CA FINAL

SUBJECT- ELECTIVE PAPER (GFRS)

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(Date :)

(Marks - 100)

NOTE: There are five case study questions in the question paper. Candidates are required to answer all the questions of any four case study questions.

CASE STUDY 1

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

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

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

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

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

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

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

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

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

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

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

Questions:

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

   (A) Rs. 30,00,000

   (B) Rs. 2,40,000

   (C) Rs. 6,00,000

   (D) Rs. 24,00,000

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

   (A) Rs. 1 crore capital reserve
   (B) Rs. 80 lakhs of capital reserve
   (C) Rs. 20 lakhs goodwill
   (D) Rs. 41 lakhs of goodwill

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

   (A) It is not an embedded derivative

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

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

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

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

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

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

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

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

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

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

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

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

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

(2 X 5 = 10 marks)

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

7. In regards to the property previously leased to Turquoise Limited, analyse the accounting implications of the bifurcation currently in progress under the relevant Ind AS and prepare a note on the classification, measurement and disclosure as at 31st March, 2019. **(4 Marks)**

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

   Scenario A: The loan is repayable on demand.

   Scenario B: The loan is repayable after 5 years.

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

CASE STUDY 2

Kapsch Telecom Inc. is an American corporation that outsources some of its product engineering work to SasTech Ltd. in India. Both the parties have a long-term business relationship with each other – probably since more than 15 years.

In those 15 years, there have been multiple changes in management of both the parties. Kapsch has undergone many changes in the ownership and leadership in the last decade or so. In the outsourcing industry, it's a customary practice to request the customers for rate increase due to inflation and o ther factors that are specific to the contract.

Off-late there have been many instances of dissatisfaction from the customer due to attrition rate. Attrition refers to number of people leaving a company or a team. Attrition in the team is one of the biggest problems for Kapsch due to process-related hassles like interview of the replacement candidates, access to the file-sharing system and a few other factors.

SasTech Ltd. has been pressured for delivery and also forced to cut down the bill rate thereby reducing the profit margins. SasTech has an Offshore Development Centre (ODC) of 500 FTEs (Full-time employees) and an onsite support of Ten FTEs who work at the Kapsch location in USA.

ODC is a specific designated area within the company's premises. It requires special access to both employees and visitors who wish to enter into the ODC area. Even employees who are part of the same company but belong to team(s) other than the ODC can't enter the ODC area with their regular access card. Internet and other IT security is also special to the ODC through a dedicated leased-line which has a probability of 0.4% downtime.

Last contract with Kapsch, reviewed by both the parties, was almost 3 years ago. As a finance prime at SasTech Ltd., you have been asked by the Business Head to work closely with the Delivery Head and the legal team to look into the financial aspects of the contract.

Multiple scenarios were worked out and many rounds of discussion happened but there was no satisfactory response from both the parties towards the closure of negotiation. Finally, after 4 months of continuous follow-up, con-calls and the intervention of SasTech's CEO, the following key terms were agreed and accepted by both the parties: (simplified extracts)

1. The monthly bill rate per FTE shall stand revised to USD 4400 from USD 4200 earlier for standard billing hours of 1920 per annum per ODC FTE.
2. Bill rate for Onsite FTEs shall stand revised to USD 11,000 per month from USD 10,500 earlier.
3. SasTech shall provide a buffer headcount of 10% (earlier 7%) of the total FTEs working in the ODC.

   (Buffer headcount is usually kept as replacement for any absent FTEs or loss of working hours due to any reason. The Buffer headcount is also trained on the job for the eventuality of attrition in the project. Buffer headcount is not billed to the client but absorbed as direct contract cost.)

4. Other terms and conditions of the contract shall remain the same except that the following new terms will be inserted through Annexure which shall form an integral part of the contract:

a. Performance Bonus will be payable to SasTech at the rate of 10% of the quarterly billing done if the average billed hours of the ODC exceed 520 hours per FTE per quarter and the attrition rate is below 5% during that quarter.

b. Attrition Penalty will be payable by SasTech as per the following table:

Attrition Rate during the quarter in the ODC	**Attrition Penalty as a percentage of Quarterly billing done**
6% to 8%	3.5%
8% to 10%	4.5%
10% to 12%	6.0%
More than 12%	10.0%

5. The process of the timesheet approval shall remain the same except that the Project Manager of Kapsch in USA shall have a final approval authority. (Earlier, ODC manager in SasTech used to aggregate and ratify the timesheet and get the same approved by the Onsite lead of SasTech in USA and the same was counter-approved by the Project Manager from Kapsch. Now the project manager is changed since last 2 years.)
6. Billing will continue to be done on a quarterly basis and the credit period shall remain as 45 days from the end of last calendar day of the quarter for which billing is done.
7. SasTech shall continue to invoice at standard bill hours on a quarterly basis even when the actual billable hours as per final timesheet are more or less than the standard hours per FTE per month unless the actual billable hours fall below 150 per month per FTE. In that case the billing shall be done on actual billable hours. Actual billable hours are also used for billing in the quarter when SasTech is eligible for performance bonus.
8. Performance Bonus, if any, shall be billed separately within 20 working days from the end of the quarter in which such bonus becomes payable as per the contract.
9. Penalty, if any, shall be deducted from the latest quarterly bill received by Kapsch after the end of the relevant quarter.
10. Both the parties to the contract shall endeavour to close the approval process of billable hours within 7 working days from the end of each quarter.
11. Work done by Buffer FTEs, if any, shall not be counted for billing.

Following is the timesheet and attrition data for four quarters since the renewed contract has come into force.

Period	**Hours approved by SasTech**	**Hours approved by Kapsch**	**Attrition rate**
Quarter 1 Financial Year 2019-2020	2,41,500	2,41,415	6.0%
Quarter 2 Financial Year 2019-2020	2,62,500	2,62,319	4.5%
Quarter 3 Financial Year 2019-2020	2,39,000	2,38,585	9.2%
Quarter 4 Financial Year 2019-2020	2,23,500	2,23,500	7.0%

Revenue from Kapsch accounts for more than 20% of the total revenue of SasTech Ltd. every year. However, Kapsch was not shown as a separate reportable segment until last audited annual financials of the company.

Since SasTech is a listed company on Bombay Stock Exchange as well as National Stock Exchange, the company has to publish quarterly financial information after the limited review of the auditors. The carrying amount of SasTech's ODC asset (for Kapsch) is Rs. 129 Lacs (after considering impact of contract with Kapsch during the year) as on 31st March 2020.

As a finance prime your help is required by the head of R2R (Record to report) team during each of the quarter close before the financial information is submitted to the auditors for limited review.

Choose the best option from the given choices for each of the question or statement below. Reasoning for the answer is not required to be given.

1. The Head of R2R was not aware of this latest contract with Kapsch in so much of details. You have discussed with him the main points of the contract including the Performance Bonus and Attrition Penalty. The Consideration agreed by both the parties in this contract is _________

   (a) Variable and requires allocation to distinct performance obligation

   (b) Variable but does not require specific allocation to distinct performance obligation

   (c) Composite consideration

   (d) Composite consideration with distinct performance obligations

2. SasTech Ltd. has decided to make provision for attrition penalty at the beginning of each quarter instead of booking that amount as loss in the case of liability of pay penalty. Historically, Kapsch ODC has seen at attrition rate of 7%. If the same attrition percentage is used for provision of attrition penalty what will be the provision amount for Q1FY19-20? Assume standard billing hours of 1920 per annum per FTE in ODC.

   (a) USD 2,30,000

   (b) USD 2,31,000

   (c) USD 2,32,000

   (d) USD 2,33,000

3. "Now that the contract has changed substantially and Kapsch accounts for about 20% of company's revenue we may have to show this as a separate operating segment", said the Head of R2R at SasTech Ltd. In view of the principles of IFRS, what is your view?

   (a) Since there is only one such contract, separate reportable segment treatment is not called for.

   (b) Head of the R2R team is right. It needs to be reported as a separate segment.

   (c) Just a disclosure as special contract is required.

   (d) Provision for Attrition Penalty is required.

4. The company is likely to get performance bonus for Quarter 2 Financial year 2019-2020. The final approval of timesheet has been received from Kapsch on 6th working day

from the end of the quarter. Compute the amount of performance bonus that can be recognized as revenue before the financial information is passed on to the auditors for limited review.

(a) USD 0.72 million

(b) USD 0.71 million

(c) USD 0.73 million

(d) USD 0.74 million

5. What are the two factors that compelled the organisation to treat Kapsch contract as a separate reportable segment?

(a) Final approval process for timesheet and attrition

(b) Performance bonus and attrition penalty

(c) Threshold for segment recognition and total contract revenue

(d) Standard hours mentioned in the contract.

(2 X 5 = 10 marks)

6. If SasTech Ltd. has reported this contract as a separate reportable segment "Revenue from special contracts", prepare "Notes to account" to disclose the amount of adjustments made on account of performance bonus and attrition penalty for Financial Year 2019-2020. Working notes should be part of your answer but not the part of disclosure.

For calculation purposes assume 1 USD = Rs. 65. **[6 marks]**

7. If final approval for timesheet for Q2FY19-20 was not received as on the date of preparing financials but received subsequently due to delay from Kapsch (as the concerned person was travelling), should the company recognise the performance bonus as Unbilled Revenue (classified as current asset in the balance sheet) or treat it as a revenue? Justify your answer citing specific reference from relevant IFRS and facts of the case. **[4 marks]**

8. As on 31st March 2020, the ODC has no other liability except the provision for attrition penalty for Quarter 4 Financial Year 2019-2020. Disclose the amount of Segment revenue, Segment assets and Segment liabilities under "Revenue from Special Contracts" if there are no other contracts of similar nature for SasTech Ltd. For calculation purposes assume 1 USD = Rs. 65. **[5 marks]**

CASE STUDY 3

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

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

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

- 1st April, 2018 - FCY 1 = Rs. 2.50.

- 31st March, 2019 – FCY 1 = Rs. 2.75.

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

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

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

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

Additional information:

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

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

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

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

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

Questions:

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

(A) Segment C.

(B) Segments C, D and B.

(C) Segments B, C, D and E

(D) All are reportable segments.

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

(A) Rs. 8,57,935.

(B) Rs. 9,97,989.

(C) Rs. 5,87,935.

(D) Rs. 11,75,869.

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

(A) Nil impact.

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

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

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

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

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

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

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

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

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

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

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

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

   (D) Having currently exercisable options which would effectively result in 60% ownership of total shareholding.

(2 x 5 = 10 Marks)

6. Analyse the terms of the revenue contracts with customers for sale of moulds as per applicable Ind AS. Determine the amount of revenue, refund liability and the asset to be recognized by Makers Ltd. for the said contracts explaining the reasons for your answers. **(4 Marks)**

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

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

CASE STUDY 4

You are Praveen an Assistant Manager in Finance and Accounts department of ABC Group (hereby referred as ABC, ABC Ltd. or group) headed by Director- Finance Aditya Goel. You assist and report to Sumit Bansal, Manager of your department. You have joined the organisation just a month ago.

Sumit Bansal is on vacation for 15 days and financial statements of ABC Limited needs to be finalized within a week. Therefore, Mr. Goel needs your assistance in finalization of consolidated as well as separate financial statements of ABC Limited for the year ended 31st March 2017.

He provided you with the following relevant information:

1. On 1st April, 2016, ABC acquired 90 million shares in PQR Limited by means of share exchange which has been classified as 'fair value through other comprehensive income' in separate financial statements of ABC Limited. The terms of the business combination were as follows:

   - ABC Limited issued eight shares for every, nine shares acquired in PQR Limited. On 1st April, 2016, the market value of ABC Limited's share was Rs.2.80 per share.

- ABC Limited will make a further cash payment to the former shareholders of PQR Limited on 30th June 2019. This payment will be based on the adjusted profits of PQR Limited for the three-year period upto 31st March 2019. On 1st April 2016, the fair value of this additional payment was estimated at Rs.25 million. This estimate had increased to Rs. 28 million by 31st March 2017 due to changes in circumstances since the date of acquisition.

Investment in PQR Limited has not been recorded in the draft financial statements of ABC Limited presented at later part of the study.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in PQR Limited at 1 April 2016 can be used for this purpose. On 1 April 2016, the market value of a PQR Limited share was Rs.2.60 per share.

On 1st April 2016, the individual financial statements of PQR Limited showed the following reserves balances:

- Retained earnings Rs.86 million.
- Other components of equity Rs.2·4 million.

The directors of ABC Limited carried out a fair value exercise to measure the identifiable assets and liabilities of PQR Limited at 1 April 2016. The following matters emerged:

- Property having a carrying value of Rs.140 million (including depreciable assets Rs.80 million) had an estimated market value of Rs.160 million (including depreciable assets Rs. 92 million). The remaining estimated economic life of the depreciable assets at 1st April 2016 was 16 years.
- Plant and equipment having a carrying value of Rs.111 million had a market value of Rs.120 million. The estimated future economic life of the plant and equipment at 1st April 2016 was three years. PQR Limited has not disposed of any of this plant and equipment since 1st April 2016.
- Intangible assets with an estimated market value of Rs.8 million had not been recognised in the individual financial statements of PQR Limited. The estimated future economic lives of these intangible assets at 1st April 2016 was four years.

The fair value adjustments have not been reflected in the individual financial statements of PQR Limited. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Impairment of the goodwill on acquisition of PQR Limited is not required since 1 April 2016.

Below are the separate financial statements of ABC and PQR Limited as on 31st March 2017:

	ABC Limited Rs.'000	PQR Limited Rs.'000
ASSETS		
Non-current assets:		
Property, plant and equipment	280,000	225,000
Investments	78,500	40,000
	358,500	265,000
Current assets:		
Inventories	85,000	56,000
Trade receivables	70,000	42,000
Cash and cash equivalents	14,000	11,000
	169,000	109,000
Total assets	527,500	374,000
EQUITY AND LIABILITIES		
Equity		
Share capital	160,000	120,000
Retained earnings	211,396	115,000
Other components of equity	5,604	4,000
Total equity	377,000	239,000
Non-current liabilities:		
Provision	1,500	Nil
Long-term borrowings	60,000	50,000
Deferred tax	22,000	25,000
Total non-current liabilities	83,500	75,000
Current liabilities:		
Trade and other payables	45,000	40,000
Short-term borrowings	22,000	20,000
Total current liabilities	67,000	60,000
Total equity and liabilities	527,500	374,000

1. On 1st April 2016, ABC has raised a long term loan from European investors. The investors subscribed for 50 million Foreign currency (FC) loan notes at par. ABC Ltd. incurred incremental issue costs of FC 1 million. Interest of FC 4 million is payable annually on 31st March, starting from 31st March 2017. The loan is repayable in FC on 31st March 2022 at a premium and the effective annual interest rate implicit in the loan is 10%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

– 1^{st} April 2016 – FC 1 = Rs.1·40.

– 31^{st} March 2017 – FC 1 = Rs.1·45.

– Average rate for the year ended 31^{st} March 2017 – FC 1 = Rs.1·42. The functional currency of the group is Indian Rupee.

2. Trade receivables of ABC Ltd. include Rs. 2 million lent to a supplier on 1^{st} April 2016, in order to assist them with their expansion plans. The cost incurred to arrange the loan is Rs. 100,000. Mr. Goel opined to recognise Rs. 100,000 as a cost in the current year. However, he had not charged interest on this loan since the loan was given to help supplier's short-term cash flow. The supplier was expected to repay Rs. 2.4 million on 31^{st} March 2018. Mr. Goel believe that no profit will accrue this year but there will be a nice bonus next year when the repayment will be received. The finance department informed him that the effective annual rate of interest on this loan is 6·9%. However, Mr. Goel did not find any relevance of this information as no interest is payable according to him.

   Just before the year ending on 31^{st} March 2017, ABC Ltd. came to know that the supplier is facing poor economic conditions which has caused significant problems to him. In order to help him, ABC Ltd. agreed to reduce the amount repayable by him on 31^{st} March 2018 to Rs.2.2 million. Mr. Goel feels that still ABC Ltd. will report profit next year on it.

3. Mr. Goel also mentioned that during the year ended 31^{st} March 2017, ABC Ltd. provided consultancy services to a customer regarding the installation of a new production system. The system has caused the customer considerable problems, so the customer has taken legal action against ABC Ltd. for the loss that has arisen as a result of the problems with the system installation. The legal department of the group felt that there is 25% chance to successfully defend the claim. However, at the same time it also felt that 75% chance is that ABC Ltd. may require to pay damages of Rs.1.6 million. Mr. Goel believes that ABC Ltd. should not suffer any overall loss because the legal department informed that the company is covered by insurance against such types of losses. Mr. Goel feels that ABC Ltd. will make a claim immediately if the outcome of the case is against the company. According to him no provision shall be made for it because ABC Ltd. is covered by insurance. However, disclosure by way of a note shall be given for it.

4. ABC Ltd. provides consultancy advice to other firms as well. On 1^{st} October 2016, ABC Ltd. signed a contract to supply 50 days of consultancy advice to a customer over the two-year period ending on 30^{th} September 2018. The contract required ABC Ltd. to submit to six- monthly audits of the firm to ensure that the performance conditions in the contract had been adhered to in the immediately preceding six months. The first six -monthly audit was carried out shortly after 31^{st} March, 2017 wherein the firm confirmed that ABC Ltd. had satisfactorily supplied 15 days of consultancy in the six-month. The total contract price was Rs.1·5 million payable on 30^{th} September 2018 even though if the service of 50 days is rendered in the initial period of the service contract . ABC Ltd. has strong budgetary control systems in place and is able to accurately forecast the costs incurred in delivering the consultancy. An appropriate rate of interest to impute to this project would be 15% for the required period.

Besides above issues Praveen has some more doubts for which he requires your assistance.

Questions:

1. Property, plant and equipment (PPE) of ABC Ltd. includes factory and head office PPE among other PPE. Factory and head office PPE have the carrying value of Rs. 16,000 thousand and Rs. 22,000 thousand respectively as on 1 st April 2016. The remaining useful lives of both the PPE are 10 years and 20 years respectively. Company carried out an impairment testing on 31 March 2017 and noted that recoverable amount of factory and head office PPE as on that date is Rs. 15,000 thousand and Rs. 20,000 thousand respectively.

   At what amount factory and head office PPE shall be recorded on 31 March 2017 ?

   (a) Factory- Rs. 15,000 thousand and Head office- Rs.20,900 thousand

   (b) Factory- Rs. 15,000 thousand and Head office- Rs.20,000 thousand

   (c) Factory- Rs. 14,400 thousand and Head office- Rs.20,000 thousand

   (d) Factory- Rs. 14,400 thousand and Head office- Rs. 20,900 thousand

2. ABC Ltd. factored Rs. 2 million of its trade receivables to a bank during the year. The Bank paid Rs. 1.8 million to ABC Ltd. Bank charged ABC Ltd. Rs. 1 lac fee for this. All responsibility of receivables will be returned to ABC Ltd. if the debts are left unpaid after 6 months.

   (i) Rs. 1.8 million shall be considered as loan and accounted for as financial liability

   (ii) Rs. 1 lac fee should be deducted as transaction cost from financial liability

   (iii) A loss of Rs. 2 lac should be recorded in the statement of profit and loss

   (iv) The receivable should be derecognised from the statement of financial position

   State which two of the above treatment represents the correct accounting

   treatment.

   (a) (i) and (ii)

   (b) (i) & (iii)

   (c) (i) & (iv)

   (d) All of the above

3. ABC Ltd. has uncertainty over two items of inventory on 31 March 2017.

   Item A relates to raw material purchased for Rs. 5 lacs for a large profitable contract with supermarket. Since then, the purchase cost of these raw material has fallen to Rs. 4 lacs. **Item B** cost Rs. 2.5 lacs. It was damaged on 15 March 2017. After performing repairing work of Rs 30,000, it was sold for Rs. 2.6 lacs on 15 April 2017.

   Determine the value at which items A & B shall be recorded on 31st March, 2017.

   (a) Item A- Rs. 4 lac and Item B- Rs. 2.30 Lac

   (b) Item A- Rs.5 lac and item B- Rs. 2.60 Lac

   (c) Item A- Rs. 5 lac and Item B- Rs. 2.30 Lac

   (d) Item A – Rs. 4 lac and Item B- Rs.2.60 Lac

4. ABC Ltd. uses first in first out method to measure its inventory for many years. On 1st April 2016, ABC Ltd. shifted to weighted average cost. This increased the inventory value at that date by Rs. 2 lacs. Which one of the following is NOT the correct accounting treatment for the financial statements for the year ended 31st March 2017?

   (a) Increase only opening retained earnings in the statement of changes in equity by Rs. 2 lacs on 31st March, 2017.

   (b) Increase inventory by Rs 2 lacs in the prior year comparative statement of financial position alongwith the opening retained earnings.

   (c) Increase the cost of sales of the current year by Rs. 2 lacs.

   (d) Reduce the profits in prior year comparative statement of profit and loss by Rs. 2 lacs.

5. ABC Ltd. has introduced a profit sharing plan from 1st April, 2016 for its employees who serve the company through out the year. If no employees leave during the year, total profit sharing payments for the year will be 2% of profit. ABC Ltd. estimates that the employee turnover will be there and their profit share would be limited to 1.5%.

   Determine the accounting treatment for this profit sharing plan.

   (a) ABC Ltd. recognises a liability and an expense of 1.5% of profit.

   (b) ABC Ltd. recognises a liability of 2% of profit.

   (c) No liability will be recognised.

   (d) Only expenses will be recognised on actual basis.

(2 X 5 = 10 marks)

6. Compute the amount of 'Goodwill' and 'Non- controlling interest' to be shown in the Consolidated financial statements of ABC Limited as on 31 st March 2017 on acquisition of PQR Ltd. **(10 Marks)**

7. Advise the appropriate accounting treatment for the Foreign Currency loan to be made by ABC Ltd. in the books. **(5 Marks)**

CASE STUDY 5

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

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

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

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

Additional information:

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

Questions:

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

   (A) Redeemable debentures with discretionary dividend.

   (B) Optionally convertible redeemable preference shares.

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

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

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

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

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

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

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

3. Disclosures of fair value are not required when:

   (A) Fair value cannot be estimated.

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

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

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

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

   (A) Total return swap.

   (B) LIBOR linked debentures.

   (C) Credit Default Swap.

   (D) Written treasury bond option.

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

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

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

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

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

(2 x 5 = 10 Marks)

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

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

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

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