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PAPER – 6E: GLOBAL FINANCIAL REPORTING STANDARDS

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

Case Study 1

Lucky Ltd. is a big business group with diversified business interests. Some of the products manufactured are Television, Mini TV, Camera, CCTV Camera and the accessories needed for the same. The company follows the International Financial Reporting Standards in preparation and presentation of its financial statements. The company seeks your advice for the following transactions as the CFO of the Company is not certain about their treatment.

Preparation of financial statements:

One of its subsidiaries which produces TV remote controller has prepared the following trial balance as on 31st March, 2023

Particulars	₹	₹
Sales		5,20,000
Raw Material Purchased	2,54,000	
Production cost	80,000	
Inventories at 31st March, 2022	72,000	
Distribution Costs	28,000	
Administrative Expenses	30,000	
Goodwill	60,000	
Property, Plant and Equipment	3,00,000	
Accumulated Depreciation at 31st March, 2022		1,00,000
Trade Receivables	90,000	
Trade Payables		24,000
Cash and Cash Equivalents	50,000	
Equity share capital		2,60,000
Retained earnings		92,000
Equity dividend paid on 1st June, 2022	32,000	
Total	9,96,000	9,96,000

It has provided the following information and wants to know the correct adjustments to be made for the same:

(i) On 31st March, 2023, the value of inventory at cost is ₹ 76,000. This includes 1,600 units of inventory costing ₹ 20 each which has been damaged due to water seepage. The cost to repair the units of inventory is ₹ 4 per piece and it is estimated that the units of inventory will be sold for ₹ 19 each.

(ii) Building: Cost ₹ 80,000 and accumulated depreciation ₹ 24,000; Plant and Equipment: Cost ₹ 2,20,000 and accumulated depreciation ₹ 76,000.

(iii) On 1st April, 2022, Lucky Ltd. revalued its building which has original cost of ₹ 80,000 to ₹ 1,16,000. Accumulated depreciation at the date of revaluation is ₹ 24,000.

At the time of revaluation, the remaining useful economic life of building is estimated to be ten years and depreciation is to be charged on the revalued amount on straight line basis. Ignore impact of tax/deferred tax. The plant and equipment are being depreciated on a straight-line basis at 20% per annum. No disposal of property, plant and equipment occurred during the year. The effect for the revaluation and depreciation is yet to be given in the above Trial Balance.

(iv) Depreciation of all property, plant and equipment, being direct expenditure, should be charged to cost of sales. Depreciation has not yet been charged for the year.

Lucky Ltd. owns 500 ordinary shares in Best Ltd., an unquoted company. Best Ltd. has a total share capital of 10,000 shares with a nominal value of ₹ 10 each. Best Ltd.'s after-tax maintainable profits are estimated at ₹ 1,40,000 for the year. An appropriate PE ratio determined from published industry data is 15 (before lack of marketability adjustment). The management of Lucky Ltd, estimates that the discount for the lack of marketability of shares of Best Ltd. and restrictions on their transfer is 20%.

Lucky Ltd. values its holding in Best Ltd.'s shares based on earnings. Lucky Ltd. also estimates the fair value of the investment in shares of Best Ltd. using a net asset valuation technique. The fair value of Best Ltd.'s net assets is ₹ 17,00,000.

Lucky Ltd. has sold 1,500 Mini TV to a retailer, namely, Fine View Ltd. for ₹ 97,50,000 (₹ 6,500 per unit). Lucky Ltd. provides price protection to Fine View Ltd. by agreeing to reimburse for the difference between this price and the lowest price that it offers for Mini TV during the next six months. Lucky Ltd. with its experience with similar arrangements makes the estimate of the following outcomes:

Price reduction in next six months (₹)	*Probability*
0	*60%*
₹ 750	*25%*
₹ 1,250	*15%*

On 1st January, 2023, Lucky Ltd. received a contract to install 300 CCTV cameras in a multi storey building namely "Apartment Sai" for a price of ₹ 5,00,000. Due to shortage of stock of CCTV camera units, Lucky Ltd. purchased those CCTV camera units from another company at the cost of ₹ 1,000 per camera. Transportation and other installation costs to complete the contract is estimated to be ₹ 1,50,000.

The CCTV cameras purchased by Lucky Ltd. have been delivered to the site in February 2023, i.e. three months before they will be installed. Lucky Ltd. uses an input method based on cost to measure progress towards completion. Lucky Ltd. has incurred actual other installation costs of ₹ 60,000 by 31st March, 2023.

Lucky Ltd., on 15th April, 2023, received a notice of demand for an additional liability of ₹ 30,00,000 from Goods and Service Tax Department on account of wrong claim of Input Tax Credit by the company during the financial year 2022-2023. The financial statements for the year 2022-2023 are approved on 30th April, 2023. On 20th April, 2023, the company appealed against the demand of ₹ 30,00,000 and the company is advised by their indirect tax consultants that ultimately the demand would get settled at ₹ 12,00,000.

Lucky Ltd. has been awarded a government grant of ₹ 3,00,000 for creation of job opportunity. The said grant would be received over a period of three years viz. ₹ 2,00,000 in year 1 and ₹ 50,000 in each of years 2 and 3. There is a condition that the company should give employment to minimum 10 persons and such employment should be maintained for at least 3 years. The company has incurred cost of ₹ 1,50,000 on recruitment of employees and the wage bill for the first year is ₹ 5,00,000 which is estimated to increase every year by ₹ 50,000 in each of the subsequent years.

Lucky Ltd. has purchased a Machinery and in consideration thereof has agreed to allot 10,000 shares of the Company of ₹ 100 each and to pay ₹ 2,00,000 in money. The fair value of the Machinery is ₹ 15 lakhs and fair value of shares of the company is ₹ 140 per share.

MCQs

1.1 The cost of sales of TV remote controller manufacturing unit for the year ended 31st March, 2023 will be:

(A) ₹ 3,93,600

(B) ₹ 3,85,600

(C) ₹ 3,76,000

(D) ₹ 3,68,000

1.2 Value of Property, Plant and Equipment to be shown in the financial statements of subsidiary of Lucky Ltd. as on 31st March, 2023 will be:

(A) ₹ 2,00,000

(B) ₹ 2,04,400

(C) ₹ 1,62,000

(D) ₹ 1,76,400

1.3 Determine the fair value of Lucky Ltd.'s investment in Best Ltd. as on the date of Statement of Financial Position based on earnings and net asset valuation technique:

(A) ₹ 21,000 & ₹ 85,000

(B) ₹ 84,000 & ₹ 85,000

(C) ₹ 1,05,000 & ₹ 85,000

(D) ₹ 16,80,000 & ₹ 17,00,000

1.4 Determine the transaction price per Mini TV supplied to Fine View Ltd.:

(A) ₹ 6,125

(B) ₹ 5,250

(C) ₹ 5,750

(D) ₹ 4,500

1.5 Lucky Ltd. shall account for the Machinery received against allotment of shares as below:

(A) Machinery to be recorded at ₹ 15,00,000 and equity will get credited with ₹ 13,00,000.

(B) Machinery to be recorded at ₹ 16,00,000 and equity will get credited with ₹ 14,00,000.

(C) Machinery to be recorded at ₹ 12,00,000 and equity will get credited with ₹ 10,00,000.

(D) Machinery to be recorded at ₹ 15,00,000 and equity will get credited with ₹ 15,00,000.

(5 x 2 = 10 Marks)

Descriptive Questions:

1.6 Explain whether event relating to the receipt of demand notice from the Goods and Service Tax department is an adjusting or non-adjusting event. Show how the above event will have a bearing on the financial statements for the year 2022-2023. ***(4 Marks)***

1.7 How the grant received from the government will be accounted for in the Statement of Profit and Loss and deferred income in the books for year 1, 2 and 3. ***(4 Marks)***

1.8 How will Lucky Ltd. recognize revenue from the contract of installation of CCTV in "Apartment Sai", if performance obligation is met over a period of time? ***(7 Marks)***

ANSWER TO CASE STUDY 1

1.1 Option (A) : ₹ 3,93,600

1.2 Option (B) : ₹ 2,04,400

1.3 Option (B) : ₹ 84,000 and ₹ 85,000

1.4 Option (A) : ₹ 6,125

1.5 Option (A): Machinery to be recorded at ₹ 15,00,000 and equity will get credited with ₹ 13,00,000.

1.6 DEFINITION:

IAS 10 defines 'Events after the Reporting Period' as follows:

Events after the reporting period are "those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) **Adjusting events after the reporting period** i.e., those that provide evidence of conditions that existed at the end of the reporting period: and

(b) **Non-Adjusting events after the reporting period** i.e., those that are indicative of conditions that arose after the reporting period.

ANALYSIS OF FACTS:

In the instant case, the demand notice has been received on 15th April, 2023, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for an additional amount has been raised because of wrong claim of Input tax Credit by the company during the reporting period 2022-2023. Accordingly, the condition existed on 31st March, 2023, as the wrong claim of Input Tax Credit was made during the reporting period 2022-2023 on which additional liability of ₹ 30,00,000 has been levied and the event has been confirmed by the way of receipt of demand notice. Therefore, it is an adjusting event.

CONCLUSION: In accordance with the principles of IAS 37, the company should make a provision in the financial statements for the year 2022-2023, at best estimate of the expenditure to be incurred, i.e., ₹ 12,00,000.

1.7 As per para 7 of IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance', government grants, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

Applying the above provisions in the given scenario, in the lack of information given in the question, two alternative solution is possible based on the following assumption:

(a) There is reasonable assurance that the entity will comply with the conditions attaching to them and the grant will be received

(b) There is no reasonable assurance that the grant will be received, or the entity will comply with the conditions attaching to the grant.

Alternative 1 When there is reasonable assurance

The grant of ₹ 3,00,000 should be recognised at the beginning of the first year as receivable and will be compensated for the related costs over three years.

The initial journal entry would be:

Grant Receivable Ac	Dr. ₹ 3,00,000	
To Deferred Income A/c		₹ 3,00,000

Calculation of grant income and deferred income:

Year	Labour Cost	Grant Income	Computation of Grant Income	Deferred Income at the end of the year	Computation of deferred income at the end of the year
	₹	₹		₹	
1	6,50,000	1,08,333	3,00,000 x (650 / 1,800)	1,91,667	(3,00,000 – 1,08,333)
2	5,50,000	91,667	3,00,000 x (550 / 1,800)	1,00,000	(1,91,667 – 91,667)
3	6,00,000	1,00,000	3,00,000 x (600 / 1,800)	-	(1,00,000 – 1,00,000)
	18,00,000	3,00,000			

Therefore, grant income to be recognised in the Statement of Profit or Loss for the years 1, 2 and 3 would be ₹ 1,08,333, ₹ 91,667 and ₹ 1,00,000 respectively.

The amount of grant that has not yet been credited to the statement of profit or loss i.e. deferred income is to be shown in the Statement of financial position. Hence deferred income balance as at end of year 1, 2 and 3 are ₹ 1,91,667, ₹ 1,00,000 and Nil respectively.

Alternative 2: When reasonable assurance is not there

The grant of ₹ 3,00,000 should be recognised over three years to compensate for the related costs.

The journal entry on receipt of grant at year 1 would be:

Grant Receivable Ac Dr. ₹ 2,00,000

To Deferred Income A/c ₹ 2,00,000

Calculation of Grant Income and Deferred Income:

Year	Labour Cost	Grant Income	Computation of Grant Income	Deferred Income at the end of the year	Computation of deferred income at the end of the year
	₹	₹		₹	
1	6,50,000	1,08,333	3,00,000 x (650 / 1,800)	91,667	(2,00,000 – 1,08,333)
2	5,50,000	91,667	3,00,000 x (550 / 1,800)	50,000	(2,50,000 – 1,08,333 – 91,667)
3	6,00,000	1,00,000	3,00,000 x (600 / 1,800)	-	(3,00,000 – 1,08,333 – 91,667 – 1,00,000)
	18,00,000	3,00,000			

Therefore, grant income to be recognised in the Statement of Profit or Loss for the years 1, 2 and 3 would be ₹ 1,08,333, ₹ 91,667 and ₹ 1,00,000 respectively.

The amount of grant that has not yet been credited to the statement of profit or loss i.e. deferred income is to be shown in the Statement of financial position. Hence deferred income balance as at end of year 1, 2 and 3 are ₹ 91,667, ₹ 50,000 and Nil respectively.

1.8 FACTS OF THE CASE:

Costs to be incurred comprise two major components – CCTV cameras and service cost of installation of those CCTV cameras.

(a) The CCTV cameras are part of the overall installation project and are not a distinct performance obligation

(b) The cost of CCTV cameras is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such CCTV cameras; and

(d) There is no modification done to the CCTV cameras, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall installation project, the company is a principal in the transaction with the customer for such CCTV cameras also.

Therefore, applying the guidance on Input method –

(i) The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs;

(ii) The cost of CCTV cameras should be excluded when measuring such progress; and

(iii) Revenue for such CCTV cameras should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (₹)
Transaction price	5,00,000
Costs incurred:	
(a) Cost of CCTV cameras (300 cameras x ₹ 1,000 per camera)	3,00,000
(b) Other costs	1,50,000
Cost incurred till date on installation	60,000
Total attributable revenue other than CCTV cameras	(5,00,000 – 3,00,000) = 2,00,000
Measure of progress:	60,000 / 1,50,000 = 40%
Revenue to be recognised:	
(a) For costs incurred (other than CCTV cameras) (5,00,000 – 3,00,000)	(2,00,000 x 40%) = 80,000
(b) Revenue for CCTV cameras	3,00,000 (equal to costs incurred)
Total revenue to be recognised	3,00,000 + 80,000 = 3,80,000

Therefore, for the year ended 31st March, 2023, Lucky Ltd. shall recognize revenue of ₹ 3,80,000 on the project.

Case Study 2

Beauty Ltd. is a diversified group having multiple business interests in many countries. The group publishes its financial statements following International Financial Reporting Standards. During closure of books for the year ended 31st March, 2023, certain transactions were highlighted by the group finance team. The Finance Controller needs your assistance on the treatment of the following transactions.

Beauty Ltd. has commenced construction of a factory building on 1st April, 2021. It borrowed ₹ 9 million for construction purposes at 11% annual rate of interest. The construction of the *building was completed on 31st October, 2022 and was ready for use as on that date. However, the factory production commenced from 15th December, 2022:*

Beauty Ltd. has granted 500 share options to its 100 employees at a price of ₹ 12 each. The market value is ₹ 22. The fair value of the option at grant date was ₹ 13. The options are to vest after three years from the grant date. The fair values of the options are estimated at ₹ 14, ₹ 15 and ₹ 17 respectively for the next three years.

Beauty Ltd. has acquired a property on lease by paying a premium of ₹ 11,00,000 for a lease term of five years. Fair value of the asset is ₹ 19,50,000. As per the terms, the annual lease rent is ₹ 2,00,000 per annum for the next five years. The present value of annual lease rent is ₹ 7,60,000. The company, having taken this property for further let out, will recognize the same as investment property under IAS 40.

Further, Beauty Ltd. has given on monthly lease office space at Pune to Akil Ltd. for a period of 10 years, on a monthly rent of ₹ 30,000. Rent will be increased after every 4 years by 10% over the previous rent paid. This lease does not amount to Finance lease.

One of the notes to the financial statements gives details of purchases of ₹ 5,98,000 made by Beauty Ltd. from King Ltd. during the financial year 2022-2023. Mr. Praveen, the Managing Director, owns 100% of the shares in King Ltd. However, he feels that there is no requirement for any disclosure to be made in financial statements of Beauty Ltd. since the transaction is carried out on normal commercial terms and is totally insignificant to Beauty Ltd. as it represents less than 1% of Beauty Ltd.'s purchases.

The State Government holds 60% shares in Beauty Ltd. and 55% shares in Fine Ltd. Beauty Ltd. has two subsidiaries, namely B Ltd. and L Ltd. Fine Ltd. has two subsidiaries, namely F Ltd. and R Ltd. Mr. Dew is one of the Key Management Personnel in Beauty Ltd.

Beauty Ltd. granted 400 Stock Appreciation Rights (SAR) each to 75 employees on 1st April, 2021 with a fair value ₹ 400. The SARs will be settled in cash. The terms of the award require the employees to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March, 2022	*₹ 420*
31st March, 2023	*₹ 440*
31st March, 2024	*₹ 430*
31st March, 2025	*₹ 436*

MCQs

2.1 Beauty Ltd., the company shall recognize lease rent as monthly income for office space at Pune:

(A) ₹ 32,400

(B) ₹ 32,460

(C) ₹ 33,000

(D) ₹ 33,100

2.2 How much interest should be capitalised for construction of factory building during the year ended 31st March, 2023?

(A) ₹ 7,42,500

(B) ₹ 5,77,500

(C) ₹ 9,90,000

(D) ₹ 6,60,000

2,3 The employee benefit cost on account of Stock Option granted to employees to be recognised in the income statement for year 1 is:

(A) ₹ 2,16,666

(B) ₹ 1,66,666

(C) ₹ 2,00,000

(D) ₹ 3,66,667

2.4 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash or by issuing equity instruments, the entity shall account for that transaction as ________ if, and to the extent that, entity has not incurred a liability to settle in cash or other assets.

(A) Cash-settled share-based payment transaction

(B) Equity-settled share-based payment transaction

(C) Share-based payment arrangement

(D) Compound financial instrument

2.5 The initial cost of the investment property taken on lease shall be recorded at:

(A) ₹ 7,60,000

(B) ₹ 11,00,000

(C) ₹ 18,60,000

(D) ₹ 19,00,000 ***(5 x 2 = 10 Marks)***

Descriptive Questions:

2.6 Explain with reasons whether the contention of Mr. Praveen, Managing Director, not to make any disclosure of purchases made from King Ltd. is in compliance with the provisions of IAS / IFRS. ***(5 Marks)***

2.7 Determine the entity to whom exemption from disclosure of related party transactions is to be given, if the state government has significant influence. Also examine the transactions and with whom such exemption does not apply. ***(4 Marks)***

2.8 Find out the expenses for issue of stock appreciation rights and pass necessary journal entries. ***(6 Marks)***

ANSWER TO CASE STUDY 2

2.1 Option (B) : ₹ 32,460

2.2 Option (B) : ₹ 5,77,500

2.3 Option (A) : ₹ 2,16,666

2.4 Option (B) : Equity-settled share-based payment transaction

2.5 Option (C) : ₹ 18,60,000

2.6 Aspects of Related Parties:

Related parties are generally characterised by the presence of control or influence between the two parties.

Definition of Related Parties:

Para 9(b)(vi) of IAS 24 'Related Party Disclosures' states that the two entities are related if key management personnel of one entity controls another entity. On this basis, King Ltd. is a related party of Beauty Ltd. as Mr. Praveen a Managing Director of Beauty Ltd. controls King Ltd.by owning 100% shares of King Ltd.

Disclosure Requirement:

Hence, the transactions between Beauty Ltd. and King Ltd. are required to be disclosed in the financial statements of Beauty Ltd. as related party transactions.

Manner of Disclosure:

Where transactions occur with related parties, IAS 24 requires that details of the transactions are disclosed in Notes to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Conclusion: Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to Beauty Ltd. does not affect the need for disclosure.

2.7 Requirement of IAS:

As per para 18 of IAS 24, 'Related Party Disclosures', if an entity had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

Exempted Reporting entities:

However, as per para 25 of the standard a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

(i) a government that has control or joint control of, or significant influence over, the reporting entity; and

(ii) another entity that is a related party because the same government has control or joint control of or significant influence over, both the reporting entity and the other entity.

Nature of Exemptions:

According to the above paras, in financial statements of all entities, the exemption in paragraph 25 applies to:

(i) transactions with the State Government; and

(ii) transactions with Other Related Entities viz Beauty Ltd., Fine Ltd., B Ltd., L Ltd., F Ltd. and R Ltd.

Applicability of Exemption:

However, that exemption does not apply to transactions with Mr. Dew. The transactions with Mr. Dew need to be disclosed under related party transactions.

2.8 Calculation of expenses for issue of stock appreciation rights

For the year ended 31st March 2022

= ₹ 420 x 400 awards x 75 employees x 1 year / 4 years of service

= ₹ 31,50,000

For the year ended 31st March 2023

= ₹ 440 x 400 awards x 75 employees x 2 years / 4 years of service - ₹ 31,50,000 previous recognised

= ₹ 66,00,000 - ₹ 31,50,000 = ₹ 34,50,000

For the year ended 31st March 2024

= ₹ 430 x 400 awards x 75 employees x 3 years / 4 years of service - ₹ 66,00,000 previously recognised

= ₹ 96,75,000 - ₹ 66,00,000 = ₹ 30,75,000

For the year ended 31st March, 2025

= ₹ 436 x 400 awards x 75 employees x 4 years / 4 years of service – ₹ 96,75,000 previously recognised

= ₹ 1,30,80,000 – ₹ 96,75,000 = ₹ 34,05,000

Journal entries in the books of Beauty Ltd **(₹)**

Date	Particulars	Debit	Credit
31.03.2022	Employee benefit expenses Dr.	31,50,000	
	To Liability against SARs		31,50,000
	(Being expenses liability for stock appreciation rights recognised)		
	Profit or Loss account Dr.	31,50,000	
	To Employee benefit expenses		31,50,000
	(Being expenses transferred to Profit or loss)		
31.03.2023	Employee benefit expenses Dr.	34,50,000	
	To Liability against SARs		34,50,000
	(Being expenses liability for stock appreciation rights recognised)		

	Profit or Loss account Dr. To Employee benefit expenses (Being expenses transferred to Profit or loss)	34,50,000	34,50,000
31.03.2024	Employee benefit expenses Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	30,75,000	30,75,000
	Profit or Loss account Dr. To Employee benefit expenses (Being expenses transferred to Profit or loss)	30,75,000	30,75,000
31.03.2025	Employee benefit expenses Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	34,05,000	34,05,000
	Profit or Loss account Dr. To Employee benefit expenses (Being expenses transferred to Profit or loss)	34,05,000	34,05,000

Case Study 3

Universe Ltd. is engaged in the construction industry and prepares its financial statements following International Financial Reporting Standards and follows April-March as their financial year. During the year 2022-2023, the company has faced some issues and for their solution seeks your professional advice.

On 1st April, 2019, Universe Ltd. purchased a land property for ₹ 4,00,00,000 and immediately leased the property to Diamond Ltd. on an operating lease. Annual rentals were ₹ 30,00,000. On 31st March, 2022, the fair value of the property was ₹ 5,40,00,000. Under the terms of the lease, Diamond Ltd. has an option to cancel the lease by giving six months' notice in writing to Universe Ltd. Diamond Ltd. gave this notice on 31st March, 2022 and vacated the *property on 30th September, 2022. On 30th September, 2022, the fair value of the property was ₹ 5,80,00,000.*

On 1st October, 2022, Universe Ltd. immediately began to convert the property into ten separate flats of equal size for sale in the ordinary course of its business. Universe Ltd. has incurred a total of ₹ 1,20,00,000 on this conversion project during the period from 1st October, 2022 to 31st March, 2023. As on 31st March, 2023, the project was in progress and not yet complete. The directors of Universe Ltd. estimate that for completion of the project, they will be required to further incur a sum of ₹ 80,00,000 and on completion, each flat can be sold for ₹ 1,00,00,000.

On 1st April, 2022, Universe Ltd. acquires 75 percent of the equity interest of Star Pvt. Ltd. for cash consideration of ₹ 750 lakhs. The owners of Star Pvt. Limited have been in dire need of funds and have to dispose of their investments within a short time. Hence, there was constraint of time to search for good buyer. The management of Universe Ltd. initially measured the separately recognizable identifiable assets acquired and the liabilities assumed as on the acquisition date in accordance with the requirement of IFRS 3. The identifiable assets are measured at ₹ 1,250 lakhs and the liabilities assumed are measured at ₹ 300 lakhs. Universe Ltd. has taken consultancy from an independent consultant, who has determined the fair value of 25 per cent non-controlling interest in Star Pvt. Ltd. to be ₹ 150 lakhs.

Universe Ltd. has reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in Star Pvt. Ltd. and the consideration transferred. After the review, it has come to the conclusion that the procedures and resulting measures were appropriate.

Universe Ltd. issued 10,00,000 8% term bonds of ₹ 1 each on 1st April, 2022, due for redemption on 1st April, 2025. Interest is payable annually on 1st April. The expectation of Investors from such an instrument is an effective interest rate of 10%. The Company seeks your assistance in determining the amount of proceeds it can receive from the issue of bond.

The following data was the extract of final statements from the records of Universe Ltd.:

	31.3.2023 (₹)	31.3.2022 (₹)
Current Assets:		
Inventory	4,60,000	5,45,000
Trade receivables	7,15,000	6,14,000
Cash & cash equivalents	2,05,000	1,11,500
Current Liabilities:		
Trade payable	6,85,000	6,95,000
Provision for tax	2,44,000	2,45,000

Summary of Statement of Profit and Loss

	₹	₹
Sales	*2,60,50,000*	
Less: Cost of sales	*(1,72,00,000)*	*88,50,000*
Other Income:		
Interest income	*1,10,000*	
Fire insurance claim received	*3,80,000*	*4,90,000*
		93,40,000
Expenses:		
Depreciation	*(1,22,000)*	
Administrative and selling expenses	*(46,70,000)*	
Interest expenses	*(1,58,000)*	
Foreign exchange loss	*(1,04,000)*	*(50,54,000)*
Net Profit before tax and extraordinary income		*42,86,000*
Income Tax		*(3,85,000)*
Net Profit		*39,01,000*

Additional information:

Trade receivables and Trade payables represent transactions relating to credit sale and credit purchase only. Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

Universe Ltd. has 450 employees which are same as it was a year ago. The company has observed average staff attrition rate of 6% per annum. The company has been providing an annual bonus to all its employees for the last 10 years. Universe Ltd. has paid bonus to all those employees who have been in service during the whole of the financial year. Bonus is paid in June following the financial year-end. The bonus of ₹ 1,25,000 to each of employee for 2021-2022 was paid in June 2022. There is a trend that Universe Ltd. increases amount of bonus based on official inflation rate which is 8% for 2022-2023, although there is no legal obligation to increase the bonus by such inflation rate.

As per HR policy of the Universe Ltd., the employees are entitled to ten working days of paid sick leave for each year. Unused sick leave may be carried forward for one financial year. The employees are entitled to take Sick leave, first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). As per HR department, as on 31st March 2023, the average unused entitlement is two days per employee. The *management, based on its past experience, expects that only 15% of the employees will use one (1) day from their carried forward leave. Salary per day is ₹ 2,000.*

MCQs

3.1 The value of flats to be shown in financial statements as on 31st March 2023 will be:

(A) ₹ 10,00,00,000

(B) ₹ 9,20,00,000

(C) ₹ 5,80,00,000

(D) ₹ 5,20,00,000

3.2 The carrying value of the reclassified property on 30th September, 2022 will be:

(A) ₹ 4,00,00,000

(B) ₹ 5,20,00,000

(C) ₹ 5,80,00,000

(D) ₹ 7 ,00,00,000

3.3 How much bonus should Universe Ltd. recognize as liabilities for the employee benefits as on 31st March, 2023?

(A) ₹ 6,07,05,000

(B) ₹ 5,71,05,000

(C) ₹ 5,28,75,000

(D) ₹ 5,62,50,000

3.4 Compute the expenses in respect of the short-term compensated absences, if they are assumed to be (a) vested short-term compensated absences, and (b) non-vested short-term compensated absences.

(A) ₹ 15,30,000 & ₹ 1,35,000

(B) ₹ 18,00,000 & ₹ 1,35,000

(C) ₹ 9,00,000 & ₹ 1,35,000

(D) ₹ 15,30,000 & ₹ 2,70,000

3.5 As per IAS 19, in case of Employee Benefits, accumulating paid absences to be carried forward and allowing the same to be used in the next financial year is classified as

(A) Post- employment benefits

(B) Termination benefits

(C) Short- term employee benefits

(D) Other long term employee benefits ***(5 x 2 = 10 Marks)***

Descriptive Questions:

3.6 Calculate the gain or loss on acquisition of Star Pvt. Ltd. and show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Star Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied.

(4 Marks)

3.7 Prepare Statement of Cash flows of Universe Ltd., showing cash generated from Operating Activities using direct method. ***(6 Marks)***

3.8 Calculate the selling price (proceeds) of the bonds issue. How should Universe Ltd. account for the bonds on initial recognition, subsequent measurement and on maturity?

Discounting factor:

3 years, 10% discounting factor = 0.7513

3 years cumulative, 10% discounting factor = 2.4869 ***(5 Marks)***

ANSWER TO CASE STUDY 3

3.1 Either Option (D) : ₹ 5,20,00,000 (If Cost model is followed)

Or No correct Option (If Fair value model is followed)

3.2 Either Option (A) : ₹ 4,00,00,000 (If Cost model is followed)

Or Option (C) : ₹ 5,80,00,000 (If Fair value model is followed)

3.3 Option (B) : ₹ 5,71,05,000

3.4 Option (B) : ₹ 18,00,000 and ₹ 1,35,000

3.5 Option (C) : Short-term employee benefits

3.6 (i) Computation of Net Identifiable Assets of Star Pvt. Ltd.

Fair value of total assets of Star Pvt. Ltd. on the date of acquisition	₹ 1,250 lakhs
Less: Liabilities assumed	(₹ 300 lakhs)
Net Identifiable Assets of Star Pvt. Ltd.	₹ 950 lakhs

(ii) Computation of Gain on Bargain Purchase of Star Pvt. Ltd. when NCI is measured at fair value

	₹ in lakhs
Purchase Consideration	750

Non-controlling Interest (given)	150
	900
Less: Net Identifiable Assets	(950)
Goodwill / (Gain on Bargain Purchase)	**(50)**

Universe Ltd. shall recognise the resulting gain of 75% interest at ₹ 50 lakh in profit or loss on the acquisition date. The gain shall be attributed to Universe Ltd. as per para 34 of IFRS 3.

(iii) Journal Entry

	₹ in lakh	₹ in lakh
Identifiable assets acquired Dr.	1,250	
To Cash (Purchase Consideration)		750
To Liabilities assumed		300
To Gain on the bargain purchase (Profit or loss)		50
To Non-controlling interest in Star Pvt Ltd.		150

(iv) Computation of Non-controlling interest on the basis of proportionate share of net identifiable assets of the acquiree

Fair value of net identifiable assets = ₹ 950 lakhs

Non-controlling interest = 25%

Non-controlling interest = ₹ 950 lakhs x 25% = ₹ 237.50 lakhs

3.7 Statement of Cash Flows from Operating Activities of Universe Ltd. for the year ended 31st March, 2023 (Direct Method)

Particulars	₹	₹
Operating Activities:		
Cash received from Trade Receivables (W.N.3)		2,59,49,000
Less: Cash paid to Suppliers (W.N.2)	1,71,25,000	
Payment for Administration and Selling expenses	46,70,000	
Payment for Income-tax (W.N.4)	3,86,000	(2,21,81,000)
		37,68,000
Adjustment for exceptional items (fire insurance claim)		3,80,000
Net cash generated from operating activities		41,48,000

Working Notes:

1. **Calculation of total purchases**

   Cost of Sales = Opening Stock + Purchases – Closing Stock

   ₹ 1,72,00,000 = ₹ 5,45,000 + Purchases – ₹ 4,60,000

   Purchases = ₹ 1,71,15,000

2. **Calculation of cash paid to Suppliers**

Trade Payables

	₹		₹
To Bank A/c (bal. fig.)	1,71,25,000	By Balance b/d	6,95,000
To Balance c/d	6,85,000	By Purchases (W.N. 1)	1,71,15,000
	1,78,10,000		1,78,10,000

3. **Calculation of cash received from Customers**

Trade Receivables

	₹		₹
To Balance b/d	6,14,000	By Bank A/c (bal. fig.)	2,59,49,000
To Sales	2,60,50,000	By Balance c/d	7,15,000
	2,66,64,000		2,66,64,000

4. **Calculation of tax paid during the year in cash**

Provision for tax

	₹		₹
To Bank A/c (bal. fig.)	3,86,000	By Balance b/d	2,45,000
To Balance c/d	2,44,000	By Profit or Loss A/c	3,85,000
	6,30,000		6,30,000

3.8 Since the effective interest rate is different from the rate of bond, the bond must have been issued at an amount different from the face value of the bond.

Maturity value of bond = ₹ 10,00,000

Interest on bond = ₹ 10,00,000 x 8% = ₹ 80,000

PV of interest to be paid = ₹ 80,000 x 2.4869 = ₹ 1,98,952

PV of principal amount paid = ₹ 10,00,000 x 0.7513 = ₹ 7,51,300

Total present value for initial recognition or sale proceeds should be = ₹ 7,51,300 + ₹ 1,98,952

Amortised cost is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

Therefore, the bond will subsequently be measured at amortised cost as follows:

Date	Particulars		Dr. (₹)	Cr. (₹)
1st April, 2022	Bank A/c	Dr.	9,50,252	
	To Bonds payable			9,50,252
31st March, 2023	Finance cost – interest on Bond	Dr.	95,025	
	To Bonds payable			15,025
	To Bank			80,000
31st March, 2024	Finance cost – interest on Bond	Dr.	96,528	
	To Bonds payable			16,528
	To Bank			80,000
31st March, 2025	Finance cost – interest on Bond	Dr.	98,195	
	To Bonds payable			18,195
	To Bank			80,000
	Bonds payable	Dr.	10,00,000	
	To Bank			10,00,000

Year	Opening balance	Finance cost @ 10%	Interest cash outflow @ 8%	Amount
	a	**b**	**c**	**d = a + b - c**
2022-2023	9,50,252	95,025	80,000	9,65,277
2023-2024	9,65,277	96,528	80,000	9,81,805
2024-2025	9,81,805	98,195*	80,000	10,00,000

* Difference is due to approximation.

Case Study 4

D Limited is a global company and prepares and presents its financial statements following International Financial Reporting Standards as its securities are listed on NY Stock Exchange. D Limited has number of business segments.

D Limited is manufacturer of defense equipment. It takes about 10 months from the receipt of material for manufacturing to the completion of the product being ready for delivery. The customer for this supply is Ministry of Defence and it takes about 9 months from the date of invoice i.e. the date of sale to make the final payment.

D Limited has entered into a contract with AM Limited for modification of their manufacturing facility which is having single performance obligation.

Based on its experience, D Limited determines that this contract will take approximately 300 hours in total to complete the project and charges ₹ 250 per hour.

After incurring 150 hours of time, D Liniited and AM Limited agree to change an aspect of the project and increase the estimate of labour hours by 100 hours at the rate of ₹ 150 per hour. The entity recognizes the effect of the modification on a cumulative catch-up basis.

D Limited is having investment in equity shares in another company F Limited as at the end of the reporting period i.e. 31st March, 2023. After the end of the reporting period but before the authorization of the financial statements, it has been found that value of investment was fraudulently inflated by committing a computation error.

D Limited is in the process of acquisition of shares of MT Limited as part of business reorganization plan. The projected free cash flows of MT Limited for the next 5 years are as follows:

					₹ in crores
	Year 1	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Cash Flows	*180*	*190*	*200*	*210*	*220*
Terminal Value					*4,000*

The weighted average cost of capital of MT Limited is 11%. The total debt as on measurement date is ₹ 1,500 crores and the surplus cash & cash equivalents is ₹ 100 crores. Total number of share of MT Limited as on date of measurements is 10,00,00,000 (Ten Crore) shares.

D Limited is also engaged in the business of manufacturing of corrugated boxes which are used as packing material for cosmetic industry and non-pharmaceutical companies. It has a wholly owned Subsidiary, G Limited, located in Europe, which is engaged in the business of *manufacturing cosmetic products. G Limited purchases the packing material from its parent company. The demand of G Limited is very high and hence to cater to its shortfall, G Limited also purchases the packing material from other companies. Purchases are made at competitive prices.*

D Limited sold packing material to G Limited for Euro 25 lakhs on 15th February, 2023. The cost of these packing material was ₹ 1,750 lakhs in the books of D Limited at the time of sale. At the year-end i.e. 31st March, 2023, all these packing materials were lying as closing stock with G Limited and the amount was also payable in their books.

Following additional information Is available:

Euro is the functional currency of G Limited while Indian Rupee is the functional currency of D Limited. Exchange rate on 15th February, 2023: 1 Euro = ₹ 80 and Exchange rate on 31st March, 2023: 1 Euro = ₹ 83.

D Limited issued 2500 share options to its 10 directors for an exercise price of ₹ 250. The directors are required to stay with the company for next 3 years.

- *Fair value of the option estimated: ₹ 275*
- *Expected number of directors to vest the option: 8*

During year 2, due to crisis in the company, the management decided to cancel the offer with immediate effect. It was estimated further as below:

- *Fair value of option at the time of cancellation was ₹ 200*
- *Market price of the share at the cancellation date was ₹ 220*

Due to cancellation, compensation of ₹ 210 per option was paid to 9 directors who were currently in employment.

D Limited has also received the following grants for its newly started venture of manufacturing defence equipment in defence corridor as a result of its commitment to invest in Global Investor Summit:

(a) ₹ 50 lakhs received as an incentive for setting up an industry.

(b) ₹ 75 lakhs received for carrying out research and development in the field of innovation of defence equipment.

(c) Five acres of land (fair value: ₹ 25 lakhs) received in defence corridor for set up of the plant.

(d) ₹ 5 lakhs received for purchase of machinery of ₹ 50 lakhs. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight-line basis.

U Limited has purchased a Software from LT Limited in exchange of a Machinery which was not in use by the company. The carrying amount of machinery in the books of D Limited is ₹ 20 lakhs and its fair value is ₹ 21 lakhs. The carrying amount of Software in the books of LT Limited is ₹ 22 lakhs and the fair value of software is ₹ 20.50 lakhs.

MCQs

4.1 How the entries shall be passed on purchase of Software in exchange of Machinery in the books of D Limited and LT Limited? = 10

	D Limited	LT Limited
(A)	Software Dr. ₹ 20 Lakhs To Machinery ₹ 20 Lakhs	Machinery Dr ₹ 22 Lakhs To Software ₹ 22 Lakhs
(B)	Software Dr. ₹ 21 Lakhs To Machinery ₹ 20 Lakhs To Gain on Sale of Machinery ₹ 1 Lakh	Machinery Dr. ₹ 20.50 Lakhs Loss on Sale of Software ₹ 1.50 Lakhs To Software ₹ 22.00 Lakhs
(C)	Software Dr. ₹ 20.50 Lakhs To Machinery ₹ 20 Lakhs To Gain on Sale of Machinery ₹ 0.50 Lakhs	Machinery Dr. ₹ 21.00 Lakhs Loss on Sale of Software ₹ 1.00 Lakhs To Software ₹ 22.00 Lakhs
(D)	Being Exchange, no entry will be passed	Being Exchange, no entry will be passed.

4.2 **Scenario 1 :** Production time is 10 months and time lag between the date of sale and collection from the customer is 9 months.

Scenario 2 : Production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months.

(A) In both the scenario the inventory and trade receivables are current in nature.

(B) In both the scenario the inventory and trade receivables are non-current in nature.

(C) In Scenario 1, inventory and trade receivables are current in nature and in Scenario 2 inventory and trade receivables are non-current in nature.

(D) In Scenario 1, inventory and trade receivables are non-current in nature and in Scenario 2 inventory and trade receivables are current in nature.

4.3 Determine how contract modification with AM Limited will be accounted for as per IFRS 15?

(A) Decrease in revenue by ₹ 3,750

(B) Increase in revenue by ₹ 3,750

(C) Decrease in revenue by ₹ 15,000

(D) Increase in revenue by ₹ 15,000

4.4 Should the event of fraudulency in value of investment be adjusted in the financial statements for the year ended 31st March 2023?

(A) The event is not an adjusting event, hence no adjustment is required.

(B) The event is an adjusting event, hence adjustment is required.

(C) Disclosure of the facts is sufficient in the financial statements and no impact will be given in value of investments.

(D) Neither any disclosure is required nor any adjustment is required as this has come to knowledge after the end of the reporting period.

4.5 Determine the value of a share of MT Limited as per Income Approach as per IFRS 13.

(A) ₹ 310.55

(B) ₹ 250.45

(C) ₹ 170.55

(D) ₹ 320.55 ***(5 x 2 = 10 Marks)***

Descriptive Questions:

4.6 Provide the accounting treatment for the sale and purchase of packaging material in books of D Limited and G Limited as the case may be. Also show its impact on consolidated financial statements. Support your answer by Journal Entries, wherever necessary, in the books of D Limited. ***(6 Marks)***

4.7 Please record the cancellation of share option scheme in the books of D Limited.

(5 Marks)

4.8 How should D Limited recognize each government grant in its books of account as per IAS 20? ***(4 Marks)***

ANSWER TO CASE STUDY 4

4.1 Option (B) :

D Ltd.		LT Ltd.	
Software	Dr. ₹ 21 lakhs	Machinery	Dr. ₹ 20.50 lakhs
To Machinery	₹ 20 lakhs	Loss on sale of Software	Dr. ₹ 1.50 lakhs
To Gain on Sale of Machinery	₹ 1 lakhs	To Software	₹ 22.00 lakhs

4.2 Option (A) : In both the scenario the inventory and trade receivables are current in nature.

4.3 Option (A) : Decrease in revenue by ₹ 3,750

4.4 Option (B) : The event is an adjusting event, hence adjustment is required.

4.5 Option (C) : ₹ 170.55

4.6 Accounting treatment in the books of D Ltd. (Functional Currency INR)

D Ltd. will recognize sales of ₹ 2,000 lakhs (25 lakhs Euro x ₹ 80)

Profit on sale of inventory = ₹ 2,000 lakhs – ₹ 1,750 lakhs = ₹ 250 lakhs.

In the Statement of Financial Position receivable from G Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 83. Therefore, unrealised forex gain will be recorded in standalone profit or loss of ₹ 75 lakhs (i.e. (₹ 83 - ₹ 80) x Euro 25 lakhs).

Journal Entries

		(₹ in lakhs)	(₹ in lakhs)
G Ltd. A/c	Dr.	2,000	
To Sales			2,000
(Being revenue recorded on initial recognition)			
G Ltd. A/c	Dr.	75	
To Foreign exchange difference (unrealised)			75
(Being foreign exchange difference recorded at the year-end)			

Accounting treatment in the books of G Ltd (Functional currency EURO)

G Ltd. will recognize purchases on 15th February, 2023 of Euro 25 lakhs which will also be its closing stock at year end.

Journal Entry

		(in Euros)	(in Euros)
Purchases	Dr.	25 lakhs	
To D Ltd.			25 lakhs

Accounting treatment in the consolidated financial statements of D Ltd.

Receivables and payables in respect of above-mentioned sale / purchase between D Ltd. and G Ltd. will get eliminated.

The closing stock of G Ltd will be recorded at lower of cost or NRV.

	(Euros in lakhs)	Rate	(₹ in lakhs)
Cost	25	80	2,000
NRV (Assumed Same)	25	83	2,075

Therefore, no write off is required.

The amount of closing stock of ₹ 2,000 lakhs includes two components:

- Cost of inventory for ₹ 1,750 lakhs; and
- Profit element of ₹ 250 lakhs; and

At the time of consolidation, the second element amounting to ₹ 250 lakhs will be eliminated from the closing stock.

Journal Entry

	(₹ in lakhs)	(₹ in lakhs)
Consolidated P&L A/c Dr.	250	
To Inventory		250
(Being profit element of intragroup transaction eliminated)		

4.7 Alternative 1: When it is assumed that 2,500 share options are given to each of the Directors

A)	Expenses to be recognised	Year 1	Year 2	
	Expected directors to remain in service at the end of the vesting period	8	9	
	Fair value of option	275	275	
	Number of options granted to each Director	2,500	2,500	
	Total	55,00,000	61,87,500	
	Expense weightage	1/3	Full	Full, as it is cancelled
	Expense for the year	18,33,333	43,54,167	Remaining amount recognised immediately as per para 28(a) of IFRS 2

B)	Cancellation compensation	
	Number of directors	9
	Amount agreed to pay	210
	Number of options / director	2,500
	Compensation amount (9 x 210 x 2,500) [Also refer accounting treatment 1 and 2]	47,25,000

Accounting treatment as per para 28(b) of IFRS 2

1. **Amount to be deducted from Equity**

Number of directors	(A)	9
Fair value of option (at the date of cancellation)	(B)	200
Number of options / director	(C)	2,500
Total	(A x B x C)	45,00,000

2. **Amount transferred to Profit or Loss**

Total cancellation compensation	47,25,000
Less: To deduct from Equity	(45,00,000)
Balance transferred to Profit or Loss	2,25,000

Alternative 2: When it is assumed that 2,500 share options are given in total to 10 Directors

A) Expenses to be recognised	Year 1	Year 2	
Expected directors to remain in service at the end of the vesting period	8	9	
Fair value of option	275	275	
Number of options granted to each Director	250	250	
Total	5,50,000	6,18,750	
Expense weightage	1/3		Full, as it is cancelled
Expense for the year	1,83,333	4,35,417	Remaining amount recognised immediately as per para 28(a) of IFRS 2

B) Cancellation compensation	
Number of directors	9
Amount agreed to pay	210
Number of options / director	250
Compensation amount (9 x 210 x 250) [Also refer accounting treatment 1 and 2]	4,72,500

Accounting treatment as per para 28(b) of IFRS 2

1. **Amount to be deducted from Equity**

Number of directors	(A)	9
Fair value of option (at the date of cancellation)	(B)	200
Number of options / director	(C)	250
Total (A x B x C)		4,50,000

2. **Amount transferred to Profit or Loss**

Total cancellation compensation	4,72,500
Less: To deduct from Equity	(4,50,000)
Balance transferred to Profit or Loss	22,500

4.8 D Ltd. should recognise the grants received in the following manner:

- **₹ 50 Lakhs received as an incentive:**

  ₹ 50 lakhs have been received as an incentive for setting up the industry. This should be recognised in Statement of Profit or Loss immediately as there are no conditions attached to the grant.

- **₹ 75 lakhs received for research and development:**

  ₹ 75 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate.

- **Five Acres of Free Land:**

  Land should be recognised at fair value of ₹ 25 lakhs and government grants should be presented in the Statement of financial position by setting up the grant as deferred income.

  Alternatively, deduct the amount of grant from the cost of the asset. In the given case, the land is granted at no cost. It will be presented in the books at nominal value.

- **₹ 5 Lakhs received for purchase of Machinery:**

  ₹ 5 lakhs should be recognised as deferred income and will be transferred to profit or loss over the useful life of the asset. In this case, ₹ 50,000 [₹ 5 lakhs/10] should be credited to profit or loss each year over a period of 10 years.

Alternatively, ₹ 5,00,000 will be deducted from the cost of the asset of ₹ 50,00,000 and depreciation will be charged on ₹ 45,00,000 (₹ 50,00,000 – ₹ 5,00,000) over its useful life of 10 years as ₹ 4,50,000 per year (i.e. ₹ 45,00,000 / 10 years).

Case Study 5

Zebra Limited is a part of multi-national company. It is required to prepare and present its accounts following the International Financial Reporting Standards.

Zebra Limited enters into 10 years contract with Supplier A for the right to transport oil from India to Bangladesh through Supplier A's pipeline. The Contract provides that Zebra Limited will have the right to use 95% of the pipeline capacity throughout the terms of the contract.

Zebra Limited on 1st April, 2022 borrowed @12% ₹ 75 lakhs to finance the construction of two assets viz. factory building and office building which can be identified as qualifying assets. The construction of both the assets started on 1st April, 2022. The loan was availed and disbursed on 1st April, 2022 and was utilized as follows with remaining funds invested temporarily at 8% in government securities.

On Factory Building

On 1st April, 2022 - ₹ 30 lakhs

On 1st October, 2022 - ₹ 20 lakhs

On Office Building

On 1st April, 2022 - ₹ 10 lakhs

On 1st October, 2022- ₹ 15 lakhs

Zebra Limited has two cash generating units X and Y. There is no goodwill within Unit's carrying value. The carrying value of CGU X is ₹ 10 lakhs and CGU Y is ₹ 40 lakhs. The company has an office building which is being used as an administrative office of the company and has not been included in above values and can be allocated to each of the cash generating units on the basis of their respective carrying values. The office building has a carrying value of ₹ 10 lakhs. The recoverable amounts are based on value in use of ₹ 10 lakhs for CGU X and ₹ 50 lakhs for CGU Y.

Zebra Limited, on 31st March 2023, paid ₹ 125 lakhs for acquisition of 100% interest in Marco Limited. Marco Limited's net assets on the date of acquisition is having a fair value of ₹ 70 lakhs. In addition, Marco Limited also had the following rights which have not been recognized in its books:

- *Trademark named "Super" - which using a discounted cash flow technique is valued at ₹ 4.20 lakhs.*

- *Sole distribution rights for an electronic product; future cash flow from which is estimated to be ₹ 3.00 lakhs per annum for the next 5 years.*

  10% discount rate is considered appropriate. The annuity factor of 5 years @ 10% is 3.79.

Zebra Limited has an investment property (building) which is being carried in books as on 31st March, 2022 at ₹ 25 lakhs. The company follows the fair value model for accounting of investment property. During the year ending 31st March 2023, the company Zebra Limited has stopped letting out the building and started using it as its office premises. On 31st March, 2023, management estimates the fair value of building at ₹ 22 lakhs. The cost of building is ₹ 20 lakhs and as per cost model the written down value will be ₹ 15 lakhs.

On 1st April, 2021, Zebra Limited purchased a property at ₹ 120 lakhs, and the company is required to make the payment in three equal installments of ₹ 40 lakhs over a two year period (Payments are made on 1st April, 2021, 31st March, 2022 and 31st March, 2023). Implicit rate of interest is 5.36 percent p.a.

Zebra Limited has done the following expenditure on a new production process in 2022-2023:

- *From 1st April, 2022 to 31st December, 2022 - ₹ 2,000 lakhs*
- *From 1st January, 2023 to 31st March, 2023 - ₹ 1,000 lakhs*
- *Total Expenditure - ₹ 3,000 lakhs*

The production process met the intangible assets recognition criteria for development on 1st January, 2023. The amount estimated to be recoverable from the process is ₹ 1,200 1akhs.

Expenditure incurred for development of the process in financial year 2023-2024 is ₹ 11,000 lakhs. Intangible asset is brought into use on 31st March, 2024 and is expected to be used for 6 years.

As at 31st March, 2025, the recoverable amount of the production process is expected to be ₹ 8,000 lakhs.

Zebra Limited has entered into a contract to supply 1,000 computers to IT Company which is setting up its office for ₹ 10 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 15 million. The penalty for non-performance of the contract is expected to be ₹ 2 million.

MCQs

5.1 Case 1 : Should Zebra Limited treat the pipeline as identified assets while determining the contract as 'lease' as per IFRS 16 where it has a right to use 95% of the pipeline capacity?

Case 2 : Will your answer be different if Zebra Limited has the right to use only 65% of the pipeline capacity throughout the terms of the contract ?

(A) Zebra Limited should treat the pipeline as identified assets in case 1 only.

(B) Zebra Limited should treat the pipeline as identified assets in case 2 only.

(C) Zebra Limited should treat the pipeline as identified assets in both cases.

(D) Zebra Limited should not treat the pipeline as identified assets in any of the case.

5 .2 The cost of assets and borrowing cost to be capitalized of two qualifying assets (i.e. Factory Building and Office Building) as per IAS 23 will be:

(A) ₹ 56,00,000 and ₹ 28,00,000

(B) ₹ 50,00,000 and ₹ 25,00,000

(C) ₹ 55,20,000 and ₹ 27,40,000

(D) ₹ 54,80,000 and ₹ 27,10,000

5.3 The amount of impairment loss of CGU X and CGU Y will be:

(A) ₹ 2 lakhs impairment loss for CGU X only.

(B) ₹ 2 lakhs impairment loss for CGU Y only.

(C) ₹ 2 lakhs impairment loss for CGU X and ₹ 2 lakhs impairment loss for CGU Y.

(D) No impairment loss for any of the CGU.

5.4 Goodwill and other intangible assets arising on the acquisition of Marco Limited as per IAS 38 will be:

(A) ₹ 55.00 lakhs

(B) ₹ 39.43 lakhs

(C) ₹ 50.80 lakhs

(D) ₹ 43.63 lakhs

5.5 Zebra Limited should reclassify its investment property into owner occupied property as on 31st March, 2023 at:

(A) ₹ 25 lakhs

(B) ₹ 22 lakhs

(C) ₹ 20 lakhs

(D) ₹ 15 lakhs ***(5 x 2 = 10 Marks)***

Descriptive Question

5.6 Pass the necessary journal entries for treatment of purchase of property on deferred payment basis in the books of Zebra Limited as per IAS 16. ***(6 Marks)***

5.7 Compute the carrying amount of the intangible assets, namely the new production process, as at 31st March, 2023 and 31st March, 2024. Also determine the charge to the Statement of Profit and Loss for financial year 2022-2023. What is the carrying amount of the *intangible assets as at 31st March, 2025 and what shall be the amount charged to Statement of Profit and Loss for the year 2024-2025 on account of impairment loss?*

(5 Marks)

5.8 *Is the contract to supply 1,000 computers, as given in facts of the case, an onerous contract as per IAS 37. If yes, how much provision in this regard is required?* ***(4 Marks)***

ANSWER TO CASE STUDY 5

5.1 Option (A) : Zebra Limited should treat the pipeline as identified assets in case 1 only.

5.2 Option (C) : ₹ 55,20,000 and ₹ 27,40,000

5.3 Option (A) : ₹ 2 lakhs impairment loss for CGU X only.

5.4 Option (A) : ₹ 55 lakhs

5.5 Option (B) : ₹ 22 lakhs

5.6 IAS 16 requires that the cost of an item of PPE is the cash price equivalent at the recognition date. Hence, the purchaser that takes up the deferred payment terms will recognise the acquisition of the asset as follows:

		(₹)	(₹)
<u>On 1st April, 2021</u>			
Property, Plant and Equipment (W.N. 1)	Dr.	1,14,00,000	
To Bank A/c			40,00,000
To Accounts Payable (W.N. 2)			74,00,000
(Initial recognition of property along with payment of 1st installment)			
<u>On 31st March, 2022</u>			
Interest Expense (W.N. 2)	Dr.	3,96,640	
Accounts payable (W.N. 2)	Dr.	36,03,360	
To Bank A/c			40,00,000
(Recognition of interest expense and payment of second installment)			
<u>On 31st March, 2023</u>			
Interest Expense (W.N. 2)	Dr.	2,03,360	
Accounts payable (W.N. 2)	Dr.	37,96,640	
To Bank A/c			40,00,000
(Recognition of interest expense and payment of final installment)			

Working Notes:

1. **Calculation of cash price equivalent at initial recognition**

Year	Payment	Discounting factor @ 5.36%	Present value
1.4.2021	40,00,000	1.000	40,00,000
31.3.2022	40,00,000	0.949	37,96,000
31.3.2023	40,00,000	0.901	36,04,000
Initial date cash price equivalent	1,20,00,000		1,14,00,000

2. **Calculation of interest expenses**

Year	Opening balance (a)	Interest @ 5.36% (b) = (a) x 5.36%	Total payment at year beginning (c)	Principal amount in the instalment (d) = (c) – (b)	Closing balance (e) = (a) -(d)
1.4.2021	1,14,00,000		40,00,000	40,00,000	74,00,000
31.3.2022	74,00,000	3,96,640	40,00,000	36,03,360	37,96,640
31.3.2023	37,96,640	2,03,360*	40,00,000	37,96,640	Nil

*Difference is due to approximation.

5.7 **(₹ in lakhs)**

(1) Expenditure to be transferred to profit or loss in 2022-2023

Total Expenditure	3,000
Less: Expenditure during development phase to be capitalised	(1,000)
Expenditure to be transferred to profit or loss	2,000

(2) Carrying amount of intangible asset on 31st March, 2023

Expenditure during Development Phase will be capitalised	1000

(Recoverable amount is higher being ₹ 1,200 lakhs, hence no impairment)

(3) Carrying amount of intangible asset on 31st March, 2024

Carrying amount of intangible asset on 31st March, 2023	1,000
Add: Further expenditure during development phase	11,000
Total capital expenditure on development phase	12,000

(4) Expenditure to be charged to profit or loss in 2024-2025

Opening balance of Intangible Asset	12,000
Less: Amortisation for the year (12,000 / 6)	(2,000)
Carrying amount of intangible asset	10,000
Less: Recoverable Amount	(8,000)
Amount charged to profit or loss on account of impairment loss	2,000

(5) Carrying Amount of Intangible Asset on 31st March, 2025

Value of Intangible Asset will be recoverable amount	8,000

5.8 Definition of "Onerous Contract:

IAS 37 *"Provisions, Contingent Liabilities and Contingent Assets"* defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Method of Determining "Unavoidable cost":

Paragraph 68 of IAS 37 states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

Conclusion:

In the instant case, cost of fulfilling the contract is ₹ 5 million (₹ 15 million – ₹ 10 million) i.e., unavoidable cost of meeting the obligation exceeds the economic benefit expected from it and hence it is "Onerous Contract" and cost of exiting from the contract by paying penalty is ₹ 2 million.

Quantum of Provision:

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it, i.e., at ₹ 2 million (lower of ₹ 2 million and ₹ 5 million).