on the date of the contract, the embedded forward contract has a fair value of zero on initial recognition.

Subsequently, company A is required to measure this forward contract at its fair value, with changes in fair value recognised in the statement of profit and loss. The following is the accounting treatment at quarter-end and on settlement:

Accounting treatment:

Date	Particulars	Amount (₹)	Amount (₹)
09-Sep-X1	<i>On initial recognition of the forward contract</i> (No accounting entry recognised since initial fair value of the forward contract is considered to be nil)	Nil	Nil
30-Sep-X1	<i>Fair value change in forward contract</i> Derivative asset (company B) Dr. [(67.8-67.5) x 10,00,000] To Profit or loss	3,00,000	3,00,000
31-Dec-X1	<i>Fair value change in forward contract</i> Forward contract asset (company B) Dr.	5,00,000	

31-Dec-X1	[(67.8-67) x 10,00,000] - 3,00,000]		
	To Profit or loss		5,00,000
	Recognition of machinery acquired and on settlement		
	Property, plant and equipment Dr. (at forward rate)	6,78,00,000	
	To Forward contract asset (company B)		8,00,000
	To Creditor (company B) / Bank		6,70,00,000

- (b) (i) Ind AS 1, inter alia, provides, “An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.” In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March, 20X2, the loan will be classified as current.
- (ii) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March, 20X2, the loan will retain its classification as non-current.
3. (a) Applying paragraph 17 of Ind AS 23 to the fact pattern, the entity would not begin capitalising borrowing costs until it incurs borrowing costs (i.e. from 1st July, 20X1)
- In determining the expenditures on a qualifying asset to which an entity applies the capitalisation rate (paragraph 14 of Ind AS 23), the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings. Once the entity incurs borrowing costs and therefore satisfies all three

conditions in para 17 of Ind AS 23, it then applies paragraph 14 of Ind AS 23 to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.

Calculation of borrowing cost for financial year 20X0-20X1

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1 st January 20X1	₹ 5 crore	0/3	Nil

Borrowing Costs eligible for capitalisation = NIL. LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs).

Calculation of borrowing cost for financial year 20X1-20X2

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1 st January, 20X1	₹ 5 crore	9/12*	₹ 3.75 crore
30 th June, 20X1	₹ 20 crore	9/12	₹ 15 crore
31 st March, 20X2	₹ 20 crore	0/12	<u>Nil</u>
Total			<u>₹ 18.75 crore</u>

Borrowing Costs eligible for capitalisation

$$= 18.75 \text{ cr.} \times 10\% = ₹ 1.875 \text{ cr.}$$

*LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs). Accordingly, this calculation uses a capitalization period from 1st July, 20X1 to 31st March, 20X2 for this expenditure.

Calculation of borrowing cost for financial year 20X2-20X3

Expenditure		Capitalization Period (current year)	Weighted average accumulated Expenditure
Date	Amount		
1 st January, 20X1	₹ 5 crore	3/12	₹ 1.25 crore
30 th June, 20X1	₹ 20 crore	3/12	₹ 5 crore
31 st March, 20X2	₹ 20 crore	3/12	₹ 5 crore
31 st March, 20X2	₹ 1.875 crore	3/12	₹ 0.47 crore
30 th June, 20X2	₹ 5 crore	0/12	Nil
Total			<u>₹ 11.72 crore</u>

Borrowing Costs eligible for capitalisation= ₹ 11.72 cr. x 10% = ₹ 1.172 cr.

(b) Computation of amounts to be recognized in the P&L and OCI:

Particulars	USD	Exchange rate	₹
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	45	47,700
Interest income to be recognized in P & L			4,200
Exchange gain on the principal amount [1,000 x (45-40)]			5,000
Exchange gain on interest accrual [100 x (45 - 42)]			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI [45 x (1,060 - 1,041)]			855

Journal entry to recognize gain/loss

Bond (₹ 47,700 – ₹ 40,000)	Dr.	7,700	
Bank (Interest received)	Dr.	2,655	
To Interest Income (P & L)			4,200
To Exchange gain (P & L)			5,300
To OCI (fair value gain)			855

4. (a) (i) **Computation of benefit attributed to prior years and current year:** Amount in ₹

Year	1	2	3	4	5
Benefit attributed to:					
- Prior years	-	131	262	393	524
- Current year (Refer W.N.1)	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>
Total (i.e. current and prior years)	<u>131</u>	<u>262</u>	<u>393</u>	<u>524</u>	<u>655</u>

- (ii) **Computation of the obligation for an employee who is expected to leave at the end of year 5 (taking discount rate of 10% p.a.)** Amount in ₹

Year	1	2	3	4	5
Opening obligation (A)	-	89	196	324	475
Interest at 10% (B = A X 10%)	-	9	20	32	47
Current service cost (C) (Refer WN 2)	<u>89</u>	<u>98</u>	<u>108</u>	<u>119</u>	<u>131</u>
Closing obligation D = (A+B+C)	<u>89</u>	<u>196</u>	<u>324</u>	<u>475</u>	<u>653</u>

Figures have been rounded off in the above table.

Working Notes:

1. A lump sum benefit is payable on termination of service and equal to 1 per cent of final salary for each year of service. The salary in year 1 is ₹ 10,000 and is assumed to increase at 7% (compound) each year.

The year on year salary would be as follows: Amount in ₹

Year	1	2	3	4	5
Salary	10,000	10,700 (10,000 x 107%)	11,449 (10,700 x 107%)	12,250 (11,449 x 107%)	13,108 (12,250 x 107%)

Accordingly, for the purpose of above-mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

2. Computation of current service cost: Amount in ₹

Year	1	2	3	4	5
1% salary at the end of year 5	-	-	-	-	131
PV factor at the end of each year to be considered at 10% p.a. (E)	0.683	0.751	0.826	0.909	1.000
PV at the end of each year	89 (131 x E)	98 (131 x E)	108 (131 x E)	119 (131 x E)	131 (131 x E)

Accordingly, for the purpose of above-mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

(b) Journal entries in the books of P Ltd (without modification of service period of stock appreciation rights) (₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75

31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.25	17.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.38	15.38
31.03.20X5	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.02	17.02

Journal entries in the books of P Ltd (with modification of service period of stock appreciation rights) (₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	28.25	28.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	20.50	20.50

Working Notes:**Calculation of expenses for issue of stock appreciation rights without modification of service period**

For the year ended 31st March 20X2

= ₹ 210 x 400 awards x 75 employees x 1 year / 4 years of service

= ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years / 4 years of service -

₹ 15,75,000 previously recognised

= ₹ 33,00,000 - ₹ 15,75,000 = ₹ 17,25,000

For the year ended 31st March 20X4

= ₹ 215 x 400 awards x 75 employees x 3 years / 4 years of service -

₹ 33,00,000 previously recognised

= ₹ 48,37,500 - ₹ 33,00,000 = ₹ 15,37,500

For the year ended 31st March, 20X5

= ₹ 218 x 400 awards x 75 employees x 4 years / 4 years of service - ₹ 48,37,500 previously recognised

= ₹ 65,40,000 - ₹ 48,37,500 = ₹ 17,02,500

Calculation of expenses for issue of stock appreciation rights with modification of service period

For the year ended 31st March 20X2

= ₹ 210 x 400 awards x 75 employees x 1 year / 4 years of service

= ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years / 3 years of service

- ₹ 15,75,000 previously recognised

= ₹ 44,00,000 - ₹ 15,75,000 = ₹ 28,25,000

For the year ended 31st March 20X4

= ₹ 215 x 400 awards x 75 employees x 3 years/ 3 years of service -
₹ 44,00,000 previous recognised

= ₹ 64,50,000 - ₹ 44,00,000 = ₹ 20,50,000.

5. (a) (i) Determination of how revenue is to be recognised in the books of ABC Ltd. as per expected value method

Calculation of probability weighted sales volume

Sales volume (units)	Probability	Probability-weighted sales volume (units)
9,000	15%	1,350
28,000	75%	21,000
36,000	10%	<u>3,600</u>
		<u>25,950</u>

Calculation of probability weighted sales value

Sales volume (units)	Sales price per unit (₹)	Probability	Probability-weighted sales value (₹)
9,000	90	15%	1,21,500
28,000	80	75%	16,80,000
36,000	70	10%	<u>2,52,000</u>
			<u>20,53,500</u>

Average unit price = Probability weighted sales value/
Probability weighted sales volume

= 20,53,500 / 25,950 = ₹ 79.13 per unit

Revenue is recognised at ₹ 79.13 for each unit sold. First 10,000 units sold will be booked at ₹ 90 per unit and liability is accrued for the difference price of ₹ 10.87 per unit (₹ 90 – ₹ 79.13), which will be reversed upon subsequent sales of 15,950 units (as the question states that ABC Ltd. achieved the same number of units of sales to the customer during the year

as initially estimated under the expected value method for the financial year 20X1-20X2). For, subsequent sale of 15,950 units, contract liability is accrued at ₹ 0.87 (80 – 79.13) per unit and revenue will be deferred.

(ii) **Journal Entries in the books of ABC Ltd.**

		₹	₹
1.	Bank A/c (25,950 x ₹ 80) Dr. To Revenue A/c (25,950 x ₹ 79.13) To Liability (25,950 x ₹ 0.87) (Revenue recognised on sale of 25,950 units)	20,76,000	20,53,424 22,576
2.	Liability (1,08,700 – 86,124) Dr. To Revenue A/c [25,950x(80-79.13)] (On reversal of liability at the end of the financial year 20X1-20X2 i.e. after completion of stipulated time)	22,576	22,576

- (b) The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue.

The fair value of consideration (cash price equivalent) of the sale of goods is calculated as follows: ₹

Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333

End of 1 st year	3,33,333	0.949	3,16,333
End of 2 nd year	<u>3,33,334</u>	0.901	<u>3,00,334</u>
	<u>10,00,000</u>		<u>9,50,000</u>

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

<i>Initial recognition of sale of goods</i>		₹	₹
Cash	Dr.	3,33,333	9,50,000
Trade Receivable	Dr.	6,16,667	
To Sale			
<i>Recognition of interest expense and receipt of second installment</i>			
Cash	Dr.	3,33,333	33,053 3,00,280
To Interest Income			
To Trade Receivable			
<i>Recognition of interest expense and payment of final installment</i>			
Cash	Dr.	3,33,334	16,947 3,16,387
To Interest Income			
(Balancing figure)			
To Trade Receivable			

Statement of Profit and Loss (extracts)
for the year ended 31st March, 20X2 and 31st March, 20X3

₹

	As at 31 st March, 20X2	As at 31 st March, 20X3
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3 ₹

	As at 31st March, 20X2	As at 31st March, 20X3
Assets		
Current Assets		
<u>Financial Assets</u>		
Trade Receivables	3,16,387	XXX

(c) Either

The usefulness of financial information can be enhanced by applying four enhancing qualitative characteristics as follows:

- ◆ **Comparability:** Users' decisions involve choosing between alternatives. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Comparability refers to the use of the same methods for the same items, and uniformity implies that like things must look alike and different things must look different.
- ◆ **Verifiability:** Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Verification can be direct or indirect.
- ◆ **Timeliness:** Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.
- ◆ **Understandability:** Classifying, characterising and presenting information clearly and concisely makes it understandable. Some phenomena are inherently complex and cannot be made easy to understand. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to

seek the aid of an adviser to understand information about complex economic phenomena.

(c) **Or**

Following entities are mandatorily required to prepare their financial statements based on Indian Accounting Standards

- All Listed Corporate Entities
- Unlisted Corporate Entities having net worth of rupees two hundred and fifty crore or more
- All holding, subsidiary, joint venture or associate companies of the above mentioned listed and unlisted corporate entities
- All NBFCs
- MF schemes

6. (a) Lease agreement substance presentation

Stakeholders make informed and accurate decisions based on the information presented in the financial statements and as such, ensuring the financial statements are reliable and of utmost importance. The directors of Sunshine Ltd. are ethically responsible to produce financial statements that comply with Ind AS and are transparent and free from material error. Lenders often attach covenants to the terms of the agreement in order to protect their interests in an entity. They would also be of crucial importance to potential debt and equity investors when assessing the risks and returns from any future investment in the entity.

The proposed action by Sunshine Ltd. appears to be a deliberate attempt to circumvent the terms of the covenants. The legal form would require treatment as a series of short-term leases which would be recorded in the profit or loss, without any right-of-use asset and lease liability being recognized as required by Ind AS 116, *Leases*. This would be a form of 'off-balance sheet finance' and would not report the true assets and obligations of Sunshine Ltd. As a result of this proposed action, the liquidity ratios would be adversely misrepresented. Further, the operating profit margins would also be adversely affected, as the expenses associated with the lease are likely to be higher than the

depreciation charge if a leased asset was recognized, hence the proposal may actually be detrimental to the operating profit covenant.

Sunshine Ltd. is aware that the proposed treatment may be contrary to Ind AS. Such manipulation would be a clear breach of the fundamental principles of objectivity and integrity as outlined in the Code of Ethics. It is important for a chartered accountants to exercise professional behaviour and due care all the time. The proposals by Sunshine Ltd. are likely to mislead the stakeholders in the entity. This could discredit the profession by creating a lack of confidence within the profession. The directors of Sunshine Ltd. must be reminded of their ethical responsibilities and persuaded that the accounting treatment must fully comply with the Ind AS and principles outlined within the framework should they proceed with the financing agreement.

However, if the CFO fails to comply with his professional duties, he will be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

(b) X Pharmaceutical Ltd. is advised as under:

1. It should recognize the drug license as an intangible asset because it is a separate external purchase, separately identifiable asset and considered successful in respect of feasibility and probable future cash inflows.

The drug license should be recorded at ₹ 1,00,00,000.

2. It should recognize the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.

The brand will be recorded at ₹ 3,00,00,000.

3. The advertisement expenses of ₹ 1,00,00,000 should be expensed off.
4. The development cost incurred during the financial year 20X1-20X2 should be capitalised.

Cost of intangible asset (Drug A) as on 31st March, 20X2

Opening cost ₹ 5,00,00,000

Development cost ₹ 5,00,00,000

Total cost ₹ 10,00,00,000

5. Research expenses of ₹ 50,00,000 incurred for developing 'Drug B' should be expensed off since technological feasibility has not yet established.

(c) Equity Valuation of KK Ltd.

Particulars	Weights	(₹ in crore)
As per Market Approach	50	5268.2
As per Income Approach	50	3235.2
Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%)		4,251.7
<i>Less:</i> Debt obligation as on measurement date		(1465.9)
<i>Add:</i> Surplus cash & cash equivalent		106.14
<i>Add:</i> Fair value of surplus assets and liabilities		<u>312.40</u>
Enterprise value of KK Ltd.		<u>3204.33</u>
No. of shares		85,284,223
Value per share		375.72

ANSWERS OF MODEL TEST PAPER 3
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING
PART – I CASE SCENARIO BASED MCQS

1. **Option (b)** : Current financial Liability
2. **Option (c)** : Non-Current financial Liability
3. **Option (c)** : ₹ 1,000 thousand
4. **Option (d)** : ₹ 810 thousand is to be recognised in the year of sale and ₹ 90 thousand to be spread over next three years.
5. **Option (c)** : ₹ Nil
6. **Option (d)** : ₹ 15 million
7. **Option (d)** : ₹ 0.125 million
8. **Option (a)** : Grant relating to an inducement to begin developing the factory can be recognized immediately in the Statement of Profit or Loss
9. **Option (d)** : ₹ 36 million
10. **Option (c)** : ₹ 37.782 million
11. **Option (b)** : Agreement is in the nature of Joint Operations
12. **Option (c)** : ₹ 20,25,00,000
13. **Option (a)** : ₹ 50,62,500
14. **Option (a)** : F Ltd. can continue following the existing accounting policy of amortising the exchange differences in respect of loan over the balance period of such long-term liability routed through statement of profit and loss for the period
15. **Option (c)** : Scanned documents of several years will acquire unnecessary office space.

PART – II DESCRIPTIVE QUESTIONS

1. A Ltd. and B Ltd. will account for the transaction as a sale and leaseback.

Step 1

Since the consideration for the sale of the building is not at fair value, A Ltd. and B Ltd. make adjustments to measure the sale proceeds at fair value. Thus, the amount of the excess sale price of ₹ 6,00,000 (as calculated below) is recognised as additional financing provided by B Ltd. to A Ltd.

Sale Price:	60,00,000
Less: Fair Value (at the date of sale):	<u>(54,00,000)</u>
Additional financing provided by B Ltd. to A Ltd.	<u>6,00,000</u>

Step 2

Calculation of the present value of the annual payments which amounts to

₹ 29,88,000 (calculated considering 20 payments of ₹ 4,00,000 each, discounted at 12% p.a.) of which ₹ 6,00,000 relates to the additional financing (as calculated above) and balance ₹ 23,88,000 relates to the lease — corresponding to 20 annual payments of ₹ 80,320 and ₹ 3,19,680, respectively (refer calculations below).

Proportion of annual lease payments:

Present value of lease payments (as calculated above) (A)	29,88,000
Additional financing provided (as calculated above) (B)	6,00,000
Relating to the Additional financing provided (C) = (E x B / A)	80,320
Relating to the Lease (D) = (E – C)	3,19,680
Annual payments (at the end of each year) (E)	4,00,000

A Ltd.:

At the commencement date, A Ltd. measures the ROU asset arising from the leaseback of the building at the proportion of the previous

carrying amount of the building that relates to the right-of-use retained by A Ltd., calculated as follows:

Carrying Amount	(A)	30,00,000
Fair Value (at the date of sale)	(B)	54,00,000
Discounted lease payments for the 20-year ROU asset	(C)	23,88,000
ROU Asset	[(A / B) x C]	13,26,667

A Ltd. recognises only the amount of the gain that relates to the rights transferred to B Ltd., calculated as follows:

Fair Value (at the date of sale)	(A)	54,00,000
Carrying Amount	(B)	30,00,000
Discounted lease payments for the 20-year ROU asset (C)		23,88,000
Gain on sale of building	(D) = (A - B)	24,00,000
Relating to the right to use the building retained by A Ltd. (E) = [(D/A) x C]		10,61,333
Relating to the rights transferred to B Ltd. (D - E)		13,38,667

At the commencement date, A Ltd. accounts for the transaction, as follows:

Cash	Dr.	60,00,000	
ROU Asset	Dr.	13,26,667	
To Building			30,00,000
To Financial Liability			29,88,000
To Gain on rights transferred			13,38,667

B Ltd.:

At the commencement date, B Ltd. accounts for the transaction, as follows:

Building	Dr.	54,00,000	
Financial Asset	Dr.	6,00,000	
(20 payments of ₹ 80,320 discounted @ 12% p.a.) (approx.)			
To Cash			60,00,000

After the commencement date, B Ltd. accounts for the lease by treating ₹ 3,19,680 of the annual payments of ₹ 4,00,000 as lease payments. The remaining ₹ 80,320 of annual payments received from A Ltd. are accounted for as:

- (a) payments received to settle the financial asset of ₹ 6,00,000 and
- (b) interest revenue.

2. (a) Journal Entry

Date	Particulars	Dr.	Cr.
		₹	₹
1/4/20X1	Loan to Mr. Y A/c Dr. Pre-paid employee cost A/c Dr. To Bank A/c (Being loan to employee recorded at fair value)	10,43,638 1,56,362	12,00,000
31/3/20X2	Loan to Mr. Y A/c Dr. To Finance Income A/c (Being finance income @ 9% recorded in the books)	93,927	93,927
31/3/20X2	Bank A/c Dr. To Loan to Mr. Y A/c (Being installment received at the end of the year)	3,00,000	3,00,000

Working Notes:

1. Calculation of initial recognition amount of loan to employee

Year	Estimated Cash Flows	PV Factor @ 9%	Present Value
	₹		₹
31/3/20X2	3,00,000	0.9174	2,75,220
31/3/20X3	3,00,000	0.8417	2,52,510
31/3/20X4	3,00,000	0.7722	2,31,660
31/3/20X5	3,00,000	0.7084	2,12,520
31/3/20X6	40,000 (W.N.2)	0.6499	25,996

31/3/20X7	40,000 (W.N.2)	0.5963	23,852
31/3/20X8	40,000 (W.N.2)	0.5470	<u>21,880</u>
Fair Value of Loan			<u>10,43,638</u>

2. Computation of Interest to be paid

Year	Opening outstanding balance a	Cash Flows b	Principal outstanding at year end c	Interest @ 4% on a d	Cumulative Interest e
		₹	₹	₹	₹
31/3/20X2	12,00,000	3,00,000	9,00,000	48,000	48,000
31/3/20X3	9,00,000	3,00,000	6,00,000	36,000	84,000
31/3/20X4	6,00,000	3,00,000	3,00,000	24,000	1,08,000
31/3/20X5	3,00,000	3,00,000	Nil	12,000	1,20,000
31/3/20X6	1,20,000	40,000 (1,20,000/3)			
31/3/20X7		40,000 (1,20,000/3)			
31/3/20X8		40,000 (1,20,000/3)			

3. Computation of finance cost as per amortization table

Year	Opening Balance (1)	Interest @ 9% (2)	Repayment (3)	Closing Balance (1+2-3)
	₹	₹	₹	₹
1/4/20X1				10,43,638
31/3/20X2	10,43,638	93,927	3,00,000	8,37,565
31/3/20X3	8,37,565	75,381	3,00,000	6,12,946
31/3/20X4	6,12,946	55,165	3,00,000	3,68,111
31/3/20X5	3,68,111	33,130	3,00,000	1,01,241
31/3/20X6	1,01,241	9,112	40,000	70,353
31/3/20X7	70,353	6,332	40,000	36,685
31/3/20X8	36,685	3,315*	40,000	Nil

*Difference of ₹ 13 (₹ 3,315 – ₹ 3,302) is due to approximation.

(b) Table showing computation of tax charge:

	Quarter ending 31 st March, 20X1	Quarter ending 30 th June, 20X1	Quarter ending 30 th September, 20X1	Quarter ending 31 st December, 20X1	Year ending 31 st December, 20X1
	₹	₹	₹	₹	₹
Profit before tax	50,000	50,000	50,000	50,000	2,00,000
Tax charge	(12,500)	(15,000)	(15,000)	(15,000)	(57,500)
	<u>37,500</u>	<u>35,000</u>	<u>35,000</u>	<u>35,000</u>	<u>1,42,500</u>

Since an entity's accounting year is not same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

3. (a) Computation of goodwill impairment

	NCI at fair value	NCI at of net assets
	₹ in '000	₹ in '000
Cost of investment		
Share exchange (6,000 x 75% x 2/3 x ₹ 6.50)	19,500	19,500
Deferred consideration (3,575 / 1.10)	3,250	3,250
Contingent consideration	12,500	12,500
Non-controlling interest at date of acquisition:		
Fair value – 1,500 x ₹ 6	9,000	
% of net assets – 34,000 (Refer W.N.) x 25%		8,500
Net assets on the acquisition date (Refer W.N.)	(34,000)	(34,000)

Goodwill on acquisition	10,250	9,750
Impairment @ 10%	1,025	975

Working Note:

Net assets on the acquisition date	₹ '000
Fair value at acquisition date	35,000
Deferred tax on fair value adjustments [20%×(35,000–30,000)]	<u>(1,000)</u>
	<u>34,000</u>

- (b) (i) The gas will be used to generate electricity, which will be sold at a profit. The economic benefits from the contract include the benefits to the entity of using the gas in its business and, because the electricity will be sold at a profit, the contract is not onerous.
- (ii) The electricity is sold to a wide range of customers. The entity first considers whether the assets used to generate electricity are impaired. To the extent that there is still a loss after the assets have been written down, a provision for an onerous contract should be recorded.
- (iii) The only economic benefit from the purchase contract costing ₹ 2,30,000 are the proceeds from the sales contract, which are ₹ 1,80,000. Therefore, a provision should be made for the onerous element of ₹ 50,000, being the lower of the cost of fulfilling the contract and the penalty cost of cancellation (₹ 55,000).

4. (a) Calculation of Investor Ltd.'s investment in XYZ Ltd. under equity method:

	₹	₹
Acquisition of investment in XYZ Ltd.		
Share in book value of XYZ Ltd.'s net assets (35% of ₹ 90,00,000)	31,50,000	
Share in fair valuation of XYZ Ltd.'s net assets [35% of (₹ 1,10,00,000 – ₹ 90,00,000)]	7,00,000	
Goodwill on investment in XYZ Ltd. (balancing figure)	<u>9,00,000</u>	

Cost of investment		47,50,000
Profit during the year		
Share in the profit reported by XYZ Ltd. (35% of ₹ 9,00,000)	3,15,000	
Adjustment to reflect effect of fair valuation [35% of (₹ 20,00,000/10 years)]	<u>(70,000)</u>	
Share of profit in XYZ Ltd. recognised in income by Investor Ltd.		2,45,000
Long term equity investment		
FVTOCI gain recognised in OCI (35% of ₹ 2,00,000)		70,000
Dividend received by Investor Ltd. during the year [35% of ₹ 10,00,000]		<u>(3,50,000)</u>
Closing balance of Investor Ltd.'s investment in XYZ Ltd.		<u>47,15,000</u>

(b) (i) Calculation of Basic EPS:

Basic EPS = Profit for the year / Weighted average Number of shares outstanding

$$\begin{aligned}
 \text{Basic EPS (Continued Operations)} &= \frac{\text{Profit from continued operations}}{\text{Weighted average Number of shares outstanding}} \\
 &= ₹ 90,00,000 / 10,00,000 \\
 &= ₹ 9.00
 \end{aligned}$$

Basic Loss per share

$$\begin{aligned}
 \text{(Discontinued operations)} &= \frac{\text{Loss from discontinued operations}}{\text{Weighted Number of shares outstanding}} \\
 &= ₹ (1,08,00,000) / 10,00,000 \\
 &= (₹ 10.80)
 \end{aligned}$$

$$\begin{aligned}
 \text{Overall Basic Loss per share} &= (₹ 18,00,000) / 10,00,000 \\
 &= ₹ (1.80) \quad (i)
 \end{aligned}$$

Calculation of Diluted EPS

Diluted EPS = Profit for the year / Adjusted Weighted average
Number of shares outstanding

EPS (Continued Operations) = Profit from continued operations /
Adjusted Weighted average
Number of shares outstanding
= ₹ 90,00,000 / 12,00,000 = ₹ 7.50

Loss per share
(Discontinued operations) = Loss from discontinued
operations/ Adjusted weighted
average number of shares
outstanding
= ₹ (1,08,00,000)/12,00,000
= (₹ 9.00)

Overall Diluted Loss per share = ₹ 18,00,000 / 12,00,000
= ₹ (1.50) (ii)

The income from continuing operations is the control number, there is a dilution in basic EPS for income from continuing operations (reduction of EPS from ₹ 9.00 to ₹ 7.50). Therefore, even though there is an anti-dilution [Loss per share reduced from ₹ 1.80 (i) to ₹ 1.50 (ii) above], diluted loss per share of ₹ 1.50 is reported.

- (ii) In case of loss from continuing operations, the potential shares are excluded since including those shares would result into anti-dilution effect on the **control number** (loss from continuing operations). Therefore, the diluted EPS will be calculated as under:

Diluted EPS = Profit for the year / Adjusted weighted
average number of shares outstanding

Overall Profit = Loss from continuing operations + Gain
from discontinued operations
= ₹ (30,00,000) + ₹ 1,08,00,000
= ₹ 78,00,000

Weighted average number
of shares outstanding = 10,00,000

Diluted EPS = ₹ 7.80

The dilutive effect of the potential common shares on EPS for income from discontinued operations and net income would not be reported because of the loss from continuing operations.

5. (a) (i) On 1st April, 20X1, entity A entered into a single transaction with three identifiable separate components:

1. Sale of a good (i.e. engineering machine);
2. Rendering of services (i.e. engineering machine maintenance services on 30th September, 20X1 and 1st April, 20X2); and
3. Providing finance (i.e. sale of engineering machine and rendering of services on extended period credit).

(ii) **Calculation and allocation of revenue to each component of the transaction**

<i>Date</i>	<i>Opening balance</i>	<i>Finance income</i>	<i>Goods</i>	<i>Services</i>	<i>Payment received</i>	<i>Closing balance</i>
1 st April, 20X1	–	–	2,51,927	–	–	2,51,927
30 th September, 20X1	2,51,927	12,596 (Note 1)	–	45,000	–	3,09,523
31 st March 20X2	3,09,523	15,477 (Note 2)	–	–	–	3,25,000
1 st April, 20X2	3,25,000	–	–	75,000	(4,00,000)	

Notes:

1. Calculation of finance income as on 30th September, 20X1

$$= 5\% \times 2,51,927$$

$$= ₹ 12,596$$

2. Calculation of finance income as on 31st March, 20X2

$$= 5\% \times 3,09,523$$

$$= ₹ 15,477$$

(iii)

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1 st April, 20X1	Mr. Anik Dr. To Revenue - sale of goods (Profit or loss A/c) (Being revenue recognised from the sale of the machine on credit)	2,51,927	2,51,927
	Cost of goods sold (Profit or loss) Dr. To Inventories (Being cost of goods sold recognised)	1,60,000	1,60,000
30 th Septemb er 20X1	Mr. Anik Dr. To Finance Income (Profit or loss) (Being finance income recognised)	12,596	12,596
	Mr. Anik Dr. To Revenue- rendering of services (Profit or loss) (Being revenue from the rendering of maintenance services recognised)	45,000	45,000
	Cost of services (Profit or loss) Dr. To Cash/Bank or payables (Being the cost of performing maintenance services recognised)	30,000	30,000
31 st March 20X2	Mr. Anik Dr. To Finance Income (Profit or loss) (Being finance income recognised)	15,477	15,477

1 st April, 20X2	Mr. Anik Dr. To Revenue - rendering of services (Profit or loss) (Being revenue from the rendering of maintenance services recognised)	75,000	75,000
	Cost of services (Profit or loss) Dr. To Cash/Bank or payables (Being the cost of performing maintenance services recognised)	50,000	50,000
	Cash/Bank Dr. To Mr. Anik (Being the receipt of cash from the customer recognised)	4,00,000	4,00,000

- (b) Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments that vested before the date of transition to Ind AS. However, if a first-time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.

Having regard to the above, X Ltd. has the following options:

- For 100 options that vested before the date of transition:
 - (a) To apply Ind AS 102 and account for the same accordingly, provided it has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.
 - (b) Not to apply Ind AS 102.

However, for all grants of equity instruments to which Ind AS 102 has not been applied, i.e., equity instruments vested but not settled before date of transition to Ind AS, X Ltd. would still need to disclose the information.

- For 200 options that will vest after the date of transition: X Ltd. will need to account for the same as per Ind AS 102.

6. (a) (i) In terms of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, an entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the **sale should be expected to qualify for recognition as a completed sale within one year from the date of classification**, except in specific cases as permitted by the Standard, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The probability of required approvals (as per the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out above are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

Based on the provisions highlighted above, the disposal of D Ltd. appears to meet the criteria of **held for sale**. J Ltd. is the probable acquirer, and the sale is highly probable, expected to be completed seven months after the year end, well within the 12-months criteria highlighted above. Accordingly, D Ltd. should be treated as a disposal group, since a single equity transaction is the most likely form of disposal. In case D Ltd. is deemed to be a separate major

component of business or geographical area of the group, the losses of the group should be presented separately as a discontinued operation within the Financial Statements of M Ltd.

In terms of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, an entity shall measure a non-current asset (or disposal group) classified as held for sale at the **lower of its carrying amount and fair value less costs to sell**. The carrying amount of D Ltd. (i.e., the subsidiary of M Ltd.) comprises of the net assets and goodwill less the non-controlling interest. The impairment loss recognised to reduce D Ltd. to fair value less costs to sell should be allocated first to goodwill and then on a pro-rata basis across the other non-current assets of the Company.

The Chief Operating Officer (COO) is incorrect to exclude any form of restructuring provision in the Financial Statements. Since the disposal is communicated to the media as well as the Stock Exchange, a constructive obligation exists. However, ongoing costs of business should not be provided for, only **directly attributable costs of restructuring** should be provided. Future operating losses should be excluded as no obligating event has arisen, and no provision is required for impairment losses of Property, Plant and Equipment as it is already considered in the remeasurement to fair value less costs to sell. Thus, a provision is required for ₹ 13.75 crores (₹ 3.75 crores + ₹ 10 crores).

(ii) Ethics

Accountants have a duty to ensure that the financial statements are **fair, transparent and comply with the accounting standards**. Mr. X have committed several mistakes. In particular, he was unaware of which costs should be included within a restructuring provision and has failed to recognise that there is no obligating event in relation to future operating losses. A chartered accountant is expected to carry his work with **due care and attention** for lending credibility to the financial statements. Accordingly, he must update his knowledge and ensure that work is carried out in accordance with relevant ethical and professional standards. Failure to do so would be a breach of **professional competence**. Accordingly, Mr. X must

ensure that this issue is addressed, for example by attending regular training and professional development courses.

It appears that the chief operating officer is looking for means to **manipulate** the financial statements for meeting the bonus targets. Neither is he willing to reduce the profits of the group by applying held for sale criteria in respect of D Ltd. nor is he willing to create appropriate restructuring provisions. Both the adjustment which comply with the requirements of Ind AS will result in reduction of profits. His argument that the management has a duty to maximize the returns for the shareholders is true, but such maximization must not be achieved at the cost of **objective** and **faithful representation** of the performance of the Company. In the given case, it appears that the chief operating officer is motivated by bonus targets under the garb of maximizing returns for the shareholders, thereby resulting in misrepresentation of the results of the group.

Further, by threatening to dismiss Mr. X, the COO has acted unethically. **Threatening and intimidating behaviour** is unacceptable and against all ethical principles. This has given rise to an **ethical dilemma** for Mr. X. He has a duty to produce financial statements but doing so in a fair manner could result in a loss of job for him. The chartered accountant should approach the chief operating officer and remind him the basic ethical principles and communicate him to do the necessary adjustments in the accounts so that they are fair and objective.

In case Mr. X, falls under undue influence of COO and applies the incorrect accounting treatment, he will be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, for contravening the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

(b) Impact on consolidated balance sheet of P Ltd. group at 31st March, 20X2

- The tax loss creates a potential deferred tax asset for the P Ltd. group since its carrying value is nil and its tax base is ₹ 10,00,000. However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.
- The development costs have a carrying value of ₹ 19,00,000 ($₹ 20,00,000 - (₹ 20,00,000 \times 1/5 \times 3/12)$). The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be ₹ 5,70,000 ($₹ 19,00,000 \times 30\%$). All deferred tax liabilities are shown as non-current.
- The carrying value of the loan at 31st March, 20X2 is ₹ 1,07,80,000 ($₹ 1,00,00,000 - ₹ 200,000 + (₹ 98,00,000 \times 10\%)$). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ₹ 7,80,000 and a potential deferred tax asset of ₹ 2,34,000 ($₹ 7,80,000 \times 30\%$).

(c) Either

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 16, 'property, plant and equipment' are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period."

As per Ind AS 40, 'investment property' is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business."

As per the above definitions, whether a building is an item of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity. It is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa. Whether a building is in the nature of PPE or investment property is determined by applying the definitions of these terms from the perspective of that entity. Thus, the classification of a building as an item of property, plant and equipment or as an investment property is not a matter of an accounting policy choice. Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is **not** a change in an accounting policy.

Or

As per Ind AS 10, even if partial information has already been published, the reporting period will be considered as the period between the end of the reporting period and the date of approval of financial statements. In the above case, the financial statements for the year 20X1-20X2 were approved on 15th May, 20X2. Therefore, for the purposes of Ind AS 10, 'after the reporting period' would be the period between 31st March, 20X2 and 15th May, 20X2.

ANSWERS OF MODEL TEST PAPER 4
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING
ANSWER TO PART – I CASE SCENARIO BASED MCQS

1. **Option (a) :** ₹ 8,40,000
2. **Option (b) :** ₹ 42,000
3. **Option (d) :** ₹ 50,000
4. **Option (c) :** 11.4375%
5. **Option (c) :** ₹ 15,000
6. **Option (a) :** ₹ 22,875
7. **Option (d) :** Loss on initial recognition of biological asset ₹ 6,000
8. **Option (a) :** Gain on remeasurement of biological asset ₹ 9,800
9. **Option (c) :** Equity
10. **Option (b) :** Financial Liability
11. **Option (b) :** Z Ltd. is an associate of H Ltd.
12. **Option (b) :** G Ltd. is an associate of H Ltd.
13. **Option (b) :** Y Ltd. is an associate of H Ltd.
14. **Option (d) :** Do not disclose assumptions and bases, so that users are not misled.
15. **Option (a) :** Ensure that all passwords are simple and are not changed regularly.

PART – II DESCRIPTIVE QUESTIONS

1. Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is

determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is ₹ 1,600 (40 shares with a fair value per share of ₹ 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's 100 shares with a fair value per share of ₹ 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

	₹	₹
Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	<u>(400)</u>	<u>(1,300)</u>
Goodwill		<u>300</u>

Consolidated balance sheet at 31st December, 20X1

The consolidated balance sheet immediately after the business combination is:

	₹
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Current assets [700 + 500]	<u>1,200</u>
Total assets	<u>6,000</u>
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	<u>1,400</u>
Total shareholders' equity	<u>3,600</u>
Non-current liabilities [1,100 + 400]	1,500
Current liabilities [600 + 300]	<u>900</u>
Total liabilities	<u>2,400</u>
Total liabilities and shareholders' equity	<u>6,000</u>

The amount recognised as issued equity interests in the consolidated financial statements (₹ 2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (₹ 1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to affect the combination.

2. (a) Ind AS 109 requires that financial assets and liabilities are recognized on initial recognition at its fair value, as adjusted for the transaction cost. In accordance with Ind AS 113 Fair Value Measurement, the fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Both parent and subsidiary recognize financial asset and liability, respectively, at fair value on initial recognition. 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.

Accounting in the books of XYZ Ltd (Parent)

Particulars	Amount	Amount
On the date of loan		
Loan to ABC Ltd (Subsidiary) Dr.	7,51,315	
Deemed Investment (Capital Contribution) in ABC Ltd. Dr.	2,48,685	
To Bank		10,00,000
(Being the loan is given to ABC Ltd and recognised at fair value)		
Accrual of Interest income		
Loan to ABC Ltd Dr.	75,131	
To Interest income		75,131
(Being interest income accrued) – Year 1		
Loan to ABC Ltd Dr.	82,645	
To Interest income		82,645
(Being interest income accrued) – Year 2		
Loan to ABC Ltd Dr.	90,909	
To Interest income		90,909
(Being interest income accrued) – Year 3		
On repayment of loan		
Bank Dr.	10,00,000	
To Loan to ABC Ltd (Subsidiary)		10,00,000

Accounting in the books of ABC Ltd (Subsidiary)

Particulars	Amount	Amount
On the date of loan		
Bank Dr.	10,00,000	
To Loan from XYZ Ltd (Payable)		751,315
To Equity (Deemed Capital Contribution from XYZ Ltd)		2,48,685
(Being the loan taken from XYZ Ltd. and recognised at Fair value)		

Accrual of Interest			
Interest expense	Dr.	75,131	
To Loan from XYZ Ltd (Payable)			75,131
(Being interest expense recognised) – Year 1			
Interest expense	Dr.	82,645	
To Loan from XYZ Ltd (Payable)			82,645
(Being interest expense recognised) – Year 2			
Interest expense	Dr.	90,909	
To Loan from XYZ Ltd (Payable)			90,909
(Being interest expense recognised) – Year 3			
On repayment of loan			
Loan from XYZ Ltd (Payable)	Dr.	10,00,000	
To Bank			10,00,000

Working Notes:

1	Computation of Present value of loan	
	Rate	10%
	Amount of Loan	10,00,000
	Year	3
	Present Value	7,51,315
2	Computation of interest for Year I	
	Present Value	7,51,315
	Rate	10%
	Period of interest - for 1 year	1
	Closing value at the end of year 1	8,26,446
	Interest for 1 st year	75,131
3	Computation of interest for Year 2	
	Value of loan as at the beginning of Year 2	8,26,446
	Rate	10%
	Period of interest - for 2 nd year	1
	Closing value at the end of year 2	9,09,091
	Interest for 2 nd year	82,645

4	Computation of interest for Year 3	
	Value of loan as at the beginning of Year 3	9,09,091
	Rate	10%
	Period of interest - for 3 rd year	1
	Closing value at the end of year 3	10,00,000
	Interest for 3 rd year	90,909

(b) Either

In accordance with Ind AS 24 'Related Party Disclosures', effective 1st January 20X3, Candour Ltd. would be regarded as a related party of Buildwell Ltd. This is because Candour Ltd. is controlled by the close family member of one of Buildwell Ltd.'s key management personnel. This means that from 1st January 20X3, the purchases from Candour Ltd. would be regarded as related party transactions.

As per the provisions of para 18 of Ind AS 24, transactions with related parties need to be disclosed in the notes to the financial statements, together with the nature of the relationship. It is irrelevant whether or not these transactions are at normal market rates. As per para 23 of the standard, disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

The disclosure is required to state that Candour Ltd., controlled by the spouse of a director, supplied goods to the value of ₹ 4.5 million (3 x ₹ 1.5 million) in the current accounting period.

Or

The entity should use First-in-first-out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.

However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

3. (a) **Statement of Cash Flows for the year ended 31st March 20X3**
(Indirect method)

Particulars	₹	₹
Cash flow from operating activities:		
Net Profit before taxes and extraordinary items (7,20,000+8,80,000)	16,00,000	
Add: Depreciation	<u>6,00,000</u>	
Operating profit before working capital changes	22,00,000	
Increase in inventories	(1,80,000)	
Decrease in trade receivables	16,80,000	
Advances	(12,000)	
Decrease in trade payables	(60,000)	
Increase in outstanding expenses	<u>2,40,000</u>	
Cash generated from operations	38,68,000	
Less: Income tax paid (Refer W.N.4)	<u>(8,68,000)</u>	
Net cash from operations		30,00,000
Cash from investing activities:		
Purchase of land	(4,80,000)	
Purchase of building & equipment (Refer W.N.2)	(28,80,000)	
Sale of equipment (Refer W.N.3)	<u>3,60,000</u>	
Net cash used for investment activities		(30,00,000)
Cash flows from financing activities:		
Issue of share capital	8,40,000	
Dividends paid	<u>(7,20,000)</u>	
Net cash from financing activities:		1,20,000

Net increase in cash and cash equivalents		1,20,000
Cash and cash equivalents at the beginning		6,00,000
Cash and cash equivalents at the end		7,20,000

Working Notes:

1. Building & Equipment Account

Particulars	₹	Particulars	₹
To Balance b/d	36,00,000	By Sale of assets	7,20,000
To Cash/bank (purchases)(bal.fig)	<u>28,80,000</u>	By Balance c/d	<u>57,60,000</u>
	<u>64,80,000</u>		<u>64,80,000</u>

2. Building & Equipment Accumulated Depreciation Account

Particulars	₹	Particulars	₹
To Sale of asset (acc. depreciation)	4,80,000	By Balance b/d	12,00,000
To Balance c/d	<u>13,20,000</u>	By Profit & Loss A/c (provisional)	6,00,000
	<u>18,00,000</u>		<u>18,00,000</u>

3. Computation of sale price of Equipment

Particulars	₹
Original cost	7,20,000
Less Accumulated Depreciation	<u>(4,80,000)</u>
Net cost	2,40,000
Profit on sale of assets	<u>1,20,000</u>
Sale proceeds from sale of assets	<u>3,60,000</u>

4. Provision for tax Account

Particulars	₹	Particulars	₹
To Bank A/c	8,68,000	By Balance b/d	1,20,000
To Balance c/d	1,32,000	By Profit & Loss A/c (provisional)	<u>8,80,000</u>
	<u>10,00,000</u>		<u>10,00,000</u>

- (b) As per Ind AS 19, net remeasurement of ₹ 900 would be recognized in other comprehensive income.

Computation of Net remeasurement

$$\begin{aligned}
 &= \text{Remeasurement} - \text{Actuarial loss} \\
 &= ₹ 1000 \text{ (Refer WN - 1)} - ₹ 100 \text{ (Given in the question)} \\
 &= ₹ 900.
 \end{aligned}$$

Computation of net interest expense

Particulars	₹
Defined benefit liability as at 1 st April 20X1 (A) (Given in the question)	12,000
Fair value of plan asset as at 1 st April 20X1 (B) (Given in the question)	<u>(10,000)</u>
Net defined benefit liability (A - B)	<u>2,000</u>
Net interest expense (as it is net liability) (Refer note given below)	200

Note: Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question-

$$\begin{aligned}
 &= \text{Net defined benefit liability} \times \text{Discount rate} \\
 &= 2,000 \times 10\% \\
 &= ₹ 200.
 \end{aligned}$$

Working Note:

Computation of amount of remeasurement

Particulars	₹
Actual return on plan asset for the year ended 31 st March 20X2 (Given in the question) (C)	2,000

Less: Interest income on ₹ 10,000 held for 12 months at 10%	(D)	<u>(1,000)</u>
Remeasurement	(E = C - D)	<u>1,000</u>

4. (a) Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 20X2

- i. The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is ₹ 30,00,000. However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.
- ii. The development costs have a carrying value of ₹ 15,20,000 (₹ 16,00,000 – (₹ 16,00,000 x 1/5 x 3/12)). The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be ₹ 4,56,000 (₹ 15,20,000 x 30%). All deferred tax liabilities are shown as non-current.
- iii. The carrying value of the loan at 31st March, 20X2 is ₹ 1,07,80,000 (₹ 1,00,00,000 – ₹ 200,000 + (₹ 98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ₹ 7,80,000 and a potential deferred tax asset of ₹ 2,34,000 (₹ 7,80,000 x 30%).

(b) In the facts provided above, the entity has made sale of two goods – machine and spare parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2-4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations –

- (i) Sale of machinery
- (ii) Sale of spare parts
- (iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- **Sale of machinery:** Machine has been sold to the customer and physical possession as well as legal title

passed to the customer on 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognized on 31st March, 20X3.

- **Sale of spare parts:** The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if all below criteria are met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory.
(b) the product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c) the product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery.
(d) the entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.

- **Custodial services:** Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

5. (a) Paragraph 2 of Ind AS 20, “Accounting for Government Grants and Disclosure of Government Assistance” inter alia states that the Standard does not deal with government participation in the ownership of the entity.

Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 ‘First Time Adoption of Ind AS’. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter’s contribution directly to shareholders’ funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that except in certain cases, 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.

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under ‘Other Equity’ at the date of transition to Ind AS.

(b) Identification of the contract (by applying para 9 of Ind AS 116)

(a) Identified asset

Feel Fresh Ltd. (a customer company) enters into a long-term purchase contract with M/s Radhey (a manufacturer) to purchase a particular type and quality of soaps for 10 year period.

Since for the purpose of the contract M/s Radhey has to buy a customized machine as per the directions of Feel Fresh Ltd. and also the machine cannot be used for any other type of soap, the machine is an identified asset.

(b) Right to obtain substantially all of the economic benefits from use of the asset throughout the period of use

Since the machine cannot be used for manufacture of soap for any other buyer, Feel Fresh Ltd. will obtain substantially all the economic benefits from the use of the asset throughout the period of use.

(c) Right to direct the use

Feel Fresh Ltd. controls the use of machine and directs the terms and conditions of the contract with respect to recovery of fixed expenses related to machine.

Hence the contract contains a lease.

Lease term

The lease term shall be 10 years assuming reasonable certainty. Though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate.

Identification of lease payment

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- (a) fixed payments (including in-substance fixed payments), **less** any lease incentives
- (b) variable lease payments that depend on an index or a rate
- (c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
- (d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Here in-substance fixed payments in the given lease contract are ₹ 1,74,015 p.a. The present value of lease payment which would be recovered in 8 years @ 8% would be ₹ 10,00,000 (approx.)

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Hence, lease liability will be recognized by ₹ 10,00,000 in the books of Feel Fresh Ltd. Since there are no payments made to lessor before commencement date less lease incentives received from lessor or initial direct costs incurred by lessee or estimate of costs for restoration / dismantling of underlying asset, the right of use asset is equal to lease liability.

Journal Entries
On initial recognition

ROU Asset	Dr.	10,00,000	
To Lease Liability			10,00,000
<i>To initially recognise the Lease Liability and the corresponding ROU Asset</i>			

At the end of the first year

Interest Expense	Dr.	80,000	
To Lease Liability			80,000
<i>To record interest expense and accrete the lease liability using the effective interest method ($\text{₹ } 10,00,000 \times 8\%$)</i>			
Depreciation Expense (10,00,000 / 10 years)	Dr.	1,00,000	
To ROU Asset			1,00,000
<i>To record depreciation on ROU using the straight-line method ($\text{₹ } 10,00,000 / 10 \text{ years}$)</i>			
Lease Liability	Dr.	1,74,015	
To Bank / M/s. Radhey			1,74,015
<i>To record lease payment</i>			
Cost of soap	Dr.	24,75,000	
To Bank / M/s. Radhey {5,50,000 x (4 + 0.5)}			24,75,000
<i>To record variable expenses paid as cost of the goods purchased</i>			

6. (a) The above issue needs to be examined in the umbrella of the provisions given in Ind AS 1 'Presentation of Financial Statements', Ind AS 16 'Property, Plant and Equipment' in relation to property '1' and '2' and Ind AS 40 'Investment Property' in relation to property '3'.

Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2'. It also required to depreciate these

properties irrespective of that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Venus Ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.

Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet is as follows:

Case 1: Venus Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	<u>9,000</u>	22,500
Investment Properties		
Property '3'		10,800

Case 2: Venus Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	<u>11,000</u>	27,000
Investment Properties		
Property '3'		10,800

Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property '1' [16,000 – (15,000 – 1,500)]	2,500	
Property '2' [11,000 – (10,000 – 1,000)]	<u>2,000</u>	4,500

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and shown in a separate column under Statement of Changes in Equity.

(b) Ethical Considerations

Long-term success of any organization strongly depends on the fair treatment of employees, which in turn is based on the ethical behaviour of the management as well as how the same is perceived by the stakeholders. In the given case, the CFO has suggested not paying the discretionary bonus, which the directors are considering as it will enable the company to record profits of ₹ 2 crores, thereby ensuring a bonus pay out to the directors. This suggestion is not illegal at all as the bonus is discretionary rather than statutory/contractual. In other words, the company has no legal obligation to pay the bonus to the employees. However, the reason behind non-payment of the bonus is what gives rise to ethical considerations. The suggestion by the CFO will have the aforesaid impact of reducing expenses and improving profits.

On a moral ground, the suggestion is likely to have negative consequences for the company. The employees would be dissatisfied that the bonus has been withdrawn, and further, when they would see the directors withdrawing bonuses out of the profits arising on a saving in bonus costs, it would have a negative impact on employee morale, which would result in low employee satisfaction scores and poor retention rates, which are reported as non-financial information in the financial statements. Companies are also under increasing pressure to reduce the wage gap between the management and its employees. By not

paying a bonus, this metric will be adversely affected.

The CFO's statement that the above action will not negatively impact the company as the non-financial reporting indicators are not widely read by the users is misleading. The non-financial information is becoming increasingly important to the users of financial statements as they care about companies' treatment of their employees and view it as being important in the long-term success of the company.

A chartered accountant has a responsibility to exercise due diligence and clearly consider both financial and non-financial information while discharging his professional duty. It would be unethical for a chartered accountant to guide the management on matters which may result into any kind of disadvantage (it includes even non-financial matters) to the stakeholders.

Further, a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A chartered accountant's responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Therefore, the Code contains requirements and application material to enable chartered accountants to meet their responsibility to act in the public interest. Hence, it is essential for a chartered accountant to uphold the professional standards and act in accordance with the ethical principles by ensuring transparency and accuracy in financial reporting.

ANSWERS OF MODEL TEST PAPER 5

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

PART – I CASE SCENARIO BASED MCQS

1. **Option (a)** : Bad debts expenses incurred during third quarter should be recognised in the same quarter. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.
2. **Option (d)** : ₹ 14,50,000
3. **Option (c)** : A single performance obligation
4. **Option (b)** : ₹ 2,05,00,000
5. **Option (a)** : ₹ 1,70,83,333
6. **Option (c)** : ₹ 34,16,667
7. **Option (b)** : 2.40
8. **Option (a)** : 2.29
9. **Option (d)** : Executory contract and non-derivative contract
10. **Option (c)** : Equity
11. **Option (a)** : ₹ 34,000 crores
12. **Option (b)** : ₹ 4,000 crores
13. **Option (c)** : ₹ 250 crores
14. **Option (a)** : 1st April, 20X0
15. **Option (d)** : 20X0-20X1

PART – II DESCRIPTIVE QUESTIONS

1. **Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd.**

as at 31st March, 20X2

Particulars	Note No.	₹
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	86,00,000
(2) Current Assets		
(i) Inventories	2	17,14,000

(ii) Financial Assets		
(a) Trade Receivables	3	9,98,000
(b) Cash & Cash equivalents	4	<u>2,25,000</u>
Total Assets		<u>1,15,37,000</u>
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	5	50,00,000
(ii) Other Equity	6	49,92,000
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	7	7,45,000
(b) Short term borrowings	8	<u>8,00,000</u>
Total Equity & Liabilities		<u>1,15,37,000</u>

Notes to Accounts

			₹
1.	Property Plant & Equipment		
	Land & Building	43,00,000	
	Plant & Machinery	43,00,000	86,00,000
2.	Inventories		
	DEF Ltd.	12,00,000	
	XYZ Ltd.	<u>5,14,000</u>	17,14,000
3.	Trade Receivables		
	DEF Ltd.	5,98,000	
	XYZ Ltd.	<u>4,00,000</u>	9,98,000
4.	Cash & Cash equivalents		
	DEF Ltd.	1,45,000	
	XYZ Ltd.	<u>80,000</u>	2,25,000
7.	Trade payable		
	DEF Ltd.	4,71,000	
	XYZ Ltd.	<u>2,74,000</u>	7,45,000
8.	Short-term borrowings		
	Bank overdraft		8,00,000

Statement of Changes in Equity:**1. Equity share Capital**

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
50,00,000	0	50,00,000

2. Other Equity

	Reserves & Surplus			Total
	Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning		0	24,00,000	24,00,000
Total comprehensive income for the year	0	5,72,000		5,72,000
Dividends	0	(2,00,000)		(2,00,000)
Total comprehensive income attributable to parent	0	3,35,000		3,35,000
Gain on Bargain purchase	<u>18,85,000</u>	<u> </u>	<u> </u>	<u>18,85,000</u>
Balance at the end of reporting period	<u>18,85,000</u>	<u>7,07,000</u>	<u>24,00,000</u>	<u>49,92,000</u>

It is assumed that there exists no clear evidence for classifying the acquisition of the subsidiary as a bargain purchase and, hence, the bargain purchase gain has been recognized directly in capital reserve. If, however, there exists such a clear evidence, the bargain purchase gain would be recognized in other comprehensive income and then accumulated in capital reserve. In both the cases, closing balance of capital reserve will be ₹ 18,85,000.

Working Notes:**1. Adjustments of Fair Value**

The Plant & Machinery of XYZ Ltd. would stand in the books at ₹ 14,25,000 on 1st October, 20X1, considering only six months' depreciation on ₹ 15,00,000 total depreciation being ₹ 1,50,000. The value put on the assets being ₹ 20,00,000 there is an appreciation to the extent of ₹ 5,75,000.

2. Acquisition date profits of XYZ Ltd.

₹

Reserves on 1.4.20X1	10,00,000
Profit & Loss Account Balance on 1.4. 20X1	3,00,000
Profit for 20X2:	
Total ₹ 8,20,000 less ₹ 1,00,000 (3,00,000 – 2,00,000) i.e. ₹ 7,20,000; for 6 months i.e. up to 1.10.20X1	3,60,000
Total Appreciation including machinery appreciation (10,00,000 1,50,000 + 5,75,000 – 1,00,000)	<u>16,25,000</u>
Share of DEF Ltd.	<u>32,85,000</u>

3. Post-acquisition profits of XYZ Ltd.

₹

Profit after 1.10. 20X1 [8,20,000-1,00,000]x 6/12	3,60,000
Less: 10% depreciation on ₹ 20,00,000 for 6 months less depreciation already charged for 2 nd half of 20X1-20X2 on ₹ 15,00,000 (1,00,000-75,000)	<u>(25,000)</u>
Share of DEF Ltd.	<u>3,35,000</u>

4. Consolidated total comprehensive income

₹

<i>DEF Ltd.</i>	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1	<u>(0)</u>
Profits for the year 20X1-20X2	5,72,000
Less: Elimination of intra-group dividend	<u>(2,00,000)</u>
Adjusted profit for the year	
<i>XYZ Ltd.</i>	3,72,000

Adjusted profit attributable to DEF Ltd. (W.N.3)	
Consolidated profit or loss for the year	<u>3,35,000</u>
	<u>7,07,000</u>

No Non-controlling Interest as 100% shares of XYZ Ltd. are held by DEF Ltd.

5. Gain on Bargain Purchase

₹

Amount paid for 20,000 shares		34,00,000
Par value of shares	20,00,000	
DEF Ltd.'s share in acquisition date profits of XYZ Ltd.	<u>32,85,000</u>	<u>(52,85,000)</u>
Gain on Bargain Purchase		<u>18,85,000</u>

6. Value of Plant & Machinery

₹

DEF Ltd.		24,00,000
XYZ Ltd.	13,50,000	
Add: Appreciation on 1.10. 20X1	<u>5,75,000</u>	
	19,25,000	
Add: Depreciation for 2nd half charged on pre-revalued value	75,000	
Less: Depreciation on ₹ 20,00,000 for 6 months	<u>(1,00,000)</u>	<u>19,00,000</u>
		<u>43,00,000</u>

7. Consolidated retained earnings

₹

	DEF Ltd.	XYZ Ltd.	Total
As given	5,72,000	8,20,000	13,92,000
<i>Consolidation Adjustments:</i>			
(i) Elimination of pre-acquisition element [3,00,000 + 3,60,000]	0	(6,60,000)	(6,60,000)
(ii) Elimination of intra-group dividend	(2,00,000)	2,00,000	0
(iii) Impact of fair value adjustments	<u>0</u>	<u>(25,000)</u>	<u>(25,000)</u>
Adjusted retained earnings consolidated	<u>3,72,000</u>	<u>3,35,000</u>	<u>7,07,000</u>

Assumptions:

1. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.
 2. Appreciation of ₹10 lakhs in land & buildings is entirely attributable to land element only.
 3. Depreciation on plant and machinery is on WDV method.
 4. Acquisition-date fair value adjustment to inventories of XYZ Ltd. existing at the balance sheet date does not result in need for any write-down.
2. (a) On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50%)
1-Jan-20X1	(500,000,000)	5,870,096	494,129,904	
31-Dec-20X1	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-20X2	100,000,000	44,000,000	297,489,650	45,534,807
31-Dec-20X3	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-20X4	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-20X5	100,000,000	11,000,000	(0)	11,448,430

a. 1 January 20X1 –

Particulars	(₹)	(₹)
Bank A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	494,129,904	494,129,904

b. 31 December 20X1 –

Particulars	(₹)	(₹)
Loan from bank A/c Dr.	98,175,061	155,000,000
Interest expense (profit and loss) Dr.	56,824,939	
To Bank A/c		
(Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)		

c. 31 December 20X2 – Before Wheel Co. Limited approached the bank –

Particulars	(₹)	(₹)
Interest expense (profit and loss) Dr.	45,534,807	44,000,000
To Loan from bank A/c		
To Bank A/c		
(Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)		

Upon receiving the new terms of the loan, Wheel Co. Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @ 15%	Discount factor	PV of cash flows
31-Dec-20X2	(400,000,000)			
31-Dec-20X3	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-20X4	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-20X5	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-20X6	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-20X7	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-20X8	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-20X9	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-20Y0	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-20Y1	40,000,000	12,000,000	0.3754	19,522,235

31-Dec-20Y3	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650
Difference				54,033,141
Percentage of carrying amount				13.59%

Note: Calculation done above is on full decimal, though in the table discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31 December 20X2 – accounting for extinguishment

Particulars	(₹)	(₹)
Loan from bank (old) A/c Dr.	397,489,650	
Loss on modification of loan (profit and loss) Dr.	2,510,350	
To Loan from bank (new) A/c		400,000,000
(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)		

e. 31 December 20X3

Particulars	(₹)	(₹)
Loan from bank A/c Dr.	40,000,000	
Interest expense (profit and loss) Dr.	60,000,000	
To Bank A/c		100,000,000
(Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)		

- (b) Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.
 - (a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.
 - (b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.
3. (a) **Assessing whether the manufacturing unit can be classified as held for sale**
1. **The manufacturing unit can be classified as held for sale due to the following reasons:**
- (i) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is 31st October, 20X1, i.e., the date at which management becomes committed to the plan.
 - (ii) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.
 - (iii) A firm purchase agreement has been entered with the buyer.
 - (iv) The sale is expected to be complete by 30th June, 20X2, i.e., within one year from the date of classification.

2. Measurement of the manufacturing unit as on the date of classification as held for sale

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

The carrying value of the disposal group as on 31st October, 20X1 is determined at ₹ 2,600. The difference between the carrying value as on 31st March, 20X1 and 31st October, 20X1 is accounted for as per the relevant Ind AS.

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The fair value less cost to sell of the disposal group as on 31st October, 20X1 is ₹ 1,750 (i.e. 1,850 - 100). This is lower than the carrying value of ₹ 2,600. Thus, an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between non-current assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value.

Thus, the assets will be measured as under:

Particulars	Carrying value – 31 st October, 20X1	Impairment	Carrying value as per Ind AS 105 – 31 st October, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	-	1,050

Inventory	400	-	400
Creditors	(250)	-	(250)
Loans	<u>(1,850)</u>	<u>-</u>	<u>(1,850)</u>
	<u>2,600</u>	<u>(850)</u>	<u>1,750</u>

3. Measurement of the manufacturing unit as at the year end

The measurement as at the end of the financial year shall be on similar lines as done above.

The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective Standards.

The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.

(b) Journal Entries

Purchase of Machinery on credit basis on 30th January 20X1:

	₹	₹
Machinery A/c (\$ 5,000 x ₹ 60) Dr. To Creditors-Machinery A/c (Initial transaction will be recorded at exchange rate on the date of transaction)	3,00,000	3,00,000

Exchange difference arising on translating monetary item on 31st March 20X1:

	₹	₹
Profit & Loss A/c [(\$ 5,000 x ₹ 65) – (\$ 5,000 x ₹ 60)] Dr. To Creditors-Machinery A/c	25,000	25,000

Machinery A/c Dr.	30,000	
To Revaluation Surplus (OCI)		30,000
[Being Machinery revalued to USD 5,500; (₹ 60 x (\$ 5,500 - \$ 5,000))]		
Machinery A/c Dr.	27,500	
To Revaluation Surplus (OCI)		27,500
(Being Machinery measured at the exchange rate on 31.3.20X1 [\$ 5,500 x (₹ 65 - ₹ 60)])		
Revaluation Surplus (OCI) Dr.	17,250	
To Deferred Tax Liability		17,250
(DTL created @ of 30% of the total OCI amount)		

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

	₹	₹
Creditors-Machinery A/c (\$ 5,000 x ₹ 65) Dr.	3,25,000	
Profit & loss A/c [(5,000 x (₹ 67 - ₹ 65)) Dr.	10,000	
To Bank A/c		3,35,000
Machinery A/c [{ \$ 5,500 x (₹ 67 - ₹ 65)}] Dr.	11,000	
To Revaluation Surplus (OCI)		11,000
Revaluation Surplus (OCI) Dr.	3,300	
To Deferred Tax Liability		3,300
(DTL created @ of 30% of the total OCI amount)		

4. (a) The annual depreciation charges prior to the change in useful life were

Buildings	₹ 1,50,00,000/15 =	₹ 10,00,000
Plant and machinery	₹ 1,00,00,000/10 =	₹ 10,00,000
Furniture and fixtures	₹ 35,00,000/7 =	<u>₹ 5,00,000</u>
Total =		<u>₹ 25,00,000 (A)</u>

The revised annual depreciation for the year ending 31st March, 20X5, would be

Buildings	$[\text{₹}1,50,00,000 - (\text{₹} 10,00,000 \times 3)] / 10$	₹ 12,00,000
Plant and machinery	$[\text{₹} 1,00,00,000 - (\text{₹} 10,00,000 \times 3)] / 7$	₹ 10,00,000
Furniture and fixtures	$[\text{₹} 35,00,000 - (\text{₹} 5,00,000 \times 3)] / 5$	₹ 4,00,000
Total		<u>₹ 26,00,000 (B)</u>

The impact on Statement of Profit and Loss for the year ending 31st March, 20X5 = ₹ 26,00,000 – ₹ 25,00,000 = ₹ 1,00,000

This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected. Accordingly, from 20X4-20X5 onward, excess of ₹ 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

(b) Journal entries in the books of P Ltd (without modification of service period of stock appreciation rights) (₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.25	17.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.38	15.38
31.03.20X5	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.02	17.02

Journal entries in the books of P Ltd
(with modification of service period of stock appreciation
rights)

(₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	28.25	28.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	20.50	20.50

Working Notes:

Calculation of expenses for issue of stock appreciation rights without modification of service period

For the year ended 31st March 20X2

$$= ₹ 210 \times 400 \text{ awards} \times 75 \text{ employees} \times 1 \text{ year} / 4 \text{ years of service} = ₹ 15,75,000$$

For the year ended 31st March 20X3

$$= ₹ 220 \times 400 \text{ awards} \times 75 \text{ employees} \times 2 \text{ years} / 4 \text{ years of service} - ₹ 15,75,000 \text{ previous recognised}$$

$$= ₹ 33,00,000 - ₹ 15,75,000 = ₹ 17,25,000$$

For the year ended 31st March 20X4

$$= ₹ 215 \times 400 \text{ awards} \times 75 \text{ employees} \times 3 \text{ years} / 4 \text{ years of service} - ₹ 33,00,000 \text{ previously recognised}$$

$$= ₹ 48,37,500 - ₹ 33,00,000 = ₹ 15,37,500$$

For the year ended 31st March, 20X5

$$= ₹ 218 \times 400 \text{ awards} \times 75 \text{ employees} \times 4 \text{ years} / 4$$

$$\begin{aligned} & \text{years of service} - ₹ 48,37,500 \text{ previously} \\ & \text{recognised} \\ & = ₹ 65,40,000 - ₹ 48,37,500 = ₹ 17,02,500 \end{aligned}$$

Calculation of expenses for issue of stock appreciation rights with modification of service period

For the year ended 31st March 20X2

$$\begin{aligned} & = ₹ 210 \times 400 \text{ awards} \times 75 \text{ employees} \times 1 \text{ year} / 4 \text{ years} \\ & \text{of service} \\ & = ₹ 15,75,000 \end{aligned}$$

For the year ended 31st March 20X3

$$\begin{aligned} & = ₹ 220 \times 400 \text{ awards} \times 75 \text{ employees} \times 2 \text{ years} / 3 \\ & \text{years of service} - ₹ 15,75,000 \text{ previous recognised} \\ & = ₹ 44,00,000 - ₹ 15,75,000 = ₹ 28,25,000 \end{aligned}$$

For the year ended 31st March 20X4

$$\begin{aligned} & = ₹ 215 \times 400 \text{ awards} \times 75 \text{ employees} \times 3 \text{ years} / 3 \\ & \text{years of service} - ₹ 44,00,000 \text{ previous recognised} \\ & = ₹ 64,50,000 - ₹ 44,00,000 = ₹ 20,50,000. \end{aligned}$$

5. (a) In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus.

AST Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes, and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. AST's best estimate of the early completion bonus is ₹ 2.13 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability- weighted amount (₹ in crore)
15%	3.75	25%	0.9375

10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			<u>2.125</u>

AST Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (₹ 2 crore or Nil) and this method would best predict the amount of consideration associated with the quality bonus. AST Limited believes the most likely amount of the quality bonus is ₹ 2 crore.

Total transaction price would be 25 cr + 2.125 cr + 2 cr = 29.125 cr.

(b) Players' Registrations

Acquisition

As per Ind AS 38 Intangible Assets, the costs associated with the acquisition of players' registrations would need to be capitalized which would be the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire such registrations. In line with Ind AS 38 Intangible Assets, costs would include transfer fees, league levy fees, and player agents' fees incurred by the club, along with other directly attributable costs, if any. Amounts capitalized would be fully amortized over the period covered by the player's contract.

Sale of registrations

Player registrations would be classified as assets held for sale under Ind AS 105 Non-Current Assets Held for Sale and Discontinued Operations when their carrying amount is expected to be recovered principally through a sale transaction and a sale is considered to be highly probable. To consider a sale to be 'highly probable', the assets (in this case, player registrations) should be actively marketed for sale at a price that is reasonable in relation to its current fair value. In the given case, it would appear that the management is committed to a plan to sell the registration, that the asset is available for immediate sale and that an active plan to locate a buyer is already in place by circulating clubs. Ind AS 105 stipulates that it should be unlikely that the plan to sell the registrations would be significantly changed or withdrawn. To fulfil this requirement, it would be prudent if only those registrations are

classified as held for sale where unconditional offers have been received prior to the reporting date.

Once the conditions for classifying assets as held for sale in accordance with Ind AS 105 have been fulfilled, the player registrations would be stated at lower of carrying amount and fair value less costs to sell, with the carrying amount stated in accordance with Ind AS 38 prior to application of Ind AS 105, subjected to impairment, if any.

Profits and losses on sale of players' registrations would be computed by deducting the carrying amount of the players' registrations from the fair value of the consideration receivable, net of transactions costs. In case a portion of the consideration is receivable on the occurrence of a future performance condition (i.e. contingent consideration), this amount would be recognized in the Statement of Profit and Loss only when the conditions are met.

The players registrations disposed of, subsequent to the year end, for ₹ 175 crores, having a corresponding book value of ₹ 49 crores would be disclosed as a non-adjusting event in accordance with Ind AS 10 Events after the Reporting Period.

Impairment review

Ind AS 36 Impairment of Assets requires companies to annually test their assets for impairment. An asset is said to be impaired if the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is higher of the asset's fair value less costs to sell and its value in use (which is the present value of future cash flows expected to arise from the use of the asset). In the given scenario, it is not easy to determine the value in use of any player in isolation as that player cannot generate cash flows on his/her own unless via a sale transaction or an insurance recovery. Whilst any individual player cannot really be separated from the single cash-generating unit (CGU), being a cricket team or a hockey team in the instant case, there may be certain instances where a player is taken out of the CGU when it becomes clear that he/she will not play for the club again. If such circumstances arise, the carrying amount of the player should be assessed against the best estimate of the player's fair value less any costs to sell and an impairment charge should be recognized in the profit or loss, which reflects any loss arising.

(c) Five fundamental principles of ethics for Chartered Accountants:

- (1) Integrity – to be straightforward and honest in all professional and business relationships.
- (2) Objectivity – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.
- (3) Professional Competence and Due Care – to:
 - (i) attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - (ii) act diligently and in accordance with applicable technical and professional standards.
- (4) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.
- (5) Professional Behaviour – to comply with relevant laws and regulations and avoid any conduct that the Chartered Accountant knows or should know might discredit the profession.

6. (a) (i) An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

Particulars	Unit
Entity XYZ's after-tax maintainable profits (A)	₹ 70,000
Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of Company XYZ (A) x (B) x (C)	₹ 8,40,000

Value of a share of XYZ = ₹ 8,40,000 ÷ 5,000 shares = ₹ 168

The fair value of Entity A's investment in XYZ's shares is estimated at ₹ 42,000 (that is, 250 shares x ₹ 168 per share).

(ii) Share price = ₹ 8,50,000 ÷ 5,000 shares = ₹ 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be ₹ 42,500 (250 shares x ₹ 170 per share).

(b) **Either**

Calculation of Net Worth:

Particulars	₹ in crores
Equity Share Capital	160
Securities Premium	200
General Reserve	150
Profit and Loss A/c	75
Miscellaneous Expenditure not written off	(80)
Net Worth as per Section 2(57) of The Companies Act, 2013	505

Note – Revaluation Reserve would not be included in the calculation of net worth as per definition mentioned in section 2(57) of The Companies Act, 2013

The company is a listed company and it does meet the net worth threshold of ₹ 500 Crores. Hence it would be covered under phase I. Hence Ind AS would be applicable to the company for accounting periods beginning on or after 1st April 2016.

Even if Company A is an unlisted company as company A's net worth is more than 500 Crores, it would be covered under Phase I of the road map and hence Ind AS would be applicable for the accounting periods beginning on or after 1st April 2016.

Or

Accounting Treatment:

Trade Receivables fall within the ambit of financial assets under Ind AS 109, Financial Instruments. Thus, the issue in question is whether the factoring arrangement entered into with Samantha Ltd. requires Natasha Ltd. to derecognize the trade receivables from its financial statements.

As per Para 3.2.3, 3.2.4, 3.2.5 and 3.2.6 of Ind AS 109, Financial Instruments, an entity shall derecognise a financial asset when, and only when:

(a) the contractual rights to the cash flows from the financial asset expire, or

- (b) it transfers the financial asset or substantially all the risks and rewards of ownership of the financial asset to another party.

In the given case, since the trade receivables are appearing in the Balance Sheet of Natasha Ltd. as at 31st March 20X2 and are expected to be collected, the contractual rights to the cash flows have not expired.

As far as the transfer of the risks and rewards of ownership is concerned, the factoring arrangement needs to be viewed in its substance, rather than its legal form. Natasha Ltd. has transferred the receivables to Samantha Ltd. for cash of ₹ 250 crores, and yet, it remains liable for making good any shortfall between ₹ 250 crores and the amount collected by Samantha Ltd. Thus, in substance, Natasha Ltd. is effectively liable for the entire ₹ 250 crores, although the shortfall would not be such an amount. Accordingly, Natasha Ltd. retains the credit risk despite the factoring arrangement entered.

It is also explicitly stated in the agreement that Samantha Ltd. would be liable to pay to Natasha Ltd. any amount collected more than ₹ 250 crores, after retaining an amount towards interest. Thus, Natasha Ltd. retains the potential rewards of full settlement.

A perusal of the above clearly shows that substantially all the risks and rewards continue to remain with Natasha Ltd., and hence, the trade receivables should continue to appear in the Balance Sheet of Natasha Ltd. The immediate payment (i.e. consideration as per the factoring agreement) of ₹ 250 crores by Samantha Ltd. to Natasha Ltd. should be regarded as a financial liability and be shown as such by Natasha Ltd. in its Balance Sheet.

(c) (a) At 31st March, 20X1, the end of the reporting period

Present obligation as a result of a past obligating event –

There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion – No provision is recognised for the cost of fitting the smoke filters.

(b) At 31st March, 20X2, the end of the reporting period

Present obligation as a result of a past obligating event –

There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement – Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion – No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

ANSWERS OF MODEL TEST PAPER 6

FINAL COURSE GROUP - I

PAPER – 1: FINANCIAL REPORTING

1. **Option (d):** Provision for ₹ 100 crores
2. **Option (c):** Financial asset measured at FVTPL
3. **Option (b):** A, B and E
4. **Option (a):** ₹ 48,753
5. **Option (c):** ₹ 15,00,000
6. **Option (c):** When there is reasonable assurance that the entity will comply with the conditions and receive the grants.
7. **Option (a):** Conflicts of interest should not compromise professional or business judgement
8. **Option (c):** Only (ii), (iii) and (iv) are true
9. **Option (c):** Current financial liability
10. **Option (d):** ₹ 1,512.80 lakhs
11. **Option (c):** ₹ 2,426 lakhs
12. **Option (a):** Expenses incurred for food court and gaming zone should be capitalised
13. **Option (b):** ₹ 16 crores
14. **Option (d):** ₹ 25 crores
15. **Option (c):** Nikhil Pvt. Ltd. should recognise the fair value of the consideration as part of the business combination, thus increasing goodwill and remeasure it at the end of each reporting period. The impact of change in fair value is recognised in the Statement of Profit and Loss.

PART-II Descriptive Questions

1. **Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.
as at 31st March, 20X4**

	Notes No.	₹ in lakhs
Assets		
Non-current assets		
Property, plant and equipment	1	21,070
Goodwill	2	150
Current assets		
Inventory	3	4,275
Financial assets		
Cash and cash equivalents	4	2,540
Trade receivables	5	6,840
Dividend receivable	6	Nil
Total		<u>34,875</u>
Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 10 each		10,000
Other equity	7	16,292
Non-controlling interest (W.N.4)		1,824
Non-current liabilities		
Financial liabilities		
Borrowings- 13% Debentures	8	2,999
Current Liabilities		
Financial liabilities		
Trade payables	9	2,180
Dividend payable	10	80
Other liabilities		1,500
Total		<u>34,875</u>

Notes to Accounts

1. Property, Plant and Equipment

₹ in lakhs

Particulars	₹	₹
H Ltd.	14,800	
S Ltd. 6,000		
Add: Fair value gain 300		
Less: Additional depreciation due to fair value gain (30)	<u>6,270</u>	21,070

2. Goodwill

₹ in lakhs

Particulars	₹	₹
Goodwill on acquisition of S Ltd. (Refer W.N.3)	250	
Less: Impairment	<u>(100)</u>	150

3. Inventory

₹ in lakhs

Particulars	₹	₹
H Ltd.	2,600	
S Ltd. 2,000		
Less: Fair value loss (300)		
Less: Unrealised gain (200/80% x 20% x 50%) (25)	<u>1,675</u>	4,275

4. Cash and cash equivalent

₹ in lakhs

Particulars	₹	₹	₹
H Ltd.	500		
Add: Cheque in Transit	<u>40</u>	540	
S Ltd.		<u>2,000</u>	2,540

5. Trade Receivable

₹ in lakhs

Particulars	₹	₹
H Ltd. 4,000		
Less: Mutual transaction (160)	3,840	
S Ltd.	<u>3,000</u>	6,840

6. Dividend Receivable

₹ in lakhs

Particulars	₹	₹
H Ltd.	320	
Less: Mutual transaction	<u>(320)</u>	Nil

7. Other Equity (Retained Earnings)

₹ in lakhs

Particulars	₹	₹
H Ltd.	16,320	
Less: Share of pre-acquisition dividend (400 x 80%)	<u>(320)</u>	16,000
Post acquisition RE of S Ltd. (W.N.1)	2,370	
Less: Share of NCI in post-acquisition RE of S Ltd. (2,370 x 20%)	<u>(474)</u>	1,896
Less: Impairment of goodwill (100 x 80%)		(80)
Less: Loss on cancellation of debentures (mutual holding) (W.N.5)		(1,499)
Less: Unrealised gain (W.N.6)		<u>(25)</u>
		<u>16,292</u>

8. Borrowings (13% Debentures)

₹ in lakhs

Particulars	₹	₹
S Ltd.	3,000	
Less: Mutual holding by H Ltd. (1,000 Debentures x ₹ 100)	<u>(1)</u>	2,999

9. Trade Payables

₹ in lakhs

Particulars	₹	₹
H Ltd.	1,700	
S Ltd. 600		
Less: Mutual transaction <u>(120)</u>	<u>480</u>	2,180

10. Dividend Payables**₹ in lakhs**

Particulars	₹	₹
S Ltd.	400	
Less: Mutual transaction	<u>(320)</u>	80

Working Notes:**1. Analysis of Retained Earnings of S Ltd.****₹ in lakhs**

Closing balance as on 31 st March, 20X4	5,000
Less: Pre-acquisition Retained Earnings as on 1 st April, 20X3 (3,000 – 400)	<u>(2,600)</u>
	2,400
Less: Additional depreciation	<u>(30)</u>
Post-acquisition Retained Earnings	<u>2,370</u>

2. Computation of net worth (net identifiable assets) as on 1st April, 20X3**₹ in lakhs**

Share Capital of S Ltd.	4,000
Pre-acquisition Retained Earnings	3,000
Fair value gain on PPE (2,800 – 2,500)	300
Fair value loss on inventory (500 - 200)	<u>(300)</u>
Net Worth or Net Identifiable Assets	<u>7,000</u>

3. Computation of Goodwill on acquisition date of S Ltd.**₹ in lakhs**

Purchase consideration	5,800
NCI (by fair value method) as on 1 st April, 20X3 [(5,800/80%) x 20%]	<u>1,450</u>
	7,250
Less: Net worth or Net Identifiable Assets (W.N.2)	<u>(7,000)</u>
Goodwill as on 1 st April, 20X3	<u>250</u>

4. Non-Controlling Interest as on 31st March, 20X4**₹ in lakhs**

NCI (by fair value method) as on 1 st April, 20X3	1,450
Less: Share of pre-acquisition dividend (400 x 20%)	(80)
Post-acquisition Retained Earnings (2,370 x 20%)	474

Less: Share of impairment of Goodwill (100 x 20%)	<u>(20)</u>
NCI as on 31 st March, 20X4	<u>1,824</u>

5. Loss on settlement of Debentures held by H Ltd. ₹ in lakhs

Investment in Debentures by H Ltd.	1,500
Less: Nominal value of debentures held by H Ltd. (1,000 x ₹ 100)	<u>(1)</u>
Loss on settlement of investment in Debentures	<u>1,499</u>

6. Computation of unrealised gain by H Ltd. on sale of goods to S Ltd. ₹ in lakhs

Cost price of the goods sold	200
Sales price of the goods sold (200/80%)	250
Profit on sale of such goods	50
Unrealized gain on 50% unsold goods (50 x 50%)	25

2. (a) Assessment of the arrangement using the definition of derivative included under Ind AS 109

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

- (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').
- (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- (c) it is settled at a future date.

The contract meets the definition of a derivative as follows:

- (a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

- (b) the initial amount received to enter into the contract is zero.
A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 40,000 on inception.
- (c) the contract is settled in future

The derivative liability is a written put option contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

- **Accounting on 1st January, 20X3**

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

- **Accounting on 31st March, 20X3**

The value of the derivative put option contract shall be recorded as a derivative financial liability in the books of Joe & Co. Ltd. by recording the following journal entry:

Particulars	Dr. (₹)	Cr. (₹)
Profit and loss A/c Dr. To Derivative financial liability (Being mark to market loss on the put option contract recorded)	50,000	50,000

- **Accounting on 30th June, 20X3**

The change in value of the derivative put option contract shall be recorded as a derivative financial liability in the books of Joe & Co. Ltd. by recording the following journal entry:

Particulars	Dr. (₹)	Cr. (₹)
Derivative financial liability A/c Dr. To Profit and loss A/c (Being partial reversal of mark to market loss on the put option contract recorded)	20,000	20,000

- **Accounting on 30th September, 20X3**

The change in value of the derivative option contract shall be recorded at zero in the books of Joe & Co. Ltd. by recording the following journal entry:

Particulars	Dr. (₹)	Cr. (₹)
Derivative financial liability A/c Dr. To Profit and loss A/c (Being gain on mark to market of put option contract booked to make the value of the derivative liability as zero)	30,000	30,000

- **Accounting on 31st December, 20X3**

The settlement of the derivative put option contract by actual purchase of USD 40,000 shall be recorded in the books of Joe & Co. Ltd. upon exercise by Box Ltd. by recording the following journal entry:

Particulars	Dr. (₹)	Cr. (₹)
Bank (USD Account) (@40,000 x ₹ 76) Dr. Profit and loss A/c Dr. To Bank (@ 40,000 x ₹ 78) (Being loss on settlement of put option contract booked on actual purchase of USD)	30,40,000 80,000	31,20,000

- (b) It is assumed that net profit for all the quarters of the year 20X3-20X4 excludes the brought forward losses of ₹ 620 lakh.

Computation of estimated total earnings for the year 20X3-20X4

Quarter	Earnings before tax (in lakhs)
1	650 (actual)
2	360 (actual)
3	(160) (estimated)
4	720+160 = <u>880</u> (estimated)
	<u>730</u> (estimated)

Tax rate for the company = 25 x 110% = 27.5%

Computation of Average Annual Effective Tax Rate

The estimated payment of the annual tax on earnings for the current year:

$$= (1,730-620) \times 27.5\% = ₹ 305.25 \text{ lakhs.}$$

As per Ind AS 34, income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income-tax rate expected for the full financial year.

$$\begin{aligned} \text{Thus, average annual effective tax rate} &= (305.25 / 1,730) \times 100 \\ &= 17.645\% \text{ (approx.)} \end{aligned}$$

Tax expense to be shown in each quarter

Quarter	Earnings before tax (in lakhs)	Tax expense @ 17.645%
1	650 (actual)	114.69
2	360 (actual)	63.52
3	(160) (estimated)	(28.23)
4	720+160 = <u>880 (estimated)</u>	<u>155.27</u>
	<u>1,730 (estimated)</u>	<u>305.25</u>

3. (a) Investment property is held to earn rentals or for capital appreciation or both. Ind AS 40 shall be applied in the recognition, measurement and disclosure of investment property. An investment property shall be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with the requirements of Ind AS 16 for cost model.

The measurement and disclosure of Investment property as per Ind AS 40 in the balance sheet would be as follows:

Particulars	Investment Properties: (₹ in crores)			
	Property X	Property Y		Period ended 31 st March, 20X4
Gross Amount:				
Opening balance	120.00		120.00	

Additions during the year		<u>20.00</u>	<u>20.00</u>	
Closing balance A	120.00	20.00		140.00
Depreciation:				
Opening balance	60.00		60.00	
Depreciation during the year (12 + 1)	<u>12.00</u>	<u>1.00</u>	<u>13.00</u>	
Closing balance B	<u>72.00</u>	<u>1.00</u>		(73.00)
Net balance (A-B)	<u>48.00</u>	<u>19.00</u>		<u>67.00</u>

The changes in the carrying value of investment properties for the year ended 31st March, 20X4 are as follows:

Amount recognized in Profit and Loss with respect to Investment Properties
(₹ in crores)

Particulars	Period ending 31 st March, 20X4
Rental income from investment properties (15.00 + 5.00)	20.00
Less: Direct operating expenses generating rental income (0.50 + 0.10 + 0.25 + 0.15 + 0.20 + 0.10)	<u>(1.30)</u>
Profit from investment properties before depreciation and indirect expenses	18.70
Less: Depreciation	<u>(13.00)</u>
Profit from earnings from investment properties before indirect expenses	<u>5.70</u>

Disclosure Note on Investment Properties acquired by the entity

The investment properties consist of Building X and Building Y. As at 31st March, 20X4, the fair value of the properties is ₹ 105 crores. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased

out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

Description of valuation techniques used and key inputs to valuation on investment properties:

Valuation technique	Significant unobservable inputs	Range (Weighted average)
Discounted cash flow (DCF) method	- Estimated rental value per sq. ft. per month - Rent growth per annum - Discount rate	- ₹ 50 to ₹ 60 - 10% every 3 years - 12% to 13%

(b) Computation of tax base

Particulars	Carrying amount (₹)	Taxbase (₹)
Carrying balance on 1 st April, 20X2	5,00,000	5,00,000
Less: Depreciation	(1,00,000)	(1,00,000)
Balance as on 31 st March, 20X3	4,00,000	4,00,000
No Temporary difference as on 31 st March, 20X3	--	--
Less: Carrying amount on the date of disposal to be reversed (accounting record) (Refer W.N.)	(32,000)	
Less: Sale proceeds of the asset to be deducted as per tax records		(1,00,000)
Less: Depreciation		
Accounting depreciation (4,00,000 x 20%)		
Tax depreciation {(4,00,000 - 1,00,000) x 20%}	(80,000)	(60,000)
Balance of the asset as on 31 st March, 20X4	<u>2,88,000</u>	<u>2,40,000</u>

Working Note:

Accounting book value on 31st March, 20X4

$$= ₹ 50,000 - ₹ 10,000 - ₹ 8,000$$

$$= ₹ 32,000$$

Carrying amount is greater than Tax base which leads to Deferred Tax Liability i.e. Temporary difference = ₹ 2,88,000 - ₹ 2,40,000 = ₹ 48,000

$$\text{Deferred Tax Liability} = ₹ 48,000 \times 35\% = ₹ 16,800$$

4. (a) (i) Accounting Treatment

The present value of such decommissioning and site restoration obligation at the end of 4th year is ₹ 4,41,000 [being 6,00,000 / (1.08)⁴]. Peacock Ltd. will recognize the present value of decommissioning liability of ₹ 4,41,000 as an addition to cost of PPE and will also recognize a corresponding decommissioning liability.

Further, the entity will recognize the unwinding of discount as finance charge every year till the estimated life of the machine.

(ii) Journal Entries

Date	Particular	Dr. (₹)	Cr. (₹)
1 st April, 20X0	Machine A/c (PPE) Dr. To Provision for decommissioning liability (Being the present value of decommissioning liability of ₹ 4,41,000 recognized as an addition to cost of PPE with corresponding recognition to decommissioning liability)	4,41,000	4,41,000
31 st March, 20X1	Finance charge Dr. To Provision for decommissioning liability (Being the unwinding of discount as finance charge recognized at the end of Year 1)	35,280	35,280

31 st March, 20X2	Profit and Loss A/ Dr. To Finance charge (Being Finance charge transferred to Profit & Loss A/c)	35,280	35,280
	Finance charge Dr. To Provision for decommissioning liability (Being the unwinding of discount as finance charge recognized at the end of Year 2)	38,102	38,102
	Profit and Loss A/ Dr. To Finance charge (Being Finance charge transferred to Profit & Loss A/c)	38,102	38,102
31 st March, 20X3	Finance charge Dr. To Provision for decommissioning liability (Being the unwinding of discount as finance charge recognized at the end of Year 3)	41,151	41,151
	Profit and Loss A/c Dr. To Finance charge (Being Finance charge transferred to Profit & Loss A/c)	41,151	41,151
	Finance charge Dr. To Provision for decommissioning liability (Being the unwinding of discount as finance charge recognized at the end of Year 4)	44,467	44,467
31 st March, 20X4	Profit and Loss A/c Dr. To Finance charge (Being Finance charge transferred to Profit & Loss A/c)	44,467	44,467
	Provision for decommissioning liability Dr. To Bank A/c (Being decommissioning liability incurred at the end of the life of the machine i.e. 4 th year)	6,00,000	6,00,000

Working Note:

The following table shows the unwinding of discount (₹)

Year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
1	4,41,000	35,280	4,76,280
2	4,76,280	38,102	5,14,382
3	5,14,382	41,151	5,55,533
4	5,55,533	44,467*	6,00,000

*Difference of ₹ 24 (44,467- 44,443) is due to rounding off.

(b) Journal Entries

31 st March, 20X2		₹	₹
Employee benefits expenses (W.N.1)	Dr.	43,12,500	
To Share-based payment reserve (equity)			43,12,500
(Being 1/3 rd expenses on share-based payment recognised)			
Profit and Loss A/c	Dr.	43,12,500	
To Employee benefits expenses			43,12,500
(Being employee benefits expenses transferred to P/L)			
31 st March, 20X3			
Share-based payment reserve (equity) (W.N.1)	Dr.	3,75,000	
To Employee benefits expenses (transferred to P/L)			3,75,000
(Being reversal of excess expenses booked on computation of 2/3 rd expenses on share-based payment)			
Employee benefits expenses	Dr.	3,75,000	
To Profit and Loss A/c			3,75,000
(Being employee benefits expenses transferred to P/L)			

31st March, 20X4		
Employee benefits expenses (W.N.3) Dr.	35,62,500	
To Share-based payment reserve (equity)		35,62,500
(Being final recognition of expenses on vesting of share-based options)		
Profit and Loss A/c Dr.	35,62,500	
To Employee benefits expenses		35,62,500
(Being employee benefits expenses transferred to P/L)		
31st March, 20X5		
Share-based payment reserve (equity) (W.N.4) Dr.	75,00,000	
Bank A/c (W.N.4) Dr.	42,18,750	
To Share Capital (W.N.4)		9,37,500
To Securities Premium (W.N.4)		1,03,12,500
To Retained Earnings (W.N.4)		4,68,750
(Being accounting on exercise of 375 options and lapse of 25 options)		

Working Notes:

1. Calculation of Employee Benefit Expenses

	31.3.20X2	31.3.20X3	31.3.20X4
No of Employees	750	750	750
Less: Employees left	(25)	(300)	(350)
Less: Employees expected	<u>(35)</u>	<u>(135)</u>	—
No of employees eligible	690	315	400
No of options per employee	250	250	250
Total options expected to vest	172,500	78,750	100,000
Fair value per option	75	75	75
Total FV	12,937,500	5,906,250	7,500,000
	1/3	2/3	3/3
Cumulative expenses	4,312,500	3,937,500	7,500,000
Expense already recognised	-	4,312,500	3,937,500
Expense to be recognised	4,312,500	-375,000	3,562,500

2. For the year ended 31st March, 20X5

Bank = 375 employees x 250 options x ₹ 45 = ₹ 42,18,750

Share capital = 375 employees x 250 options x ₹ 10
= ₹ 9,37,500

Securities Premium = 375 employees x 250 options x
₹ (75 + 35)
= ₹ 1,03,12,500

Retained Earnings = (400-375) employees x 250 options x
₹ 75
= ₹ 4,68,750

5. (a) Points earned on ₹ 1,50,00,000 @ 6 points on every ₹ 400

= [(1,50,00,000/400) x 6] = 2,25,000 points.

Out of 2,25,000 points, it is estimated that 54,000 points will remain unredeemed in the current year. Further, it is expected that 75% of the unredeemed points will be redeemed in the future.

Accordingly, value of points will be computed as follows:

Value of points redeemed in the current year

= (2,25,000-54,000) points x ₹ 0.6 each point = ₹ 1,02,600

Value of points estimated to be redeemed in future

= 54,000 points x 75% x ₹ 0.6 each point = ₹ 24,300

Total value of loyalty points = ₹ 1,02,600 + ₹ 24,300 = ₹ 1,26,900

Revenue recognized for sale of goods

= ₹ 1,48,74,165 [1,50,00,000 x (1,50,00,000 / 1,51,26,900)]

Revenue for points = ₹ 1,25,835 [1,26,900 x (1,50,00,000 / 1,51,26,900)]

Journal Entry for the year 20X3-20X4

		₹	₹
Bank A/c	Dr.	1,50,00,000	
To Sales A/c			1,48,74,165
To Liability under Customer Loyalty programme			1,25,835
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	1,01,739	
To Sales A/c			1,01,739
(On redemption of (2,25,000 – 54,000) points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year

$$= 54,000 \times 75\% = 40,500 \text{ points}$$

Total points to be redeemed within 3 years

$$= [(2,25,000 - 54,000) + 40,500] = 2,11,500 \text{ points}$$

Revenue to be recognised with respect to discounted points

$$= ₹ 1,25,835 \times (1,71,000 / 2,11,500) = ₹ 1,01,739$$

Note: The above answer is based on the consideration that 75% likelihood of redemption of award points in future. **Alternatively,** the 75% likelihood of redemption of award points in future might not be considered. In such a case, the answer would be as follows:

Points earned on ₹ 1,50,00,000 @ 6 points on every ₹ 400

$$= [(1,50,00,000 / 400) \times 6] = 2,25,000 \text{ points.}$$

Out of 2,25,000 points, it is estimated that 54,000 points will remain unredeemed in the current year.

Accordingly, value of points redeemed in the current year

$$= 2,25,000 \text{ points} \times ₹ 0.6 \text{ each point} = ₹ 1,35,000$$

Revenue recognized for sale of goods

$$= ₹ 1,48,66,204 [1,50,00,000 \times (1,50,00,000 / 1,51,35,000)]$$

Revenue for points = ₹ 1,33,796 $[1,35,000 \times (1,50,00,000 / 1,51,35,000)]$

Journal Entry for the year 20X3-20X4

		₹	₹
Bank A/c To Sales A/c To Liability under Customer Loyalty programme (On sale of Goods)	Dr.	1,50,00,000	1,48,66,204 1,33,796
Liability under Customer Loyalty programme To Sales A/c (On redemption of (2,25,000 – 54,000) points)	Dr.	1,08,175	1,08,175

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year

$$= 54,000 \times 75\% = 40,500 \text{ points}$$

Total points to be redeemed within 3 years

$$= [(2,25,000 - 54,000) + 40,500] = 2,11,500 \text{ points}$$

Revenue to be recognised with respect to discounted points

$$= ₹ 1,33,796 \times (1,71,000 / 2,11,500) = ₹ 1,08,175$$

(b) Assessment of Preliminary Impact Assessment on transition to Ind AS of Z Ltd.'s Financial Statements

(i) Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, the book value

	previous GAAP carrying value (book value) as deemed cost.	should be brought up to fair value. The resulting impact of fair valuation of land ₹ 1,00,000 should be adjusted in other equity.
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Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Property, Plant and Equipment Dr. To Revaluation Surplus (OCI- Other Equity) (Being PPE recorded at fair value on the date of transition to Ind AS)	1,00,000	1,00,000

(ii) Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised as the case may be	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is ₹ 2,80,000 as against its book value of ₹ 3,00,000. Accordingly, the difference of ₹ 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Borrowings / Loan payable Dr. To Retained earnings (Being Borrowings recorded at fair value on date of transition to Ind AS)	20,000	20,000

(c) Either

Concept of Offsetting: Offsetting refers to presenting an asset and a liability net or income and expenses net as a single amount, in the financial statements. As per Ind AS, an entity is required to report separately both assets and liabilities, and income and expenses. Offsetting in the statement of profit and loss or balance sheet is not permitted unless when offsetting reflects the substance of the transaction or other event.

Scenarios for determining applicability of the concept of offsetting:

- (a) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising from disposal of various items of property, plant and equipment shall be presented on a net basis. However, gains or losses should be presented separately if they are material.
- (b) As per paragraph 33 of Ind AS 1, offsetting is permitted only when offsetting reflects the substance of the transaction. In this case, the agreement/arrangement, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.
- (c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial

asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously. Accordingly, the receivable and payable should be offset against each other and net amount is presented in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

Or

The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

1. **Comparability:** Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Comparability refers to the use of the same methods for the same items, and uniformity implies that like things must look alike and different things must look different.
2. **Verifiability:** Verifiability means that different knowledgeable and independent observers could reach a consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.
3. **Timeliness:** Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because some users may need to identify and assess trends.
4. **Understandability:** Classifying, characterising and presenting information clearly and concisely makes it understandable.

Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or

does not provide a faithful representation of what it purports to represent.

Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new Ind AS may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.

6. (a) To identify the performance obligations under the contract and determine if they are distinct, an automated process can be implemented using technology. The following steps can be taken:
 - a. Analyze the clauses in the contract related to the services provided (broadband services, voice call services, modem sales).
 - b. Each clause should be codified using appropriate parameters or tags to capture the relevant information.
 - c. Assign Boolean values (0 or 1) to each parameter or tag in the codified clauses.
 - d. Use "0" to represent "No" and "1" to represent "Yes" for each parameter.
 - e. Define the criteria for evaluating the performance obligations based on the parameters and their Boolean values.
 - f. Consider factors such as the type of service involved, benefits derived by the customer, and promises made in the contract regarding the transfer of goods or services.
 - g. Develop an automated algorithm or script that evaluates the Boolean values of the parameters according to the defined criteria.
 - h. Calculate scores or weights for each parameter based on their significance in determining performance obligations.
 - i. Utilize the scores or weights assigned to the parameters to determine if the performance obligations are distinct.

- j. If the total score exceeds a certain threshold, consider it a separate performance obligation.

The automated process should flag and identify these distinct performance obligations based on the evaluation results.

Considering the above facts, the following conclusion arises:

There are three separate obligations

- Broadband Service
- Voice Call Services
- Modem

- (b) According to paragraph 35 of Ind AS 16, when an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

- (i) **The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.**

The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.

In such a situation, the revised carrying amount of the machinery will be as follows:

Gross carrying amount ₹ 5,00,000 $[(4,00,000/2,40,000) \times 3,00,000]$

Less: Net carrying amount (₹ 3,00,000)

Accumulated depreciation ₹ 2,00,000 (1,60,000 + 40,000)

Journal Entry (₹)

Plant and Machinery (Gross Block) Dr.	1,00,000	
To Accumulated Depreciation		40,000
To Revaluation Reserve		60,000
(Being the value of gross block of the asset restated to make it consistent with revalued amount)		

Depreciation subsequent to revaluation

Since the Gross Block has been restated, the depreciation charge will be revised to ₹ 50,000 per annum (₹ 5,00,000 /10 years).

Journal Entry

(₹)

Depreciation	Dr	50,000	
To Accumulated Depreciation			50,000
(Being the revised depreciation after revalued charged)			

(ii) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 39 and 40 of Ind AS 16.

In this case, the gross carrying amount is restated to ₹ 3,00,000 to reflect the fair value and accumulated depreciation is set at zero.

Journal Entry

Accumulated Depreciation	Dr.	₹ 1,60,000	
To Plant and Machinery (Gross Block)			₹1,60,000
(Being the asset brought down to the carrying value)			
Plant and Machinery (Gross Block)	Dr.	₹ 60,000	
To Revaluation Reserve			₹ 60,000
(Being revaluation of the asset recognised)			

Depreciation subsequent to revaluation

Since the revalued amount is the revised gross block, the useful life to be considered is the remaining useful life of the asset which results in the same depreciation charge of ₹ 50,000 per annum as per Option A (₹ 3,00,000 / 6 years).

Journal entry

Depreciation	Dr.	50,000	
To Accumulated Depreciation			50,000
(Being the revised depreciation charged to the Gross Block)			

- (c) (a) In case, it is assumed that the judgement of court has been received after the approval of previous year's financial statements of the reporting entity and the probability for payment of arrears of salaries and wages was remote in the previous year because of which the entity had neither made any provision or disclosure, then the liability for arrears of salary and wages would be considered as a change in accounting estimate in the current year.

Alternatively, if it is assumed that in case the judgement of court has been received before the approval of financial statements of the previous year, then the entity should have adjusted the liability in that year itself. In the absence of said accounting treatment in the previous year, it will be considered a mistake and would be accounted for as a prior period error.

- (b) In the given case, since the information regarding expenses of ₹ 1,50,000 in the previous year was available with the entity, and was omitted due to an oversight, it will be considered as a prior period error.
- (c) As per para 32 of Ind AS 8, a loss allowance for expected credit losses (i.e. provision for doubtful debts) applying Ind AS 109, *Financial Instruments*, is an example of accounting estimate. Hence, any change in the previous year's estimate on account of recovery of such loss allowance in the current year would be a change in the accounting estimate in the current year because of the uncertainties inherent in business activities and it is not possible to measure the provision for doubtful debts with precise accuracy.

- (d) This is neither a case of prior period error nor a change in accounting estimates. In the given case, the company did not have any information as on the balance sheet date and it is the mistake committed by the Group Insurance company and not the reporting entity. Hence, the demand for an additional premium amount by the Group Insurance Company will not be considered as a prior period error for the reporting entity. Further, the entity had paid the premium amount in the previous year, so no accounting estimate was involved thereupon. Therefore, the additional demand cannot be considered as a change in accounting estimate for the reporting entity.