Test Series: October, 2019

MOCK TEST PAPER 1

FINAL (NEW) COURSE

PAPER 1: GLOBAL FINANCIAL REPORTING STANDARDS

ANSWERS

CASE STUDY 1

I. Answers to Multiple Choice Question

1. Option B

Reason

IAS 17 Leases stipulates the accounting treatment of sale and leaseback transactions. When an asset is sold and immediately leased back under a finance lease, the substance of the transaction is a financing arrangement, the asset providing security for the loan.

Any profit on sale should not be recognised immediately, but should instead be deferred and recognised over the lease term. In this case the profit of Rs. 4,80,000 should be recognised over a ten year period, on a straight line basis. For the year ended 31st March, a profit of Rs. 48,000 should be recognised. The rental expense of Rs. 2,16,000 should be added back to profit and recognised as a reduction in the lease liability.

Profit before interest and tax should be reduced by Rs. 4,32,000 (Rs. 4,80,000 of profit transferred to deferred income, net of Rs. 48,000 recognised in the accounting period). The reversal of the rental expense increases profit by Rs. 2,16,000.

Deferred income is recognised under liabilities, split between current (Rs. 48,000 in respect of the accounting period year ended 31st March 20X6 and long-term (Rs. 384,000).

The de recognition of the asset was correct, but as with any other finance lease, the asset should be recognised in non-current assets. Leased assets should be recognised at lower of fair value and the present value of minimum lease payments. In this case the figures are the identical.

The non-current asset should be depreciated over the lease term: Rs. 15,60,000/10 = Rs. 1,56,000. The charge therefore reduces profit before interest and tax.

The carrying amount of the asset in the statement of financial position at 31st March 20X6 should be Rs. 15,60,000 – Rs. 1,56,000 = Rs. 14,04,000. Amounts in respect of the lease liability should be calculated by reference to the 7% interest rate implicit in the lease:

Date	Balance [1]	Finance cost 7% [2]	Lease payment [3]	Balance [1 + 2 – 3]
	Rs.	Rs.	Rs.	Rs.
31 March 20X6	15,60,000	1,09,200	(2,16,000)	14,53,200
31 March 20X7	14,53,200	1,01,724	(2,16,000)	13,38,924

Current liability would be next lease payment of Rs. 2,16,000 –Rs. 1,01,724 = Rs. 1,14,276.

Long-term liability would be Rs. 14,53,200 - Rs. 1,14,276 = Rs. 13,38,924.

2. Option C

Reason

Impairment of the machine in PQR

The appropriate discount rate to use in calculating value in use is 9% pre-tax.

Year ended	Cash flow Rs.	Discount factor	Amount Rs.
31 March 20X7	2,76,000	0.9174	2,53,202
31 March 20X8	1,92,000	0.8417	1,61,606
31 March 20X9	1,20,000	0.7722	92,664
31 March 20Y0	1,14,000	0.7084	80,758
			5,88,230

The recoverable amount is the higher of value in use and fair value less costs to sell. The recoverable amount is therefore Rs. 5,88,230.

3. Option A

Reason

Land is not depreciated as it has an indefinite life. Land should be shown in the statement of financial position at its original cost of Rs. 6,72,000. The building element was recognised at cost of Rs. 24,00,000.

Carrying amount before the revaluation on 31st March 20X3 would have been Rs. 21,60,000 (Rs. 24,00,000 – two years depreciation Rs. 2,40,000). The buildings element should then be revalued upwards to Rs. 27,00,000 and the surplus over carrying amount of Rs. 5,40,000 recognised in other comprehensive income and credited to revaluation surplus.

Depreciation would now be Rs. 1,50,000 (Rs. 27,00,000/18). {Note: Management could elect to make an annual transfer of Rs. 30,000 from revaluation surplus to retained earnings through the statement of changes in equity} On the 31st March 20X6 the following balances should be included in the Statement of financial position.

	Rs.
Land	672,000
Rs. 27,00,000 – three years' depreciation at Rs. 150,000 per annum)	2,250,000

The buildings element open market value is now only Rs. 19,80,000 and an impairment loss of Rs. 2,70,000 should be recognised.

4. – D

Reason

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is the equivalent to the repayment of a loan.

Under IAS 32 Financial Instruments: Presentation, these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

	1 April, 20X5	Interest @18%	Paid at 4%	31 March, 20X6
	Rs.	Rs.	Rs.	Rs.
20X5-20X6	480,000	86,400	(19,200)	547,200

An amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and a finance charge of Rs. 86,400 included within profit or loss. Equity should be reduced by both the Rs. 480,000 proceeds of issue and the Rs. 67,200 i.e. total by 5,47,200.

5. B

Reason

An amount of Rs. 15,00,000 (Rs. 18,00,000 x 10/12) should be capitalised in the SFP representing the expenditure since 1 June. The expenditure incurred prior to 1 June (2/12 x Rs.18,00,000) should be recognised as an expense, retrospective recognition as an asset is not allowed.

II. Answer to Descriptive Question

6. Issue 1

IAS 17 Leases stipulates the accounting treatment of sale and leaseback transactions. When an asset is sold and immediately leased back under a finance lease, the substance of the transaction is a financing arrangement, the asset providing security for the loan.

Any profit on sale should not be recognised immediately, but should instead be deferred and recognised over the lease term. In this case the profit of Rs. 4,80,000 should be recognised over a ten year period, on a straight line basis. For the year ended 31st March, a profit of Rs. 48,000 should be recognised. The rental expense of Rs. 2,16,000 should be added back to profit and recognised as a reduction in the lease liability.

Profit before interest and tax should be reduced by Rs. 4,32,000 (Rs. 4,80,000 of profit transferred to deferred income, net of Rs. 48,000 recognised in the accounting period). The reversal of the rental expense increases profit by Rs. 2,16,000.

Deferred income is recognised under liabilities, split between current (Rs. 48,000 in respect of the accounting period year ended 31st March 20X6 and long-term (Rs. 384,000).

The de recognition of the asset was correct, but as with any other finance lease, the asset should be recognised in non-current assets. Leased assets should be recognised at lower of fair value and the present value of minimum lease payments. In this case the figures are the identical.

The non-current asset should be depreciated over the lease term: Rs. 15,60,000/10 = Rs. 1,56,000. The charge therefore reduces profit before interest and tax.

The carrying amount of the asset in the statement of financial position at 31st March 20X6 should be Rs. 15,60,000 – Rs. 1,56,000 = Rs. 14,04,000. Amounts in respect of the lease liability should be calculated by reference to the 7% interest rate implicit in the lease:

Date	Balance [1]	Finance cost 7% [2]	Lease payment [3]	Balance [1 + 2 – 3]
	Rs.	Rs.	Rs.	Rs.
31 Mar 20X6	15,60,000	1,09,200	(2,16,000)	14,53,200
31 Mar 20X7	14,53,200	1,01,724	(2,16,000)	13,38,924

Current liability would be next lease payment of Rs. 2,16,000 – Rs. 1,01,724 = Rs. 1,14,276.

Long-term liability would be Rs. 14,53,200 - Rs. 1,14,276 = Rs. 13,38,924.

Finance costs recognised in Statement of Comprehensive Income for 20X5-20X6 should be Rs. 1,09,200

Issue 2

The gain on holding the shares in JKL is Rs. 1 per share, so Rs. 25,000 for 25,000 shares. However, the gain has been incorrectly recognised. IFRS 9 Financial Instruments requires that where financial assets are classified as equity, gains or losses arising from changes in fair value should be recognised in other comprehensive income. The effect on the financial statements is to remove the gain of Rs. 25,000 from profit before interest and tax, because it will be recognised instead in other comprehensive income. There is no change in equity.

Issue 3

(i) Impairment of the machine in PQR

The appropriate discount rate to use in calculating value in use is 9% pre-tax.

Year ended	Cash flow Rs.	Discount factor	Amount Rs.
31 Mar 20X7	2,76,000	0.9174	2,53,202
31 Mar 20X8	1,92,000	0.8417	1,61,606
31 Mar 20X9	1,20,000	0.7722	92,664
31 Mar 20Y0	1,14,000	0.7084	80,758
			5,88,230

The recoverable amount is the higher of value in use and fair value less costs to sell. The recoverable amount is therefore Rs. 5,88,230. Impairment of Rs. 6,60,000-5,88,230= Rs. 71,770

The impairment loss must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of Rs. 36,000 is eliminated against impairment loss, and the remainder of the impairment loss (Rs. 35,770) is charged to profit and loss.

Any compensation by government would be accounted for as such when it becomes receivable. At this time, the government has only stated that it may reimburse the company and therefore credit should not be taken for any potential government receipt.

(ii) Freehold manufacturing building

Land is not depreciated as it has an indefinite life. Land should be shown in the statement of financial position at its original cost of Rs. 6,72,000. The building element was recognised at cost of Rs. 24,00,000.

Carrying amount before the revaluation on 31st March 20X3 would have been Rs. 21,60,000 (Rs. 24,00,000 – two years depreciation Rs. 2,40,000). The buildings element should then be revalued upwards to Rs. 27,00,000 and the surplus over carrying amount of Rs. 5,40,000 recognised in other comprehensive income and credited to revaluation surplus.

Depreciation would now be Rs. 1,50,000 (Rs. 27,00,000/18). {Note: Management could elect to make an annual transfer of Rs. 30,000 from revaluation surplus to retained earnings through the statement of changes in equity} On the 31st March 20X6 the following balances should be included in the Statement of financial position.

	Rs.
Land	672,000
Rs. 27,00,000 – three years' depreciation at Rs. 150,000 per annum)	2,250,000

The buildings element open market value is now only Rs. 19,80,000 and an impairment loss of Rs. 2,70,000 should be recognised. As the loss is less than the revaluation surplus on the related asset, the entire loss should be recognised in other comprehensive income and set off against the revaluation surplus, so that it now becomes Rs. 2,70,000 (Rs. 5,40,000 – Rs. 2,70,000).

The adjustment necessary is therefore:

		Rs.	Rs.
	Depreciation SCI Dr. To Accumulated Depreciation SFP	150,000	 150,000
	Impairment loss (OCI) Dr. To Non-current assets	270,000	 270,000

Issue 4

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is the equivalent to the repayment of a loan.

Under IAS32 Financial Instruments: Presentation- these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

	1 April, 20X5	**Interest @18%**	**Paid at 4%**	**31 March, 20X6**
	Rs.	Rs.	Rs.	Rs.
20X5-20X6	480,000	86,400	(19,200)	547,200

An amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and a finance charge of Rs. 86,400 included within profit or loss. Equity should be reduced by both the Rs. 480,000 proceeds of issue and the Rs. 67,200 i.e. total by 5,47,200.

The adjustment necessary is therefore:

		Rs.	Rs.
equity –preference shares (SFP)	Dr.	4,80,000	
Finance costs (SCI)/equity retained earnings	Dr.	86,400	
To Equity – retained earnings (SFP)			19,200
To Borrowings (SFP)			5,47,200

Issue 5

IAS 38 Intangible Assets requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 20X5 was the last criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits expected to exceed costs – (2 years)
- An amount of Rs. 15,00,000 (Rs. 18,00,000 x 10/12) should be capitalised in the Statement of Financial Position representing the expenditure since 1 June. The expenditure incurred prior to 1 June (2/12 x Rs.18,00,000) should be recognised as an expense, retrospective recognition as an asset is not allowed.

IAS 36 Impairment requires an intangible asset not yet available for use to be tested for impairment annually. A cash flow of Rs. 12,00,000 in perpetuity would clearly have a present value in excess of Rs. 12,00,000 and hence there would be no impairment. However, the research director is technically qualified so impairment tests should be based on her estimate of a four-year remaining life and a present value of the future cost savings of Rs. 9,60,000. This is greater than the offer received (fair value less costs to sell) of Rs. 7,80,000 and should be used as the recoverable amount. The carrying amount should be reduced to Rs. 9,60,000 and an impairment loss of Rs. 5,40,000 recognised in the profit and loss for the year.

The adjustment necessary is therefore:

		Rs.	Rs.
Operating expenses- development expenditure	Dr.	3,00,000	
Operating expenses –impairment of intangible	Dr.	5,40,000	
To Intangible assets – development expenditure			8,40,000

Issue 6

The office property development is clearly speculative and therefore there is no contractual purchaser. Because of the intent to sell the building upon completion, it should be reclassified as inventory rather than an investment property. It needs to be recognised under IAS 2.

Inventory should be recognised at lower of cost and NRV, so at 31st March 20X6 the development should be measured at Rs. 27,60,000 cost. The gain of Rs. 1,20,000 should be derecognised.

The adjustment necessary is therefore:

		Rs.	Rs.
Inventory	Dr.	27,60,000	
Gains on investment property	Dr.	1,20,000	
To Investment property			28,80,000

ANSWER TO CASE STUDY 2

I. Answers to Multiple Choice Questions

1. Option (a)-Variable and requires allocation to distinct performance obligation

Reason

Para 85 of IFRS 15 Revenue from contracts with customers,

Variable amount should be allocated entirely to a performance obligation or to a distinct good or service as part of single performance obligation if both the following conditions are satisfied:

a) Variable payment relates specifically to entity's efforts to satisfy performance obligation or transfer the distinct good or service

b) Such allocation is consistent with the object of Para 73 keeping in mind all of the performance obligations and payment terms in the contract.

Since performance bonus and attrition penalty both are variable in nature, the company needs to allocate the consideration separately for each variable element.

2. Option (b)USD 2,31,000

Reason

Monthly billing rate per FTE for standard hours is USD 4400, so for 500 FTEs the billing per quarter would be USD 4400 x 500 x 3 = 66,00,000. Based on the attrition penalty table, applicable percentage for 7% attrition would be 3.5%. So, 66,00,000 x 3.5% = 231,000

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

Reason

As per para 5 of IFRS 8,

An operating segment is a component of an entity:

a) That engages in business activities from which it earns revenues and incur expenses

b) Whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance and

c) For which discrete financial information is available.

Looking at the substance of the case, this contract calls for a treatment of separate operating segment.

4. Option (a)USD 0.72 million

Reason

Hourly bill rate as per standard hours = USD 4400 x 12 /1920 = USD 27.5 per hour.

No. of billed hours as per final approval = 262319

Billing for the quarter = 2,62,319 x USD 27.5 = USD 72,13,772.5

Performance bonus at the rate of 10% = USD 7,21,377.25 or USD 0.72 million

5. Option (b) - Performance bonus and attrition penalty

Reason

The performance bonus and attrition penalty affect the certainty cash flows from the contract which also make the contract significantly different from other customer contracts of the company.

II. Answers to Descriptive Questions

6. Notes to Accounts for adjustments on account of variable components:

Contract Value		xxxxxxx
Adjustments on account of variable components:		
Less: Attrition Penalty	(4,83,02,719)	
Add: Performance Bonus	4,68,89,521	
Net adjustments		(14,13,198)

Working Note: (not part of disclosure)

Quarter (1)	Billable hours in ODC (2)	ODC invoice amount (3)	Performance Bonus (4)	Attrition Penalty (5)
1	160 x 500 x 3 = 2,40,000	240000 x 27.5 x 65 = 42,90,00,000	Not eligible	42,90,00,000 x 3.5% = 150,15,000
2	2,62,319 (as per final approval)	2,62,319 x 27.5 x 65 = 46,88,95,213	(3) x 10% = 4,68,89,521	Not liable
3	160 x 500 x 3 = 2,40,000	2,40,000 x 27.5 x 65 = 42,90,00,000	Not eligible	42,90,00,000 x 4.5% = 193,05,000
4	2,23,500 (as per final approval)	2,23,500 x 27.5 x 65 = 39,95,06,250	Not eligible	39,95,06,250 x 3.5% = 139,82,719
		1,72,64,01,463	**4,68,89,521**	**483,02,719**

7. Since invoice cannot be raised without final approval, the bonus element can't be treated as revenue. However, based on the substance of the case, the company can treat the same as unbilled revenue and show it as part of current assets in the balance sheet as on the end of Quarter 2 Financial Year 2019-2020. However, the unbilled amount and final billed revenue may vary since Kapsch many times approve less hours then the hours approved by SasTech.

Facts of the case:

There's a contractual right of the company to be entitled for performance bonus since the company has in-principle satisfied the basic condition and thus has fulfilled its performance obligation under the contract.

Requirement of relevant IFRS:

Para 105 of IFRS 15, when either party to the contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

Application and justification:

Since the company has already provided the services and met the basic conditions of eligibility for performance bonus the same can be recognized as unbilled revenue. The act of getting the formal approval is only a matter of time and hence does not impair the substance of the case. As per the principles of IFRS 15, the company has fulfilled its performance obligations by rendering the required services to the customer and also satisfied the criteria for performance bonus by keeping the attrition lower than the threshold and also by making its employees more than the standard number of working hours.

8. **Segment Information:**

Special Contracts:

This segment consists of contracts with customers which have special performance obligations which are different from other contracts in terms of nature, timing, amount and certainty of revenues and cash flows from the contracts.

Particulars	Rs. **in Crores**
Segment Revenue	181.08
Segment Assets	1.29
Segment Liabilities	1.40

Working Notes (not part of disclosure)

- Segment Revenue

Onsite 10 (FTEs) x 12 (months) x USD 11,000 x 65 (Rs. per USD) =		858,00,000
ODC (as per working notes in answer for Q.6 above) –		
Invoice Value	Rs. 172.64 crore	
Less: Adjustments (net) on account of variable components	(Rs. 0.14 Crore)	
Net ODC revenue (as per para 50-54 of IFRS 15)		Rs. 172.50 Crore
Total Contract Revenue		Rs. 181.08 Crore

- Segment Assets refer to ODC's carrying value of assets as given in the case ie Rs. 129 lacs.
- Segment liability is the provision for Attrition Penalty for Q4FY19-20 which has been worked out as per working notes in answer for Q.6 above ie. 1,39,82,719.

ANSWER TO CASE STUDY 3

I. Answer to Multiple Choice Question

1. Option (c) - Rs. 383 Lacs

Reason:

Carrying value as on 31st March 2018:

		Rs. in lacs
Cows		*120*
Land		*150*
Civil structure (useful life 15 years)	*[65 – {(65 lacs / 15 year x 12 month) x 2 month}]*	*64.278*
Milking equipment and other tools (useful life 7 years)	*[50-{(50 lacs / 7 year x 12 month) x 2 month}]*	*48.81*

2. Option (a) – Rs. 390 Lacs (approx.)

Reason

	Opening Balance 1.4.2018	***Additions***	***Deletions***	***Fair value adjustments***	***Depreciation for 12 months***	***Closing balance***
	Rs. in lacs	***Rs. in lacs***	***Rs. in lacs***	***Rs. in lacs***	***Rs. in lacs***	***Rs. in lacs***
Cows	*120*	*(3.24 + 2.88) 6.12*	*(5 x 0.60) 3.00*	*-*	*-*	*123.12*
Land	*150*			*15*		*165*
Civil structure (useful life 15 years)	*64.278*				*4.33*	*59.948*
Milking equipment and other tools (useful life 7 years)	*48.81*				*7.14*	*41.67*
						389.738

3. Option (b) - Rs. 9.34 Lacs

Reason:

Period	Actual production	Target	Surplus	Directors	Sold	Sales value
Q1	2,27,505	2,27,500	5	5	-	-
Q2	2,41,040	2,39,200	1,840	92	1,748	1,57,320
Q3	2,42,880	2,39,200	3,680	184	3,496	3,14,640
Q4	2,39,400	2,34,000	5,400	270	5,130	4,61,700
						9,33,660

Sales value is calculated @ Rs. 90 per litre.

4. Option (a) IAS 2 'Inventories'

Reason:

As per para 3 of IAS 41, IAS 41 is applied to agricultural produce, which is the harvested produce of the entity's biological assets, at the point of harvest. Thereafter, IAS 2 Inventories or another applicable Standard is applied. Hence for unsold stock IAS 2 will be applied.

5. **Option (b)** **Fair value less costs to sell**

Reason:

Since cattle feed is covered under IAS 41 'Agriculture', the valuation shall be fair value less costs to sell.

II. Answer to Descriptive Question

6. **Statement of Profit and Loss of Sai Caterers Pvt. Ltd. (Milk Procurement Unit)**

For the year ended 31st March, 2019

	Particulars	Figures as at the end of current reporting period Rs.
I	Revenue from operations:	
	Revenue - From inter-segment transfers	3,28,96,500
	Revenue – Direct sales	9,33,660
II	Other Income	-
III	Total Income (I + II)	**3,38,30,160**
IV	EXPENSES	
	Cost of materials consumed:	
	Daily feed for cows	1,09,50,000
	Medical expenses on cows	4,80,000
	Employee benefits expense	43,80,000
	Depreciation expenses	11,47,000
	Other expenses:	
	Office overheads	3,00,000
	Distribution cost	25,67,228
	Marketing cost for Godhan	1,55,610
	Total expenses (IV)	**1,99,79,838**
V	Profit/(loss) before tax (I-IV)	**1,38,50,322**

Working Notes:

1. **Employee benefits:**

No. of employees required to manage cows = 20

Cost	(Rs. 15,000 x 20 x 12 month)	36,00,000
Add: Cost of project manager	(Rs. 65,000 x 1 x 12 month)	7,80,000
Total employee cost		43,80,000

2. **Cost of daily feed:**

Rs. 150 x 200 cows x 365 days = Rs. 109,50,000

3. **Medical cost:**

Rs. 200 x 200 cows x 12 months = Rs. 4,80,000

4. **Distribution cost:**

Rs. 2.7 per litre for internal consumption

Total milk supplied during the year – 9,50,825 litres (2,27,505 + 2,41,040 + 2,42,880 + 2,39,400)

So, cost of distribution = 9,50,825 litres x Rs. 2.7 = Rs. 25,67,228 (rounded off)

5. **Marketing cost related to Godhan:**

Milk sold under the brand – 10,374 litres (1,748 + 3,496 + 5,130)

Marketing Cost per litre (as given) Rs. 15

So, marketing cost = Rs. 15 x 10,374 litres = Rs. 1,55,610

6. **Office overheads:**

Rs. 25,000 per month (given), so annually Rs. 3,00,000

7. **Depreciation:**

Refer answer to MCQ 2 above. According to it depreciation for the year = Rs. 11,47,000 lacs approx.

8. **Revenue**

Revenue from Godhan (direct sales) – Milk sold – 10,374 litres at Rs. 90 per litre = Rs. 9,33,660

Milk consumed internally = 9,39,900 litres.

Inter-segment transfers of milk is @ Rs. 35 per litre

So, internal revenue would be = 9,39,900 litre x Rs. 35.00 = 3,28,96,500

ANSWER TO CASE STUDY 4

I. Multiple Choice Question

1. **Option a.**

Reason

Since there have been many contracts which could not go through beyond the stage of consultancy, the service in itself is an operating segment. And the case study also mentions that revenue from consultancy constituted 12% of the overall revenue for the year. So, by thresholds criteria also, it becomes a reportable operating segment.

2. **Option b.**

Reason

Information about consultancy segment is given as 19 contracts and an average revenue of Rs. 5 lacs so it amounts to 19 x 5 lacs = Rs. 95 Lacs

If Rs. 95 lacs is 12% of the total revenue,

Then the total revenue would be 95 / 0.12 = Rs. 791.67 Lacs or Rs. 7.92 crore (approx.)

3. **Option c.**

Reason

As calculated above, if the total revenue is Rs. 7.92 crore,

It's given that revenue from Consultancy Services segment is Rs. 95 Lacs and that from Generic Equipment is Rs. 2.12 crore, the balance revenue would pertain to Customized Equipment segment which is Rs. 7.92 crore – (Rs. 0.95 crore + Rs. 2.12 crore) = Rs. 4.85 crore.

4. Option b.

Reason

Total contract value = Rs. 101 Lacs. Discount on account of cancellation of one location was Rs. 10 Lacs so, the actual revenue receivable was Rs. 91 Lacs (101-10).

However, the actual amount received from the client was Rs. 92 Lacs. Since the sign-off documents is signed and there's no obligation from the company's point of view, the extra amount of Rs. 1 lac received can be recognised as revenue as per IFRS 15.

Para 15 of IFRS 15 says the following:

"….the entity shall recognise consideration received as revenue only when either of the following events has occurred:

a) The entity has no remaining obligations to transfer goods or services to the customer and all or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

b) The contract has been terminated and the consideration received from the customer is non-refundable."

Rs. 30 lacs is the cost of earning revenue and hence should not be deducted from revenue.

5. Option a.

Reason

Recognition criteria as per Para 9 are met. Except that the extra Rs. 1 lac received may need to be returned before signing the final Sign-off document.

II. Answers to Description Questions

6. Original revenue estimate from Contract No. 123 – Rs. 51 Lacs

Actual Cost incurred for raw material	Rs. 26 Lacs
Add: 10% Cancellation fee	Rs. 2.6 Lacs
Actual revenue that can be recognised from Contract No. 123	Rs. 28.6 Lacs
Out of which the company has recognized as Consultancy Revenue since the client has already paid it	Rs. 5 lacs
Remaining revenue to be recognised from the Contract	Rs. 23.6 Lacs

Disclosure as per Para 113 of IFRS 15 'Revenue from Contracts with Customers'

"During the year, the company had a contract with a customer for a value of Rs. *51 Lacs.*

Due to some unforeseen circumstances the contract was terminated before actual delivery and hence the contractual receivables were impaired substantially.

The actual revenue recognised from the contract was Rs. *28.6 Lacs.*

The direct cost incurred for the contract on raw materials was Rs. *26 Lacs and indirect cost allocated for labour and overheads were about* Rs. *5 Lacs. Hence the total impairment loss from the contract was as follows:*

Revenue recognised		Rs. *28.6 Lacs*
Less: Direct cost	Rs. *26.0 Lacs*	
Indirect cost	Rs. *5.0 Lacs*	*Rs. 31.0 lacs*
Actual Loss from the contract		Rs. *2.4 Lacs"*

7. Looking at the substance over form principle of accounting the revenue of Rs. 11 Lacs should be recognized as on 31st March 2020 because the installation and trial were successful and the contractual value is clear. Just that the sign-off document is to be signed. Since there was no objection from customer from the date of trial till the date of book closure and also the amount has been received on 2nd April, 2020, the revenue of Rs. 11 Lacs should be recognized as on the balance sheet date.

Disclosure with respect to IFRS 15

During the year the company has executed several contract with customers for customized equipment. Contract revenue is recognised when the following criteria are met:

a) Our contract with the customer is approved and commercial value is clear.

b) Customized Equipment has been successfully delivered, installed and trial done to the satisfaction of the customer.

c) It is probable that the customer will pay the due amount within a reasonable time.

The company ensures that the substance of relevant accounting standard is followed while recognising revenue from customer contracts.

During the year, the company has recognized full revenue from contracts which have been successfully executed – goods delivered, installed and trial done successfully to the satisfaction of the client. However, sign-off documents were pending to be signed as on the balance sheet date which were subsequently done on or before 15th of April 2020 for all such contracts where full revenue was recognized by the company.

8. As per para 22 of IFRS 8, following is disclosed about an entity:

The company operates in mainly 3 segments:

- *Generic Equipment*
- *Customized Equipment and*
- *Consultancy Services*

Customers of the Generic Segment are from the similar business environment. They are either restaurants, hotels or resorts who need Equipment of different size and shape and do not need any consultancy services.

Customers from Customized Equipment Segment are usually the Trusts of Religious Institutions or Non-Government Organisations (NGOs) that distribute free food to either the visitors or the school children who are supported by such Institutions or NGOs.

Consultancy Services constitutes a separate segment because it meets the threshold of 10% or more of the total revenue of the entity. Many of our customers stop at the level of consultancy services although some had to plan for the same and a few customers come with an intention of only consultancy from the company.

The segment revenue is disclosed below:

Reportable Segment	***Segment Revenue***	***% of Total Revenue***
Generic Equipment	*4,85,00,000*	*61.24%*
Customized Equipment	*2,12,00,000*	*26.77%*
Consultancy Services	*95,00,000*	*11.99%*
	7,92,00,000	*100%*

CASE STUDY 5

I. Answers to Multiple Choice Question

1. Option (c) Rs. **64,60,000**

Reason

Trademarks are intangible assets. IAS38 Intangible Assets rule about measurement subsequent to initial recognition is that an intangible asset can only be measured using the revaluation model if it is traded in the market where the items are homogeneous. Each trademark is by definition unique, so IAS38 is explicit that trademarks should not be measured using the revaluation model.

The trademark should be measured at its cost of Rs. 68,00,000 and then amortized over twenty years. Rs. 3,40,000 should be recognized as an expense in the profit/loss for the current period and the asset measured at Rs. 64,60,000 in the Statement of Financial Position. The Rs. 20,40,000 increase in fair value should be reversed out of other comprehensive income and the revaluation surplus in respect of this asset should be zero.

2. Option (b) Rs. 52,85,000

Reason

IAS 36 states that if an asset's value is higher than its recoverable amount, an impairment loss has occurred. The impairment loss should be written off to profit and loss for the year.

The carrying value of the non-current assets at 31 March 20X2 is cost less depreciation:

Rs. 1,02,00,000 – (Rs. 1,02,00,000/5) = Rs. 81,60,000

This needs to be compared to the value in use at 31 March 20X2, which using a discount rate of 5%, is calculated as:

Year ended	31-Mar	31-Mar	31-Mar	31-Mar	Total
	20X3	20X4	20X5	20X6	
Cash flows (Rs. '000) [A]	952	1513	1700	1870	
Discount rate [B]	0.9524	0.907	0.8638	0.8227	
Value [A * B]	907	1372	1468	1538	5285

The value in use of Rs. 52,85,000 is below the carrying value, so the carrying value must be written down to Rs. 52,85,000.

3. Option (b) No provision

Reason

The treatment of the compensation received in the form of reimbursements is governed by IAS37 Provisions, Contingent Liabilities and Contingent Assets. Reimbursements from governmental indemnities are recorded in profit or loss when the compensation becomes receivable, and the receipt is treated as a separate economic event from the item it was intended to compensate for. In this case, receipt is uncertain and this no credit can be taken for compensation of 20% of the impairment loss.

4. Option (c) Either of the two

Reason

On 1 April 20X1 when the property was vacated by XYZ Ltd and leased out, it should be reclassified from property, plant and equipment to investment property and accounted for under IAS 40 Investment Property. Because it has not previously leased out any properties XYZ Ltd should adopt as its accounting policy any of the two options permitted under IAS 40 i.e. cost model and revaluation model.

5. Option (c) Rs. 29,79,590

Reason

IAS 37 Provisions, Contingent Liabilities and Contingent Assets states that a provision should be recognised only if there is a present obligation resulting from a past event. The terms of the lease contract mean that XYZ Ltd has an obligation to incur expenditure in order to return the buildings to the lessor in good condition. The past obligating event would appear to be the signing of the lease. Thus, there is a strong case for recognising a provision for the expenditure.

Following is the computation of the expense to be recognised:

Payment	***PVF @ 10%***	***Present value***
Rs. 3,40,000	*0.909*	*Rs. 3,09,060*
-	*0.826*	*-*
-	*0.751*	*-*
Rs. 39,10,000	*0.683*	*Rs. 26,70,530*
Grand total		*Rs.* ***29,79,590***

Statement of Comprehensive Income *Dr. Rs. 29,79,590*

To Provision (SFP) *Rs. 29,79,590*

II. Answers to Description Questions

6. Revised Consolidated Statement of Comprehensive Income for the year ended 31 March 20X2

	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
	Draft	WN1	Issue 1	Issue 2	Issue 3	Issue 4	Issue 5	Issue 6	Issue 7	Final
Revenue	37,187.5	2,176				816	-2,550			37,629.5
Cost of Sales	-21,802.5	-1,020					2,422.5	-2,979.59		-23,379.59
Gross Profit	15,385	1156				816	-127.5	-2,979.59		14,249.91
Operating expenses	-2,082.5	-510	-340						-510	-3,442.5
Impairment loss					-2,875					-2,875
Suspense	-1275									-1275
Profit from operations	12027.5	646	-340		-2875	816	-127.5	-2979.59	-510	6657.41
Dividend from ABC Ltd	170	-170								0
Finance costs	-8041			2.04					-4.25	-8043.21
Loss on investment property						-340				-340
Profit before taxation	4156.5	476	-340	2.04	-2875	476	-127.5	-2979.59	-514.25	-1725.8
Income tax	-1246.1	-105.4								-1351.5
Profit (loss) for the year	2910.4	370.6	-340	2.04	-2875	476	-127.5	-2979.59	-514.25	-3077.3
Other comprehensive income										0
Revaluations	2040		-2040			3510				3510
Re-measurement defined benefits									-165.75	-165.75
Total comprehensive income for the period	4950.4	370.6	-2380	2.04	-2875	3986	-127.5	-2979.59	-680	266.95
Attributable to										
Owners of XYZ Ltd	3961	370.6	-2380	2.04	-2875	3986	-102	-2979.59	-680	-696.95
NCI	989.4						-25.5			963.9

Working Notes:

1. Jointly controlled entity

XYZ Ltd subscribed for 40% (800,000 / 20,00,000) of the equity capital of ABC Ltd. The remaining equity interest (30% each) is shared by two other shareholders. Despite the different shareholdings,

all three shareholders have agreed that key decisions require unanimous consent by all three parties. This meets the definition of joint control.

The entity should be classified as a joint venture in accordance with IFRS 11, *Joint Arrangements*. Therefore, XYZ Ltd can reflect its interest in the joint venture at cost plus share of post-acquisition total comprehensive income. No goodwill arises as shares acquired on incorporation of ABC Ltd.

XYZ Ltd's dividend from ABC Ltd of (40% of Rs. 4,25,000) should be removed from Statement of Comprehensive Income and replaced with it's share of profits (40% x Rs. 13,51,500)

Treatment of outstanding issues:

Issue 1:

Trademarks are intangible assets. IAS38 Intangible Assets rule about measurement subsequent to initial recognition is that an intangible asset can only be measured using the revaluation model if it is traded in the market where the items are homogeneous. Each trademark is by definition unique, so IAS38 is explicit that trademarks should not be measured using the revaluation model.

The trademark should be measured at its cost of Rs. 68,00,000 and then amortized over twenty years. Rs. 3,40,000 should be recognized as an expense in the profit/loss for the current period and the asset measured at Rs. 64,60,000 in the Statement of Financial Position. The Rs. 20,40,000 increase in fair value should be reversed out of other comprehensive income and the revaluation surplus in respect of this asset should be zero.

Issue 2:

The shares are listed on a recognized stock market. The board minute provides evidence of the intention and ability to hold these shares until redemption, so they should be held to maturity. This asset should initially be measured at fair value being the cost of Rs. 34,000 (shares issued at par). Subsequently they should be measured at amortized cost using the effective interest rate.

Preference shares balance as at 31st March should be measured at initial amount recognized plus any income less any payments of principal sum (including dividend receipts)

	Rs.
Fair value at acquisition (34,000 x Rs. 1)	34,000
Add interest income at effective rate (34,000x6%)	2,040
Less interest/dividends received (34,000 x 4%)	(1,360)
	34,680

In the consolidated Statement of Financial Position at 31 March 20X2 the held to maturity asset should be presented within non-current assets (redemption is still 3 years away) and measured at Rs. 34,680.

Issue 3:

IAS 36 states that if an asset's value is higher than its recoverable amount, an impairment loss has occurred. The impairment loss should be written off to profit and loss for the year.

The carrying value of the non-current assets at 31 March 20X2 is cost less depreciation:

Rs. 1,02,00,000 – (Rs. 1,02,00,000/5) = Rs. 81,60,000

This needs to be compared to the value in use at 31 March 20X2, which using a discount rate of 5%, is calculated as:

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Discount rate [B]	0.9524	0.907	0.8638	0.8227	
Value [A * B]	907	1372	1468	1538	5285

The value in use of Rs. 52,85,000 is below the carrying value, so the carrying value must be written down giving rise to an impairment loss of Rs. 28,75,000.

Issue 4:

Under the revaluation model, the property should be measured at fair value at 1 April 20X1. Depreciation on the property is (Rs. 34,00,000 –Rs. 3,40,000)/34 = Rs. 90,000. On 1 April 20X1, the property's carrying value is Rs. 29,50,000 (Rs. 34,00,000 – (Rs. 90,000 x 5)) and the surplus of Rs. 35,10,000 (Rs. 64,60,000 –Rs. 29,50,000) should be recognized as revaluation surplus under IAS16 in other comprehensive income. No depreciation should be recognized under this model but the decrease in fair value over the year of Rs. 3,40,000 (Rs. 64,60,000 –Rs. 61,20,000) should be recognized in profit/loss, along with the rental income of Rs. 8,16,000.

Issue 5:

The inter-group sales of Rs. 25,50,000 should be eliminated from both revenue and cost of sales. The unrealised profit of Rs. 1,27,500 (25/125 x 6,37,500) should be included in XYZ Ltd cost of sales.

Issue 6:

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that a provision should be recognised only if there is a present obligation resulting from a past event. The terms of the lease contract mean that XYZ Ltd has an obligation to incur expenditure in order to return the buildings to the lessor in good condition. The past obligating event would appear to be the signing of the lease. Thus, there is a strong case for recognising a provision for the expenditure.

Following is the computation of the expense to be recognised:

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-	0.751	-
Rs. 39,10,000	0.683	Rs. 26,70,530
Grand total		Rs. **29,79,590**

Statement of Comprehensive Income Dr. Rs. 29,79,590

To Provision (SFP) Rs. 29,79,590

Issue 7:

Reconciliation of assets and obligation

	Asset	Obligation
	Rs.	Rs.
Fair value/present value at 1 April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,25,000	
Benefits paid	-2,55,000	-2,55,000
Return on gain (assets) (balancing figure)	68,000	
Acturial Loss (balancing figure)		2,33,750
Closing balance as at March 31,20X2	23,80,000	27,20,000

In the Statement of Comprehensive Income, the following amounts will be recognised:

	Rs.
Current service cost	5,10,000
Net interest on net defined liability (106250–102000)	4,250

In the Statement of Financial Position

	Rs.
Net defined liability (Rs. 27,20,000 – Rs. 23,80,000)	3,40,000

Defined benefit re-measurements recognised in other comprehensive income

	Rs.
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)