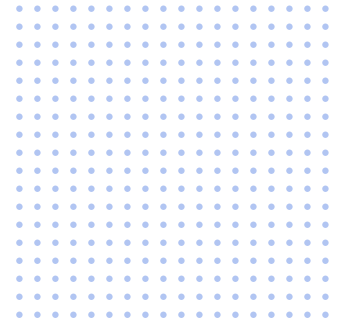




FOR CA FINAL EXAM PREPARATION

CA Final 2023 Suggested Answers · Paper 1 Financial Reporting (Old Scheme)

EXAM	YEAR	TYPE
CA Final	2023	Suggested Answers

SUBJECT	DATE
Paper 1 Financial Reporting (Old Scheme)	November 2023

PAPER – 1 : FINANCIAL REPORTING

Question No. 1 is compulsory. Candidates are required to answer any **four** questions from the remaining **five** questions.

Working notes should form part of the respective answers.

Question 1

The extracts of the Balance Sheets of Hammer Ltd. and its subsidiary Sleet Ltd. as on 31st March, 2023 are given below:

Particulars	Note No.	Hammer Ltd. (₹)	Sleet Ltd. (₹)
I. ASSETS			
A. Non-Current Assets			
Property, Plant and Equipment	1	6,00,000	3,25,000
Intangible Assets	2	1,25,000	75,000
Investments		6,25,000	1,25,000
B. Current Assets			
Inventories		1,25,000	1,60,000
Financial Assets			
Trade receivables		3,25,000	2,90,000
Cash and Cash equivalents		<u>1,50,000</u>	<u>3,50,000</u>
Total Assets		<u>19,50,000</u>	<u>13,25,000</u>
II EQUITY AND LIABILITIES			
A. Equity			
Equity Share Capital (₹ 10 each)		10,00,000	5,00,000
Other Equity	3	5,50,000	3,75,000
B. Non- Current Liabilities			
Financial Liabilities			
Borrowings	4	-	1,00,000

2

FINAL EXAMINATION: NOVEMBER, 2023

C. Current Liabilities			
Financial Liabilities			
Short term borrowings			
Bank Overdraft		1,00,000	50,000
Trade Payables		<u>3,00,000</u>	<u>3,00,000</u>
Total Equity and Liabilities		<u>19,50,000</u>	<u>13,25,000</u>

Notes to Accounts

Note No.	Particulars	Hammer Ltd. (₹)	Sleek Ltd. (₹)
1.	Property, Plant and Equipment		
	(a) Plant and Machinery	2,00,000	1,25,000
	(b) Furniture and Fittings	<u>4,00,000</u>	<u>2,00,000</u>
		<u>6,00,000</u>	<u>3,25,000</u>
2.	Intangible Assets		
	Goodwill	1,25,000	75,000
3.	Other Equity		
	(a) General Reserve	2,00,000	1,25,000
	(b) Retained Earnings	<u>3,50,000</u>	<u>2,50,000</u>
		<u>5,50,000</u>	<u>3,75,000</u>
4.	Borrowings		
	8% Debentures of ₹ 100 each	-	1,00,000

Additional information:

Hammer Ltd. acquired 20,000 equity shares of Sleek Ltd. on 1st April, 2022 at a cost of ₹ 2,40,000 and further acquired 17,500 equity shares on 1st October, 2022 at a cost of ₹ 1,92,500;

The 8% debentures of Sleek Ltd. includes debentures held by Hammer Ltd. of nominal value of ₹ 35,000. These were acquired by Hammer Ltd. on 1st January, 2022 at a cost of ₹ 84,000;

The retained earnings of Sleek Ltd. had a credit balance of ₹ 75,000 as on 1st April, 2022. On that date the balance of General Reserve was ₹ 50,000;

PAPER – 1 : FINANCIAL REPORTING**3**

- Sleek Ltd. had paid dividend @ 10% on its paid-up equity share capital out of the balance of retained earnings as on 1st April, 2022 for the financial year 2021-2022. The entire dividend received by Hammer Ltd. was credited in its statement of profit and loss;
- As per the resolution dated 28th February 2023, Sleek Ltd. had allotted bonus shares @ 1 equity share for every 10 shares held out of its general reserve. The accounting effect has not been given;
- Trade receivables of Hammer Ltd. includes bills receivables of ₹ 2,00,000 drawn upon Sleek Ltd. Out of this, bills of ₹ 50,000 have been discounted with bank;
- During the financial year 2022-2023, Hammer Ltd. purchased goods from Sleek Ltd., of ₹ 25,000 at a sales price of ₹ 30,000, 40% of these goods remained unsold on 31st March, 2023;
- On 1st October, 2022, machinery of Sleek Ltd. was overvalued by 20,000 for which necessary adjustments are to be made. Depreciation is charged @ 10% per annum;
- The parent company i.e., Hammer Ltd. has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume the fair value per equity share of Sleek Ltd. at ₹ 11 on the date when control of Sleek Ltd. was acquired by Hammer Ltd.

You are required to prepare a consolidated balance sheet, as per Ind AS, of Hammer Ltd. and its subsidiary Sleek Ltd. as at 31st March, 2023. **(20 Marks)**

Answer**Consolidated Balance Sheet of Hammer Ltd. as at 31st March, 2023**

	Notes No.	₹ in lakhs
Assets		
Non-current assets		
Property, plant and equipment	1	9,06,000
Intangible assets	1	2,00,000
Financial assets		
Investment	1	2,33,500
Current assets		
Inventories	1	2,83,000

4

FINAL EXAMINATION: NOVEMBER, 2023

Financial assets		
Trade receivables	1	4,65,000
Cash and cash equivalents	1	<u>5,00,000</u>
Total		<u>25,87,500</u>
Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 10 each	2	10,00,000
Other equity	3	7,47,750
Non-controlling interest (W.N.)		1,74,750
Non-current liabilities:		
Financial liabilities		
Borrowings	1	65,000
Current Liabilities:		
Financial liabilities		
Bank Overdraft	1	1,50,000
Trade payables	1	<u>4,50,000</u>
Total		<u>25,87,500</u>

Notes to Accounts

Note 1: Assets and Liabilities

₹

Particulars	Hammer Ltd.	Sleek Ltd.	Adjustments	Total
Property, Plant and Equipment	6,00,000	3,25,000	-20,000 +1,000	9,06,000
Intangible Assets	1,25,000	75,000		2,00,000
Investments	1,92,500*	1,25,000	-84,000	2,33,500
Inventories	1,25,000	1,60,000	-2,000	2,83,000
Trade Receivables	3,25,000	2,90,000	-1,50,000	4,65,000
Cash and Cash Equivalents	1,50,000	3,50,000		5,00,000
Borrowings	0	1,00,000	-35,000	65,000
Bank Overdraft	1,00,000	50,000		1,50,000
Trade Payables	3,00,000	3,00,000	-1,50,000	4,50,000

*6,25,000 – 2,40,000-1,92,500

PAPER – 1 : FINANCIAL REPORTING

5

Note 2: Equity Share Capital

1,00,000 equity shares of ₹ 10 each, fully paid	<u>10,00,000</u>
	<u>10,00,000</u>

Note 3: Consolidated Other Equity

General Reserve	W.N.1	2,28,125
Retained Earnings	W.N.1	3,64,625
Capital Reserve	W.N.2	<u>1,55,000</u>
		<u>7,47,750</u>

Working Notes:

1. Consolidated Other Equity

Particulars	General Reserve	Retained Earnings
Standalone - Hammer Ltd.	2,00,000	3,50,000
Less: Fair Value Loss of existing stake [2,40,000 - (20,000 x 11)]		(20,000)
Less: Loss on cancellation of debentures		(49,000)
Add: Share in Post-acquisition Profits	<u>28,125</u>	<u>83,625</u>
	<u>2,28,125</u>	<u>3,64,625</u>

2. Computation of Goodwill or Bargain Purchase for (75% stake)

(i) Computation of net worth (net identifiable assets) as on 1st October, 2022

Share Capital	5,00,000
Pre-acquisition Retained Earnings (after adjusting downward revaluation of machinery)	1,17,500
Pre-acquisition General Reserve	37,500
Bonus issue*	<u>50,000</u>
Net Identifiable assets	<u>7,05,000</u>

***Note:** Bonus shares issued in 1:10 ratio i.e. ₹ 50,000 and bonus issue has not been accounted for yet. The opening balance of the general reserve is ₹ 50,000 while the closing balance is ₹ 1,25,000 which implies that ₹ 75,000 have been

6

FINAL EXAMINATION: NOVEMBER, 2023

transferred during the year and this amount should be allocated between pre and post-acquisition based on time proportion. Therefore, the general reserve on the date of acquisition will be ₹ 50,000 + 50% of ₹ 75,000 i.e. ₹ 37,500 = ₹ 87,500. Here, it should be noted that the date of bonus issue is 28th February, 2023 and bonus amount is ₹ 50,000. Since the balance of post-acquisition general reserve (50% of ₹ 75,000 i.e. ₹ 37,500) is insufficient, it is assumed that bonus shares are issued from pre-acquisition general reserve i.e. balance on the date of acquisition assuming that transfer to general reserve, in general, is an appropriation of profit which is done at the end of the year. This implies that outstanding balance in general reserve at the time of bonus issue is the opening balance.

However, one may assume otherwise like insufficient post-acquisition balance of ₹ 12,500 (50,000 – 37,500) has only been adjusted through pre-acquisition share of ₹ 87,500 or first adjustment of bonus issue has been done and later bifurcation of remaining balance has been done into pre and post-acquisition. In such a case balance of consolidated general reserve (post-acquisition), net worth, bargain purchase and NCI will undergo a change.

(ii) Computation of bargain purchase i.e capital reserve

Net worth or Net identifiable assets		7,05,000
Purchase consideration (1,92,500 + 2,20,000)	4,12,500	
NCI [12,500 shares x ₹ 11 (i.e. ₹ 1,92,500 / 17,500 shares)]	<u>1,37,500</u>	<u>5,50,000</u>
Bargain purchase (capital reserve)		<u>1,55,000</u>

3. Non-Controlling Interest A/c (at Fair Value)

NCI at fair value as on 1 st October, 2023	1,37,500
Post-acquisition General Reserve	9,375
Post-acquisition Retained Earnings	<u>27,875</u>
NCI at fair value as on 31 st March, 2023	<u>1,74,750</u>

PAPER – 1 : FINANCIAL REPORTING

7

4. Analysis of Other Equity

(i) General Reserve

Closing balance as on 31 st March, 2023		1,25,000
Less: Opening Balance	pre	<u>(50,000)</u>
Net Profit transferred during the year		<u>75,000</u>
For 6 months till 30 th September, 2022	pre	37,500
For 6 months from 1 st October, 2022 to 31 st March, 2023	post	<u>37,500</u>
Total pre-acquisition reserve (50,000 + 37,500)	pre	87,500
Less: Bonus issue	pre	<u>(50,000)</u>
Balance General Reserve	pre	<u>37,500</u>
Share of Hammer Ltd. in pre-acquisition reserve (75%)	pre	28,125
Share of NCI in pre-acquisition reserve (25%)	pre	9,375
Share of Hammer Ltd. in post-acquisition reserve (75%)	post	28,125
Share of NCI in post-acquisition reserve (25%)	post	9,375

(ii) Retained Earnings (RE)

Closing balance as on 31 st March, 2023		2,50,000
Less: Opening balance		75,000
Less: Dividend @10%	pre	<u>(50,000)</u>
During the year		<u>2,25,000</u>
For 6 months till 30 th September, 2022	pre	<u>1,12,500</u>
For 6 months from 1 st October 2022 to 31 st March, 2023	post	1,12,500
Add: Saving in Depreciation (W.N.5)		1,000
Less: Unrealised Gain [(30,000-25,000) x 40%]		<u>(2,000)</u>
Net post-acquisition RE	post	<u>1,11,500</u>
Total pre-acquisition RE (25,000 + 1,12,500)	pre	1,37,500
Less: Downward revaluation of machinery		<u>(20,000)</u>
	pre	<u>1,17,500</u>

8

FINAL EXAMINATION: NOVEMBER, 2023

Share of Hammer Ltd. in pre-acquisition RE (75%)	pre	88,125
Share of NCI in pre-acquisition RE (25%)	pre	29,375
Share of Hammer Ltd. in post-acquisition RE (75%)	post	83,625
Share of NCI in post-acquisition RE (25%)	post	27,875

5. Plant and Machinery balance as on 31st March 2023

	₹
Balance as on 31.3.2023 as given in question (after depreciation)	1,25,000
Less: Downward revaluation less depreciation saving	<u>(19,000)*</u>
	<u>1,06,000</u>

*Saving in depreciation = ₹ 20,000 - ₹ 19,000 = ₹ 1,000.

Question 2

- (a) As per the provisions of section 135 of the Companies Act, 2013 read with relevant rules, circulars and notifications related to 'Corporate Social Responsibility' (CSR), discuss the following situations:
- A company is formed under section 8 of the Companies Act, 2013 to undertake charitable activities. The management of the Company is of the opinion that since all the activities of the Company are charitable in the normal course of business, the CSR provisions are not applicable to it. You are required to advise whether the CSR provisions are applicable to the Company. The Company fulfils all the criteria listed in section 135 of the Companies Act, 2013.
 - C Limited is covered under the provisions of section 135 of the Companies Act, 2013. The Company fulfils all the criteria listed in section 135 of the Companies Act, 2013. It has a holding company H Limited and a subsidiary company S Limited. Neither H Limited nor S Limited fulfils the criteria listed in section 135 of the Companies Act, 2013. Advise whether H Limited and S Limited are required to comply with the provisions of section 135 of the Companies Act, 2013.
 - For the financial year 2020-2021, CBC Ltd. was within the purview of CSR provisions as per the Companies Act, 2013 as its net profit for the financial year exceeded ₹ 5 crores. It also satisfied the 'net worth' and 'turnover' criteria. The Company duly discharged its CSR obligations in the financial year 2021-2022. However, due to adverse market conditions during the financial year 2021-2022, the turnover fell below ₹ 1,000 crores and the Company incurred a loss. Its net

PAPER – 1 : FINANCIAL REPORTING**9**

worth also fell below ₹ 500 crores. The Company is of the opinion that CSR provisions are no longer applicable to it with effect from the financial year 2021-2022. Discuss.

- (iv) An office building is constructed exclusively for the CSR activities under section 135 of the Companies Act, 2013 of the Company. The entire expenditure is treated as revenue expenditure and charged to statement of profit and loss. Discuss whether the treatment of charging cost of construction of the aforesaid building to statement of profit and loss is correct. Whether any disclosures as per Schedule III of the Companies Act, 2013 have to be made? **(8 Marks)**
- (b) XYZ Limited is a sales and marketing company in amusement and entertainment domain. It negotiates and agrees in advance with four famous amusement parks to purchase their tickets for online sale through its payment gateway to general public. The negotiated rates are at a discount when compared with the price of tickets sold directly by amusement parks to the general public. XYZ Limited is free to determine its sale price of the ticket. As part of the agreement, XYZ Limited will also assist the amusement parks/general public with respect to services provided by the amusement parks to the general public. However, each amusement park will continue to be responsible for fulfilling its / their obligation associated with the ticket, including solutions to dissatisfied customers. For XYZ Limited, there is no credit risk as payment is collected from customers beforehand. However, it carries an inventory risk as tickets have to be purchased in advance and unsold tickets are loss to XYZ Limited. Discuss whether XYZ Limited is a principal or an agent? **(6 Marks)**
- (c) Whether the following expenses shall form part of 'costs incurred to obtain a contract'. Give reasons:
- (i) Commission paid only upon successful signing of the contract;
 - (ii) Legal fees for drafting the terms of the arrangement/ agreement;
 - (iii) Travel expenses of a sales person pitching for a new client contract;
 - (iv) Salaries of sales people working exclusively on obtaining new clients;
 - (v) Bonus based on quarterly sales;
 - (vi) Commission paid to sales manager which is based on contracts obtained.
- (6 Marks)**

10

FINAL EXAMINATION: NOVEMBER, 2023

Answer

- (a) (i) Section 135 of the Companies Act applies to every company meeting the specified criteria. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This implies that companies set up for the purposes of CSR / public welfare are also required to comply with the provisions of CSR since they are incorporated under the Companies Act.

Further, as per clause 2(d) of the Companies (Corporate Social Responsibility Policy) Rule, 2014, "Corporate Social Responsibility (CSR)" means the activities undertaken by a Company in pursuance of its statutory obligation laid down in section 135 of the Act in accordance with the provisions contained in these rules but shall not include activities undertaken in pursuance of normal course of business of the company except research work. Therefore, though all the activities of the company are charitable in nature, they are activities in the normal course of their business. Hence, those activities do not constitute activities of corporate social responsibility.

Based on the above discussions, since the company formed under section 8 of the Companies Act, 2013 is a company under the Companies Act, 2013 and fulfills the criteria prescribed under section 135(1) of the Companies Act, 2013, CSR provisions will be applicable to it.

- (ii) Any company incorporated under the Act, which fulfills the criteria on a standalone basis, irrespective of its status of holding or subsidiary, needs to comply with CSR provisions. Since neither H Limited nor S Limited fulfills the criteria listed in section 135(1) of the Companies Act, 2013, H Limited and S Limited both are not required to comply with the requirements of Section 135 relating to CSR.
- (iii) Section 135(1) of the Companies Act requires that any company fulfilling the net worth / turnover / net profit criterion in the immediately preceding financial year shall constitute a Corporate Responsibility committee and sub-section (5) requires such company to incur 2% of the average profit of the last three years. It is only a computational requirement. Applicability of CSR provisions is based on meeting any of the limits in the 'immediately preceding year'. As the company does not meet the limits in the financial year 2021-2022, the company is not required to fulfill the CSR obligations in the financial year 2022-2023.

PAPER – 1 : FINANCIAL REPORTING**11**

- (iv) In cases where an expenditure of revenue nature is incurred on any of the activities mentioned in Schedule VII to the Act by the company on its own, the same should be charged as an expense to the statement of profit and loss. In case the expenditure incurred by the company is of such nature which may give rise to an 'asset', a question may arise as to whether such an 'asset' should be recognised by the company in its balance sheet. In this context, it would be relevant to note the definition of the term 'asset' as per the Conceptual Framework for Financial Reporting in accordance with Ind AS issued by ICAI. As per the Conceptual Framework, an 'asset' is a "resource controlled by an enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise". Hence, in cases where the control of the 'asset' is transferred by the company, it should not be recognised as 'asset' in its books and such expenditure would need to be recognized as an expense in the statement of profit and loss as and when incurred.

Rule (7) of the Companies (Corporate Social Responsibility) Rules, 2014 provides for transfer of any capital asset created by the company to (i) a company established under section 8 of the Act, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number under sub-rule (2) of rule 4; or (ii) beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or (iii) a public authority. Proviso to rule (7) further provides that if the asset has been created prior to amendment of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall within a period of one hundred and eighty days from such commencement shall transfer the same as stated above.

Since, the company has charged the expenses on construction of building to the Statement of Profit and Loss as expenses, it is assumed that the control of the asset has been transferred. Accordingly, the company has to disclose in its financial statements as about it under CSR activities as per General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013.

General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the following shall be disclosed about CSR activities:

- (i) amount required to be spent by the company during the year,
- (ii) amount of expenditure incurred,

12

FINAL EXAMINATION: NOVEMBER, 2023

- (iii) shortfall at the end of the year, if any
 - (iv) total of previous years shortfall, if any
 - (v) reason for shortfall, if any
 - (vi) nature of CSR activities,
 - (vii) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
 - (viii) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year shall be shown separately.
- (b)** To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to enter the particular amusement park on a particular date. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:
- (a) the entity is primarily responsible for fulfilling the contract, which is providing the right to enter the amusement park. However, the entity is not responsible for providing the services in amusement park, which will be provided by the amusement park owner.
 - (b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.
 - (c) the entity has discretion in setting the sales prices for tickets to its customers.

The entity i.e. XYZ Limited concludes that its promise is to provide a ticket (i.e. a right to enter the amusement park on a particular date) for the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

PAPER – 1 : FINANCIAL REPORTING

13

(c) Table showing expenses whether forming part of 'Cost to obtain a Contract'

S.No.	Cost	Capitalize or expense / cost to obtain a contract	Reason
i	Commission paid only upon successful signing of a contract	Capitalize/Yes	Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing.
ii	Legal fees for drafting terms of agreement	Expense/No Capitalize/Yes	If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract. Alternatively, it can be 'Capitalised / Yes', due to the absence of words "to approve & sign" i.e. if the agreement is approved and signed, then is an incremental cost which needs to be capitalised.
iii	Travel expenses for a salesperson pitching a new client contract	Expense/No	Because the costs are incurred regardless of whether the new contract is won or lost, the entity expense out the costs, unless they are expressly reimbursable.
iv	Salaries for salespeople working exclusively on obtaining new clients	Expense/No	Salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
v	Bonus based on quarterly sales	Capitalize/Yes	Bonuses based solely on sales are incremental costs to obtain a contract.

14

FINAL EXAMINATION: NOVEMBER, 2023

S.No.	Cost	Capitalize or expense / cost to obtain a contract	Reason
vi	Commission paid to sales manager based on contracts obtained	Capitalize/Yes	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract.

Question 3

- (a) A consumer products entity, Entity A Limited (lessee) enters into a lease agreement with Entity B Limited (lessor) for a dedicated production line to manufacture one of its store-brand household products for a period of three years. Entity A Limited has agreed to order a minimum 1,00,000 units per month and to make a payment to Entity B Limited as per the following agreed rates:

- (i) ₹ 240 per unit if the ordered quantity is between 1,00,000 to 1,20,000 units;
- (ii) ₹ 246 per unit if the ordered quantity is between 1,20,001 to 1,50,000 units.

As per the terms of the agreement, Entity A Limited has the exclusive right to use the production line. Entity B Limited cannot use the specified production line for any other customer. The type of household product is specified in the contract. Entity A Limited issues instructions to Entity B about the quantity and timing of products to be delivered. If the production line is not producing the household product for Entity A, it remains idle. Entity B Limited operates and maintains the production line on a daily basis. Entity A Limited has estimated that for manufacturing each unit, Entity B Limited incurs an average cost of ₹ 195. Further, the observable stand-alone price for the rent of the production line is ₹ 60,00,000 per month. Entity A Limited's incremental borrowing rate at the commencement date of the lease is 10% per annum.

Entity A Limited concludes that the arrangement contains a lease as per Ind AS 116. It also elects not to apply the practical expedient in paragraph 15 of Ind AS 116 of not to separate the non-lease component(s) from the lease component(s). Accordingly, it separates non-lease components from lease components.

You are required to:

- (i) Analyse the above and identify lease component(s) and non-lease component(s);

PAPER – 1 : FINANCIAL REPORTING**15**

And at the commencement of the lease:

- (ii) Compute and allocate the consideration into lease component(s) & non-lease component(s);
- (iii) Compute the lease liability (the present value factor @ 10% per annum of 2.49 for 3 years may be adopted);
- (iv) Determine the recognition / treatment of lease component(s) and non-lease component(s). **(8 Marks)**

(b) The following details are available for Hydra Limited as at 31st March 2023:

Disposal Group	Carrying Amount at the reporting data before classification as held for sale (Amount in ₹)	Carrying amount as remeasured immediately before classification as held for sale (Amount in ₹)
Goodwill	7,50,000	7,50,000
Property, Plant and Equipment (carried at revalued amounts)	23,00,000	20,00,000
Building (carried at cost)	28,50,000	28,50,000
Investment in Equity Instruments	12,00,000	11,00,000
Inventory	9,00,000	7,50,000

Hydra Limited estimates that the fair value less costs to sell of the disposal group is ₹ 65,00,000.

State, as per applicable Ind AS, how and at what amount of loss should Hydra Limited recognize 'disposal group' before classifying it as held for sale. Also compute the impairment loss if any, and how it should be allocated by Hydra Limited. **(8 Marks)**

- (c) N Ltd. is engaged in the business of manufacturing of bottles for both, pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, H Ltd., which is engaged in the business of pharmaceuticals. H Ltd. purchases the pharmaceutical bottles from its parent company. The demand of H Ltd. is very high and hence to cater to its shortfall, H Ltd. also purchases the bottles from other companies. Purchases are made at competitive prices.

16

FINAL EXAMINATION: NOVEMBER, 2023

N Ltd. sold pharmaceuticals bottles to H Ltd. for Euro 24 lakhs on 1st February, 2023. The cost of these bottles was ₹ 1660 lakhs in the books of N Ltd. at the time of sale. As at 31st March, 2023, all these bottles were lying as closing stock in the books of H Limited. Also as at 31st March, 2023, the entire amount against the supply of these bottles was payable by H Ltd.

The functional currency of:

- *H Limited is Euro; and*
- *N Limited is INR.*

Following additional information is available:

Exchange rate on 1 st February, 2023	1 Euro = ₹ 83
Exchange rate on 31 st March, 2023	1 Euro = ₹ 85

Provide the journal entries in the books of N Ltd. and H Ltd. on the transaction date(s) as well as 31st March, 2023, if any. Assume net realizable value of stock was always equal to its cost.

(4 Marks)

Answer

(a) (i) and (ii) Identification of lease and non-lease components and allocation of consideration into these components

In the given case, the agreement contains a lease component (production line) and a non-lease component (job work). As Entity A has not elected to apply the practical expedient as provided in paragraph 15 of Ind AS 116, it will separate the lease and non-lease components and allocate the total consideration to the lease and non-lease components in the ratio of their relative stand-alone selling prices.

As Entity A is required to purchase a minimum of 1,00,000 units per month at the rate of ₹ 240 per unit, there is in substance fixed payment of ₹ 2,40,00,000 per month – although the payments are structured as variable lease payments, there is no genuine variability in those payments as Entity A is required to purchase a minimum quantity 1,00,000 units per month, i.e., for ₹ 2,40,00,000 per month.

The observable stand-alone price for lease component (which is factory rent) is ₹ 60,00,000. The observable stand-alone price of non-lease component (which is job work charges) is ₹ 1,95,00,000 (₹ 195 x 1,00,000 units).

PAPER – 1 : FINANCIAL REPORTING**17**

Entity A is required to allocate the total consideration per month as follows:

Observable standalone price: Lease component	₹ 60,00,000
Observable standalone price: Non-lease component	₹ 1,95,00,000
Total	₹ 2,55,00,000
Lease component as a percentage of observable prices (₹ 60 lakh / ₹ 255 lakh) x 100	23.53%
Allocation of consideration to lease component (₹ 2,40,00,000 x 23.53%)	₹ 56,47,200
Non-lease component (₹ 2,40,00,000 – ₹ 56,47,200)	₹ 1,83,52,800

(iii) Computation of lease liability

The total allocation for a year will be ₹ 6,77,66,400 (₹ 56,47,200 x 12)

As Entity A's incremental borrowing rate is 10%, it discounts lease payments using this rate and the lease liability at the commencement date is calculated as follows:

Lease Liability at commencement date = ₹ 6,77,66,400 x 2.49 = ₹ 16,87,38,336.

(iv) Accounting treatment of lease components and non-lease components

- Entity A recognises lease liability amounting to ₹ 16,87,38,336 as at commencement date based on lease payments amounting to ₹ 56,47,200 per month.
- The remaining amount of ₹ 1,83,52,800 (₹ 2,40,00,000 – ₹ 56,47,200) which is attributable to job work charges is recognised in the statement of profit and loss as and when incurred.

(b) Statement showing calculation of disposal group immediately before classifying it as held for sale

Disposal Group	Carrying amount at the reporting date before classification as held for sale ₹	Carrying amount as remeasured immediately before classification as held for sale ₹
Goodwill	7,50,000	7,50,000
Property, Plant and Equipment (carried at revalued amounts)	23,00,000	20,00,000

18

FINAL EXAMINATION: NOVEMBER, 2023

Building (carried at cost)	28,50,000	28,50,000
Investment in Equity Instruments	12,00,000	11,00,000
Inventory	<u>9,00,000</u>	<u>7,50,000</u>
Total	<u>80,00,000</u>	<u>74,50,000</u>

The entity should recognise the loss of ₹ 5,50,000 (₹ 80,00,000 - ₹ 74,50,000), in accordance with applicable Ind AS, immediately before classifying it as held for sale.

Computation and allocation of impairment loss

The entity estimated that fair value less costs to sell of the disposal group amounts to ₹ 65,00,000.

Since the entity has classified a disposal group as held for sale it should measure it at the lower of its carrying amount ₹ 74,50,000 and fair value less costs to sell ₹ 65,00,000 which comes to ₹ 65,00,000.

The entity should recognise an impairment loss of ₹ 9,50,000 (₹ 74,50,000 - ₹ 65,00,000) when the disposal group is initially classified as held for sale.

The Inventory and Investment are remeasured as per Ind AS 2 and Ind AS 109 at not more than fair value at the date of remeasurement immediately classified as held for sale.

Therefore, this impairment loss of ₹ 9,50,000 is allocated to remaining assets in the proportion of their carrying value other than inventory and investment in equity instrument. Firstly, the impairment loss reduces the amount of goodwill in the disposal group. Then, the remaining impairment loss of ₹ 2,00,000 (₹ 9,50,000 - ₹ 7,50,000) is used to other assets pro-rata based on the carrying amount of those assets as follows:

Table showing the allocation of impairment loss

Disposal Group	Carrying amount as remeasured immediately before classification as held for sale (as per applicable Ind AS) ₹	Allocated Impairment Loss ₹	Carrying amount after allocation of Impairment Loss ₹
Goodwill	7,50,000	(7,50,000)	-
Property, Plant and Equipment (carried at revalued amounts)	20,00,000	(82,474)	19,17,526

PAPER – 1 : FINANCIAL REPORTING

19

Building (carried at cost)	28,50,000	(1,17,526)	27,32,474
Investment in Equity Instruments	11,00,000	-	11,00,000
Inventory	<u>7,50,000</u>	<u>-</u>	<u>7,50,000</u>
Total	<u>74,50,000</u>	<u>(9,50,000)</u>	<u>65,00,000</u>

(c) Accounting treatment in the books of N Ltd. (Functional Currency INR)

N Ltd. will recognize sales of ₹ 1,992 lakhs (24 lakhs Euro x ₹ 83)

Profit on sale of inventory = ₹ 1,992 lakhs – ₹ 1,660 lakhs = ₹ 332 lakhs.

On balance sheet date, receivable from H Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85.

Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 48 lakhs [i.e. (₹ 85 - ₹ 83) x 24 lakhs]

Journal Entries

		(₹ in lakhs)	(₹ in lakhs)
1 st February, 2023	H Ltd. A/c Dr. To Sales (Being revenue recorded on initial recognition)	1,992	1,992
31 st March, 2023	H Ltd. A/c Dr. To Foreign exchange difference (unrealised) (Being foreign exchange difference recorded at year end)	48	48

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

H Ltd. will recognize inventory on 1st February, 2023 of Euro 24 lakhs which will also be its closing stock at year end.

Journal Entry

		(in Euros)	(in Euros)
1 st February, 2023	Purchase Dr. To N Ltd.	24 lakhs	24 lakhs

20

FINAL EXAMINATION: NOVEMBER, 2023

Question 4

- (a) Ore Exploration Ltd. is engaged in the manufacturing of drilling and mining equipment for over last 25 years. The management of the company is planning to expand the manufacturing activities for which funds are needed. On 1st April, 2019, to meet out the financial requirement Ore Exploration Ltd. issued 50,000, Compulsory Convertible Cumulative Preference Shares (CCCPs) of ₹ 100 each. These preference shares carry a coupon rate of 12% p.a. and is payable every year. The Company has substantial profits for payment of preference dividend. Under the terms of instrument, every two preference shares are convertible into 1 equity share of ₹ 100 each at the end of 4th year. The prevailing annual market interest rate for a similar debt without conversion option is 15% per annum. The transaction cost of completing the issue process of the instrument is 3% of the proceeds. The effective interest rate is 16.60% per annum.

You are required to:

- (i) Compute the liability and equity component;
- (ii) Provide the 'liability' ledger account for various years at amortized cost using the effective interest rate;
- (iii) Pass necessary accounting entries for the whole period.

Note: Use the following present values of Re. 1 at different discounting factors for the purpose of calculation, wherever required.

Year	1	2	3	4
13%	0.8850	0.7831	0.6931	0.6133
15%	0.8696	0.7561	0.6575	0.5718
18%	0.8475	0.7182	0.6086	0.5158

(14 Marks)

- (b) Discuss the cost constraint on useful financial information.

OR

Discuss the characteristics of good financial statements*.

(6 Marks)

* PS: Read 'Financial Statements' as 'Financial Information'.

PAPER – 1 : FINANCIAL REPORTING

21

Answer

- (a) This is a compound financial instrument with two components – liability representing present value of future cash outflows (i.e. dividend) and balance represents equity component.

(i) Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor @ 15%	Net present Value
1 st April, 2019		0	1	0.00
31 st March, 2020	Dividend	6,00,000	0.8696	5,21,760
31 st March, 2021	Dividend	6,00,000	0.7561	4,53,660
31 st March, 2022	Dividend	6,00,000	0.6575	3,94,500
31 st March, 2023	Dividend	6,00,000	0.5718	<u>3,43,080</u>
Total Liability Component				17,13,000
Total Proceeds				<u>50,00,000</u>
Total Equity Component (Bal fig)				<u>32,87,000</u>

a. Allocation of transaction costs

Particulars	Amount	Allocation of 3% transaction cost	Net Amount
Liability Component	17,13,000	51,390	16,61,610
Equity Component	<u>32,87,000</u>	<u>98,610</u>	<u>31,88,390</u>
Total Proceeds	<u>50,00,000</u>	<u>1,50,000</u>	<u>48,50,000</u>

b. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability.

22

FINAL EXAMINATION: NOVEMBER, 2023

	Opening Financial Liability A	Interest @ 16.60% B	Cash Flow C	Closing Financial Liability A+B-C
1 st April, 2019	16,61,610	-	-	16,61,610
31 st March, 2020	16,61,610	2,75,827	6,00,000	13,37,437
31 st March, 2021	13,37,437	2,22,015	6,00,000	9,59,452
31 st March, 2022	9,59,452	1,59,269	6,00,000	5,18,721
31 st March, 2023	5,18,721	81,279*	6,00,000	-

* Difference of ₹ 4,829 (i.e. 86,108 – 81,279) is due to approximation.

(ii) Preference Shares (Liability) Account

Date	Particulars	Amount	Date	Particulars	Amount
31.3.2020	To Bank	6,00,000.00	1.4.2019	By Bank	16,61,610.00
31.3.2020	To Balance c/d	13,37,437.00	31.3.2020	By Finance Cost	2,75,827.00
		19,37,437.00			19,37,437.00
31.3.2021	To Bank	6,00,000.00	1.4.2020	By Balance b/d	13,37,437.00
31.3.2021	To Balance c/d	9,59,452.00	31.3.2021	By Finance Cost	2,22,015.00
		15,59,452.00			15,59,452.00
31.3.2022	To Bank	6,00,000.00	1.4.2021	By Balance b/d	9,59,452.00
31.3.2022	To Balance c/d	5,18,721.00	31.3.2022	By Finance Cost	1,59,269.00
		11,18,721.00			11,18,721.00
31.3.2023	To Bank	6,00,000.00	1.4.2022	By Balance b/d	5,18,721.00
		6,00,000.00	31.3.2023	By Finance Cost	81,279.00
					6,00,000.00

(iii) Journal Entries to be recorded for entire term of arrangement

Date	Particulars	Debit	Credit
1.4.2019	Bank A/c Dr. To Preference Shares (Liability) A/c To Equity Component of Preference shares A/c (Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)	48,50,000	16,61,610 31,88,390

PAPER – 1 : FINANCIAL REPORTING

23

31.3.2020	Preference Shares (Liability) A/c Dr. To Bank A/c (Being dividend at the coupon rate of 12% paid to the shareholders)	6,00,000	6,00,000
31.3.2020	Finance cost A/c Dr. To Preference Shares (Liability) A/c (Being interest as per EIR recorded)	2,75,827	2,75,827
31.3.2021	Preference Shares (Liability) A/c Dr. To Bank A/c (Being dividend at the coupon rate of 12% paid to the shareholders)	6,00,000	6,00,000
31.3.2021	Finance cost A/c Dr. Preference Shares (Liability) A/c (Being interest as per EIR recorded)	2,22,015	2,22,015
31.3.2022	Preference Shares (Liability) A/c Dr. To Bank A/c (Being dividend at the coupon rate of 12% paid to the shareholders)	6,00,000	6,00,000
31.3.2022	Finance cost A/c Dr. Preference Shares (Liability) A/c (Being interest as per EIR recorded)	1,59,269	1,59,269
31.3.2023	Preference Shares (Liability) A/c Dr. To Bank A/c (Being dividend at the coupon rate of 12% paid to the shareholders)	6,00,000	6,00,000
31.3.2023	Finance cost A/c Dr. To Preference Shares (Liability) A/c (Being interest as per EIR recorded)	81,279	81,279
31.3.2023	Equity Component of Preference shares A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)	31,88,390	25,00,000 6,88,390

24

FINAL EXAMINATION: NOVEMBER, 2023**(b) Either**

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Both the providers and users of financial information incur costs in reporting and analysing financial information. In applying the cost constraint, the ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

Because of the inherent subjectivity, different individual's assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

(b) OR

Characteristics of good financial information are:

1. Relevance

"Relevant financial information"

- Is financial information with (a) predictive value or (b) confirmatory value or both
- Makes it capable of making a difference in decisions made by users
- Makes it relevant financial information

Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

The characteristic of 'relevance' also includes the concept of materiality. Information is material if omitting, misstating or obscuring it could reasonably be

PAPER – 1 : FINANCIAL REPORTING

25

expected to influence decisions that the primary users of general-purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity.

2. Faithful Representation

To be useful, financial information must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

- ◆ *Complete*: A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.
- ◆ *Neutral*: A neutral depiction is without bias in the selection or presentation of financial information.

Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.

- ◆ *Free from error*: Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects.

Question 5

- (a) A Ltd. announced a stock appreciation right (SAR) on 1st April, 2020 for each of its employees. The scheme gives the employees the right to claim cash payment equivalent to an excess of market price of Company's shares on exercise date over the exercise price of ₹ 250 per share in respect of 100 shares, subject to a condition of continuous employment of 3 years. The SAR is exercisable after 31st March, 2023 but before 30th June, 2023. The fair value of SAR was:

- ₹ 42 in 2020-2021;

26

FINAL EXAMINATION: NOVEMBER, 2023

- ₹ 46 in 2021-2022; and
- ₹ 48 in 2022-2023.

In 2020-2021, the company estimates that 2% of its employees shall leave the Company annually. This was revised to 3% in 2021-2022. Actually:

- 15 employees left the company in 2020-2021;
- 10 employees left the company in 2021-2022; and
- 8 employees left the company in 2022-2023.

The SAR therefore actually vested in 492 employees on 30th June, 2023* and when SAR was exercised, the intrinsic value was ₹ 50 per share.

Compute, by fair value method, the SAR expense for financial years;

- 2020-2021;
- 2021-2022;
- 2022-2023;
- 2023-2024.

Also provide SAR ledger from inception till closure. Discuss whether this account is in the nature of liability or equity? **(8 Marks)**

- (b) Haymond Limited has three segments H, M & D. The following information is provided for the year ending 31st March, 2023: All amounts are in ₹ Lakhs

Particulars	Segments			Head Office
	H	M	D	
Sales to M	500	-	-	
Sales to D	-	5	-	
Other Sales (Domestic)	10	-	-	
Sales (Export)	680	170	40	
Operating Profit /(Loss) before tax	30	5	(8)	

* PS: Read '30th June, 2023' as 31st March, 2023'.

PAPER – 1 : FINANCIAL REPORTING

27

Reallocated cost from Head Office	4	2	2	
Interest cost	2	3	1	
Fixed Assets*	20	4	12	5
Net Current Assets	12	4	9	3
Long Term Liabilities	2	1	12	2

Other Information:

- (i) Share Capital amounts to ₹ 40,00,000
- (ii) Reserve & Surplus amounts to ₹ 12,00,000

Prepare segment information as per Ind AS 108.

(8 Marks)

- (c) Beauty Ltd. purchased a patent right of a face-wash on 1st April, 2020 for ₹ 4,20,000; which has a legal life of 10 years. Due to the highly competitive nature of the product, the management of the company estimates a useful life of only 6 years. Straight line amortization is determined by the management to be the best method. As at 1st April, 2021, management is uncertain that the process can actually be made economically feasible and decides to write down the patent to an estimated market value of ₹ 2,00,000 and also decides to amortize it over 2 years. As at 1st April, 2022, having perfected the related production process, the asset is now appraised at a value of ₹ 3,50,000. Furthermore, the estimated useful life is now believed to be 3 more years.

You are required to determine the value of intangible asset at the end of financial year:

- 2020-2021;
- 2021-2022;
- 2022-2023.

Also, discuss the treatment of revaluation gain in financial year 2022-2023. **(4 Marks)**

Answer

- (a) Number of employees at the grant date to whom the SARs were granted = 492 + 15 + 10 + 8 = 525 employees

* PS: Read 'Fixed Assets' as 'Non-current Assets'.

The amount recognized as an expense in each year and as a liability at each year-end is as follows:

Year	Expense	Liability	Calculation of Liability
	₹	₹	
31 st March, 2021	6,86,000	6,86,000	$[(525-15) \times 0.98 \times 0.98] \times 100 \times 42 \times \frac{1}{3}$
31 st March, 2022	8,01,333	14,87,333	$\{[(525-15-10) \times 0.97 \times 100 \times 46 \times \frac{2}{3}] - 6,86,000\}$
31 st March, 2023	8,74,267	23,61,600	$[525-15-10-8] \times 48 \times 100 - 14,87,333$
30 th June, 2023	(98,400)*	0	$[(492 \times 100 \times 50) - 23,61,600]$

*Difference of opening liability ₹ 23,61,600 and actual liability paid ₹ 24,60,000 $[(492 \times 100 \times 50) - 23,61,600]$ is recognised to Profit and loss i.e. ₹ 98,400.

SAR Ledger

Date	Particular	Amount	Date	Particular	Amount
31.3.2021	To Balance c/d	6,86,000	31.3.2021	By Employee benefits expenses	6,86,000
		<u>6,86,000</u>			<u>6,86,000</u>
31.3.2022	To Balance c/d	14,87,333	1.4.2021	By Balance b/d	6,86,000
			31.3.2022	By Employee benefits expenses	8,01,333
		<u>14,87,333</u>			<u>14,87,333</u>
31.3.2022	To Balance c/d	23,61,600	1.4.2022	By Balance b/d	14,87,333
			31.3.2023	By Employee benefits expenses	8,74,267
		<u>23,61,600</u>			<u>23,61,600</u>
30.6.2023	To Bank	24,60,000	1.4.2022	By Balance b/d	23,61,600
			30.6.2023	By Employee benefits expenses	98,400
		<u>24,60,000</u>			<u>24,60,000</u>

SAR Account is in the nature of liability because it is a cash settled share-based transaction which is summed up on payment of cash to the employees at the end of the exercise period.

PAPER – 1 : FINANCIAL REPORTING

29

(b) (A) Information about operating segment

- (1) The company's operating segment comprise: H, M & D
- (2) Segment revenue, results and other information

Haymond Ltd.
Segment Information / Report

(All amounts are ₹ in lakhs)

Particulars	Reportable Segments			Head Office/ Unallocated items	Total
	H	M	D		
1. Segment Revenue					
Sales:					
Domestic	10	—	—	—	10
Export	<u>680</u>	<u>170</u>	<u>40</u>	—	<u>890</u>
External Sales	690	170	40		900
Inter-segment sales	<u>500</u>	<u>5</u>	<u>—</u>	=	<u>505</u>
Total Sales	1,190	175	40		1,405
Less: Inter-segment sales	<u>(500)</u>	<u>(5)</u>	<u>—</u>	—	<u>(505)</u>
Total Sales / Revenue	<u>690</u>	<u>170</u>	<u>40</u>		<u>900</u>
2. Results					
Segment result	30	5	(8)		27
Reallocated cost	<u>(4)</u>	<u>(2)</u>	<u>(2)</u>		<u>(8)</u>
Profit from operation before interest, taxation and Exceptional items	26	3	(10)		19
Finance cost (Interest expense)	<u>(2)</u>	<u>(3)</u>	<u>(1)</u>		<u>(6)</u>
Profit before tax and exceptional items	<u>24</u>	<u>0</u>	<u>(11)</u>		<u>13</u>
3. Information in relation to assets and liabilities					
Reportable segment non-current assets	20	4	12	5	41
Reportable segment net current assets	<u>12</u>	<u>4</u>	<u>9</u>	<u>3</u>	<u>28</u>

30

FINAL EXAMINATION: NOVEMBER, 2023

Total Assets	<u>32</u>	<u>8</u>	<u>21</u>	<u>8</u>	<u>69</u>
Non-current liabilities	2	1	12	2	17

B. Geographical Information

	Domestic Sales	Export Sales	₹ in lakhs Total
External sales	10	890	900

(c) Value as on 31st March 2021

Original cost	₹ 4,20,000
Less: Amortisation (4,20,000 / 6 years)	(₹ 70,000)
Net carrying value as on 31 st March 2021	<u>₹ 3,50,000</u>

Value as on 31st March 2022

On 1st April 2021, the downward revaluation is recorded by writing down the asset to the estimated value of ₹ 2,00,000, which necessitates a ₹ 1,50,000 charge to profit & loss (carrying value ₹ 3,50,000 less fair value ₹ 2,00,000).

Amortisation provided for the financial year 2021-2022 is ₹ 1,00,000 (₹ 2,00,000/2)

Net value as on 31st March 2022 = ₹ 2,00,000 – ₹ 1,00,000 = ₹ 1,00,000.

Value as on 31st March 2023

As on 1st April 2022, the carrying value of the patent is ₹ 1,00,000.

Revalued amount of patent is ₹ 3,50,000.

Out of total revaluation gain of ₹ 2,50,000, ₹ 1,50,000 will be charged to profit & loss and balance amount of ₹ 1,00,000 (₹ 2,50,000 – ₹ 1,50,000) will be credited to revaluation reserve.

Amortisation provided for the financial year 2022-2023 is ₹ 1,16,667 (₹ 3,50,000 / 3)

Net value as on 31st March 2023 = ₹ 3,50,000 – ₹ 1,16,667 = ₹ 2,33,333.

Question 6

- (a) *Diamond Limited is transitioning to Ind AS. It has certain investments in Ruby Limited's Convertible Debt Instruments, which are currently (on the date of transition to Ind AS) exercisable and would provide Diamond Limited with a controlling stake over Ruby Limited on exercise of the conversion rights. Diamond Limited evaluated that*

PAPER – 1 : FINANCIAL REPORTING

31

Ruby Limited should be treated as its subsidiary under Ind AS. Hence it would require consolidation in its Ind AS Consolidated Financial Statements. Ruby Limited was not considered as a Subsidiary, Associate or a Joint Venture under Previous GAAP.

How should Ruby Limited be consolidated on transition to Ind AS. Assume that Diamond Limited has opted to avail the exemption from retrospective re-statement of past business combinations as per applicable Ind AS? **(5 Marks)**

- (b) Poor Limited borrowed 120 Lakhs from a Scheduled Bank. The terms of loan are as under:

- Rate of Interest @ 10% per annum, payable yearly
- Tenure of Loan 12 Years.
- Principal to be paid at the end of tenure i.e. 12th Year.

Poor Limited defaulted in payment of Interest in year 5, 6, 7 and 8. A loan reschedule agreement took place at the end of 9th year with the Bank. As per the agreement, Poor Limited is required to pay ₹ 220 Lakhs at the end of 10th year. The default continued till the end of 10th year.

You are required to calculate as per relevant Ind AS:

- (i) Book Value of the Loan at the end of the 10th Year.
- (ii) Additional amount to be paid to the Bank on Account of Rescheduling.

(assume interest is compounded in the case of default). **(5 Marks)**

- (c) A shipping company is required by law to bring all its ships into dry dock every 5 years for a major inspection and overhaul. Overhaul expenditure might at first sight seem to be repair to the ships but is actually a cost incurred in getting the ship back into a seaworthy condition. As such the costs must be capitalised.

A ship that cost ₹ 40 Crore with 20-year life must have a major overhaul every 5 years. The estimated cost of the first overhaul is ₹ 10 Crores.

Calculate:

- (i) the depreciation charged for first five years;
- (ii) the carrying amount at the end of 5th year. **(5 Marks)**

- (d) HG Incredibles Limited had in the recent past made a right issue. In its offer document to its members, it had projected a surplus of ₹ 50 crores during the year ending 31.03.2023. The draft result for the year ended 31.03.2023, prepared on the hitherto

followed accounting policies and presented for perusal of the Board of Directors showed a surplus of ₹ 5 Crores. The Board in consultation with the Managing Director, decided on the following:

- (i) *Value year-end Inventory at Works Cost (₹ 40 Crores) instead of hitherto method of valuation of inventory at Prime Cost (₹ 20 Crores);*
- (ii) *Not to provide for "After Sales Expenses" during the warranty period. Till the last year, provision for 1% of Sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against provision. The Board now decided to account for expenses as and when actually they are incurred. Sales during the year was ₹ 800 Crores;*
- (iii) *Provide depreciation for the year on Straight Line Method on account of substantial additions in Gross Block during the year, instead of on Reducing Balance Method, which was hitherto adopted. As a consequence, ₹ 21 Crores depreciation is now less charged than it would have been provided under the old method. (₹ 67 Crores on Reducing Balance method and ₹ 46 Crores in Straight Line Method).*
- (iv) *Provide for other than temporary fall in the value of investments, which fall took place in last 6 years, amounting to ₹ 12 Crores.*

Discuss the above situations as per applicable Ind AS, particularly Ind AS 8. Whether the above are changes in accounting policies or changes in estimates? (5 Marks)

Answer

- (a) Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no consolidated financial statements were required under previous GAAP), then the subsidiary's assets and liabilities would be included in the parent's opening consolidated financial statements at such values as would appear in the subsidiary's separate financial statements if the subsidiary were to adopt the Ind AS as at the parent's date of transition. For this purpose, the subsidiary's separate financial statements would be prepared as if it was a first-time adopter of Ind AS i.e. after applying the relevant first-time adoption mandatory exceptions and voluntary exemptions. In other words, the parent will adjust the carrying amount of the subsidiary's assets and liabilities to the amounts that Ind AS would require in the subsidiary's balance sheet.

The deemed cost of goodwill equals the difference at the date of transition between:

PAPER – 1 : FINANCIAL REPORTING**33**

- (a) the parent's interest in those adjusted carrying amounts; and
- (b) the cost in the parent's separate financial statements of its investment in the subsidiary.

The measurement of non-controlling interest and deferred tax follows from the measurement of other assets and liabilities.

It may be noted here that the above exemption is available only under those circumstances where the parent, in accordance with the previous GAAP, has not presented consolidated financial statements for the previous year; or where the consolidated financial statements were prepared in accordance with the previous GAAP, but the entity was not treated as a subsidiary, associate or joint venture under the previous GAAP.

(b) (i) Computation of book value of the loan at the end of 10th year

$$= ₹ 1,20,00,000 \times 1.10 \times 1.10 \times 1.10 \times 1.10 \times 1.10 \times 1.10$$

$$= ₹ 2,12,58,732 \text{ (i.e. adding interest for 5th to 10th year)}$$

(ii) Computation of additional amount to be paid to bank on rescheduling

$$\text{Rescheduled amount to be paid at the end of the 10th year} = ₹ 2,20,00,000$$

$$\text{Additional amount to be paid on rescheduling} = ₹ 2,20,00,000 - ₹ 2,12,58,732$$

$$= ₹ 7,41,268$$

(c) (i) Computation of depreciation charged for the first 5 years

The depreciation charge for the first five years of the asset's life will be as follows:

	Overhaul component (₹ in crores)	Ship (other than overhaul component) (₹ in crores)
Cost	10	30
Years	5	20
Depreciation per year	2	1.50

Total accumulated depreciation for the first five years will be -

$$= (₹ 2 \text{ crores} + ₹ 1.50 \text{ crores}) \times 5 \text{ years}$$

$$= ₹ 17.50 \text{ crores}$$

34

FINAL EXAMINATION: NOVEMBER, 2023

(ii) **Computation of carrying amount of the ship at the end of 5th year**

Carrying amount of the ship at the end of 5th year = ₹ 40 crores - ₹ 17.50 crores
 = ₹ 22.50 crores

- (d) (i) Paragraph 36(a) of Ind AS 2, 'Inventories', specifically requires disclosure of 'cost formula used' as a part of disclosure of accounting policies adopted in measurement of inventories.

Accordingly, a change in cost formula is a change in accounting policy. The entity should apply the change in the accounting policy retrospectively. For retrospective application of a change in accounting policy, adjust the opening balance of each affected component for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. Usually, the adjustment is made to retained earnings.

Income tax effect due to change in accounting policy will be accounted for in accordance with Ind AS 12.

- (ii) Here, since the question talks about making of provision, it is assumed that assurance warranty has been provided by the entity. Further, providing for 1% against after sales expenses is an accounting policy decision. Now since, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred, there is a change in accounting policy decision.

The change in accounting policy is accounted for retrospectively. For retrospective application of a change in accounting policy, adjust the opening balance of each affected component for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. Usually, the adjustment is made to retained earnings.

Income tax effect due to change in accounting policy will be accounted for in accordance with Ind AS 12.

- (iii) Determination of depreciation method involves an accounting estimate and thus depreciation method is not a matter of an accounting policy. Accordingly, as per Ind AS 16, a change in depreciation method should be accounted for as a change in accounting estimate in accordance with Ind AS 8. Change in accounting estimate

PAPER – 1 : FINANCIAL REPORTING**35**

is accounted for prospectively. However, the effect of the change is recognised as income or expense of the year in which the change is made. The effect, if any, on future periods is recognised as income or expense in those future periods.

- (iv) Accounting for investment made by the entity falls under the purview of Ind AS 109 'Financial Instruments'. As per Ind AS 109, subsequent measurement of financial instruments is done on following basis:
- (a) Measured at Amortised cost
 - (b) Measured at Fair value through Other Comprehensive Income (FVTOCI)
 - (c) Measured at Fair value through Profit or Loss (FVTPL)

In case the entity has subsequently measured its financial asset i.e. investment on the basis of FVTOCI or FVTPL, then change in fair value would have been recorded earlier in previous reporting period too. In such a case, there is no change in accounting policy or accounting estimate. However, if the entity had not accounted for previous changes in its books, then it is an error. If the material error occurred before the earliest prior period presented, an entity shall, unless impracticable, correct the same retrospectively in the first set of financial statements approved for issue after their discovery by restating the opening balances of assets, liabilities and equity for the earliest prior period presented. Further, fair value change is to be accounted for at every reporting date. Hence, restatement of the comparative amounts for the prior period(s) presented in which the error occurred is also required to be done.

Further, if an entity reclassifies any financial asset, it must do so prospectively from reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest. Reclassification of financial asset will be accounted for in accordance with the guidance given in Ind AS 109.