Mock Test Paper - Series II

Date of Paper: 30th September, 2024

Time of Paper: 2 P.M. to 5 P.M.

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

Time Allowed – 3 Hours **Maximum Marks – 100**

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case Scenario based MCQs (30 Marks)

Part I is compulsory.

Case Scenario 1

ABC Ltd. maintains its accounts and prepares its annual financial statements in accordance with Indian Accounting Standards (Ind AS). It is a diversified global business group with operations spanning multiple sectors. The finance team while working on finalizing the books for the year ending 31st March, 20X3, encountered challenges with the following transactions:

(i) ABC Ltd. manufactures automobile parts. It has shown a net profit of ₹ 20,00,000 for the third quarter of 20X2-20X3.

Following adjustments are made while computing the net profit:

(1) Bad debts of ₹ 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(2) ₹ 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore, fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

(ii) ABC Ltd. enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be provided like engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

(iii) In financial year 20X1-20X2, ABC Ltd. incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

- On 1st April, 20X2 - Purchase cost of the property ` 1,80,00,000
- On 1st April, 20X2 – Non-refundable transfer taxes ` 20,00,000 (not included in the purchase cost)

- On 2nd April, 20X2- Legal cost related to property acquisition ` 5,00,000
- On 6th April, 20X2- Advertisement campaign to attract tenants ` 3,00,000
- On 8th April, 20X2- Opening ceremony function for starting business ` 1,50,000

Throughout 20X2-20X3, incurred ` 1,00,000 towards day-to-day repair maintenance and other administrative expenses.

ABC Ltd. uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

Analyze the transactions mentioned above and choose the most appropriate option in the below questions 1 to 6 in line with relevant Ind AS:

1. What will be the treatment of bad debts incurred during the third quarter?

   The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.

   (a) Bad debts expenses incurred during third quarter should be recognised in the same quarter. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.

   (b) Bad debts expenses incurred during third quarter should be recognised equally in the third and fourth quarter. Accordingly, the treatment done in the books is correct and no further adjustment in this regard is required.

   (c) Bad debts expenses incurred during third quarter should be recognised at the end of the financial year in the last quarter. Accordingly, ` 50,000 already deducted should be added back from ` 20,00,000.

   (d) No bad debt accounted in the interim financial statements in any of the quarter.

2. The correct net profits to be shown in Interim Financial Report of the third quarter shall be

   (a) ₹ 15,00,000

   (b) ₹ 20,00,000

   (c) ₹ 19,50,000

   (d) ₹ 14,50,000

3. How many performance obligations does the entity have?

   (a) Three performance obligations

   (b) Two performance obligations

   (c) A single performance obligation

   (d) More than three performance obligations

4. What is the cost of the entire property?
   (a) ₹ 1,80,00,000
   (b) ₹ 2,05,00,000
   (c) ₹ 2,06,00,000
   (d) ₹ 1,85,00,000
5. What is the cost of the investment property?
   (a) ₹ 1,70,83,333
   (b) ₹ 2,05,00,000
   (c) ₹ 34,16,667
   (d) ₹ 1,80,00,000
6. What is the cost of the owner-occupied property?
   (a) ₹ 1,70,83,333
   (b) ₹ 2,05,00,000
   (c) ₹ 34,16,667
   (d) ₹ 1,80,00,000 **(6 x 2 Marks = 12 Marks)**

Case Scenario 2

DEF Ltd. is a diversified business group operating in multiple business segments across different parts of the world with multiple subsidiaries. It maintains its books of accounts and publishes its annual financial statements under Indian Accounting Standards. The finance team has been working on closing the books of accounts and generating financial statements for the year ended 31st March 20X1 and are facing issues in the following transactions while finalization of financial statements:

(i)

Profit attributable to ordinary equity holders of the parent entity for year 20X1	` 1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	` 20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	` 15.00

(ii) DEF Ltd. enters into a contract to buy 100 tonnes of cocoa beans at 1,000 per tonne for delivery in 12 months. On the settlement date, the market price for cocoa beans is 1,500 per tonne. The contract cannot be settled net in cash and is entered for delivery of cocoa beans in line with DEF Ltd.'s expected purchase/ usage requirements.

(iii) DEF Ltd. invests in compulsorily convertible preference shares (CCPS) issued by its subsidiary B Ltd. at ` 1,000 each (` 10 face value + ` 990 premium). Under the terms of the instrument, each CCPS is compulsorily convertible into one equity share of B Ltd at the end of 5 years. Such CCPS carry dividend @ 12% per annum, payable only when declared at the discretion of B Ltd.

Analyze the transactions mentioned above and choose the most appropriate option in the below questions 7 to 10 in line with relevant Ind AS:

7. Based on the facts given in scenario (i), what will be basic EPS of the entity?

   (a) 2.29

   (b) 2.40

   (c) 2.00

   (d) 1.77

8. Based on the facts given in scenario (i), what will be diluted EPS of the entity?

   (a) 2.29

   (b) 2.40

   (c) 2.00

   (d) 1.77

9. What is the nature of the contract entered into for cocoa beans?

   (a) Cash contract

   (b) Non-executory and derivative contract

   (c) Derivative contract

   (d) Executory and non-derivative contract

10. What is the nature of the financial instrument mentioned in point (iii)?

   (a) Financial Asset

   (b) Financial Liability

   (c) Equity

   (d) Not a financial instrument **(4 x 2 Marks = 8 Marks)**

Case Scenario 3

PQR Ltd. is required to adopt Ind AS from 1st April, 20X1, with comparatives for one year, i.e., for 20X0-20X1. On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ` 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(` in crore)
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ` 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ` 25,000 crore. The following additional information is relevant at that date:

	(` in crore)
Fair value of the 30% interest already owned	9,000
Fair value of XYZ's identifiable net assets	30,000

Analyze the transactions mentioned above and choose the most appropriate option in the below questions 11 to 15 in line with relevant Ind AS:

11. What is the fair value of the total consideration transferred by PQR Ltd. to XYZ Ltd.?

    (a) ₹ 34,000 crores

    (b) ₹ 33,850 crores

    (c) ₹ 33,000 crores

    (d) ₹ 25,000 crores

12. What is the amount of goodwill in the said business combination?

    (a) ₹ 3,000 crores

    (b) ₹ 4,000 crores

    (c) ₹ 2,150 crores

    (d) ₹ 3,850 crores

13. What is the gain on previously held interest in XYZ Ltd. recognised in profit or loss?

    (a) ₹ 150 crores

    (b) ₹ 100 crores

    (c) ₹ 250 crores

    (d) Nil

14. What is the transition date for PQR Ltd. for adopting Ind AS?

    (a) 1st April, 20X0

    (b) 1st April, 20X1

    (c) 1st April, 20X2

    (d) 1st April, 20X3

15. PQR Ltd. present its comparatives financial statements for the year-

(a) 20X1-20X2

(b) 20X2-20X3

(c) 20X0-20X3

(d) 20X0-20X1 **(5 x 2 Marks = 10 Marks)**

PART – II DESCRIPTIVE QUESTIONS

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

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Maximum Marks – 70 Marks

1. DEF Ltd. acquired 100% ordinary shares of ` 100 each of XYZ Ltd. on 1st October 20X1. On 31st March, 20X2 the summarised Balance Sheets of the two companies were as given below:

	DEF Ltd.	**XYZ Ltd.**
Assets		
Property Plant Equipment		
Land & Buildings	15,00,000	18,00,000
Plant & Machinery	24,00,000	13,50,000
Investment in XYZ Ltd.	34,00,000	-
Inventory	12,00,000	3,64,000
Financial Assets		
Trade Receivable	5,98,000	4,00,000
Cash	1,45,000	80,000
Total	**92,43,000**	**39,94,000**
Equity & Liabilities		
Equity Capital (Shares of ` 100 each fully paid)	50,00,000	20,00,000
Other Equity		
Other reserves	24,00,000	10,00,000
Retained Earnings	5,72,000	8,20,000
Financial Liabilities		
Bank Overdraft	8,00,000	-
Trade Payable	4,71,000	1,74,000
Total	**92,43,000**	**39,94,000**

The retained earnings of XYZ Ltd. showed a credit balance of ` 3,00,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; DEF Ltd. has recognised the dividend received to profit or loss account; Fair Value of P&M as on 1st October 20X1 was ` 20,00,000. The rate of depreciation on plant & machinery is 10%.

Following are the increases on comparison of fair value as per respective Ind AS with book value as on 1st October 20X1 which are to be considered while consolidating the Balance Sheets.

Liabilities	**Amount**	**Assets**	**Amount**
Trade Payables	1,00,000	Land & Buildings	10,00,000
		Inventories	1,50,000

Notes:

a) It may be assumed that the inventory is still unsold on balance sheet date and the Trade Payables are also not yet settled.

b) Also assume that the Other Reserves of both the companies as on 31st March 20X2 are the same as was on 1st April 20X1.

c) All fair value adjustments have not yet started impacting consolidated post-acquisition profits.

Prepare Consolidated Balance Sheet as at 31st March, 20X2. **(14 Marks)**

2. (a) Wheel Co. Limited borrowed ` 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: ` 5,870,096

Effective interest rate on loan: 11.50%

On 31 December 20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3
- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2 **(10 Marks)**

(b) An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

(i) Will the inventory and the trade receivables be current in nature?

(ii) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different? **(4 Marks)**

3. (a) On 1st September, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On 31st October, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by 30th February, 20X2 and the sale is expected to be completed by 30th June, 20X2.

The assets and liabilities attributable to this manufacturing unit are as under: **(Amount in `)**

Particulars	Carrying value as on 31st March, 20X1	Carrying value as on 31st October, 20X1
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on 31st March, 20X1 is ` 2,000 and as on 31st October, 20X1 is ` 1,850. The cost to sell is ` 100 on both these dates. The disposal group is not sold at the period end i.e., 31st March, 20X2. The fair value as on 31st March, 20X2 is lower than the carrying value of the disposal group as on that date.

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. Measure the manufacturing unit on the date of classification as held for sale.
3. Measure the manufacturing unit at the end of the financial year.

(8 Marks)

(b) On 30th January, 20X1, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 $ = ` 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = ` 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = ` 67. The fair value of the machinery remains unchanged for the year ended on 31st March 20X2. Tax rate is 30%. A Ltd. follows revaluation method in respect of Plant & Machinery.

Pass the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. **(6 Marks)**

4. (a) A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS. Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	**Original Cost**	**Estimated useful life**
Buildings	` 15,000,000	15 years
Plant and machinery	` 10,000,000	10 years
Furniture and fixtures	` 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Examine the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5. (**6 Marks)**

(b) P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value ` 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March 20X2	` 210
31st March 20X3	` 220
31st March 20X4	` 215
31st March 20X5	` 218

What would be the difference if at the end of the second year of service (i.e. at 31st March 20X3), P Ltd. modifies the terms of the award to require only three years of service? **(8 Marks)**

5. (a) AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.

Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of ` 25 crore.

The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)
- 10 percent bonus if completed by the 32nd month (40% likelihood)
- 5 percent bonus if completed by the 34th month (15% likelihood)

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of ` 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.

Determine the transaction price. **(6 Marks)**

(b) Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31 March 20X2.

Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.

At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of ` 49 crores.

Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above. **(4 Marks)**

(c) Explain the five fundamental principles of ethics for Chartered Accountants. **(4 Marks)**

6. (a) (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ` 10. Entity XYZ's after-tax maintainable profits are estimated at ` 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is ` 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

(5 Marks)

(b) **Either**

Following is a snapshot of audited balance sheet of company A as on 31st March 2014. Company A's equity shares are listed on Bombay Stock Exchange since 2010.

Liabilities	**` in crores**	**Assets**	**` in crores**
Equity Share Capital	160	Fixed Assets	455
Securities Premium	200	Investments	200
General Reserve	150	Current Assets	50
Revaluation Reserve	40	Miscellaneous Expenditure not written off	80
Profit and Loss A/c	75		
Liabilities	160		
Total	**785**	**Total**	**785**

As per roadmap, which Phase company A fall into? Will your answer change if Company A is an unlisted company? **(5 Marks)**

Or

As at 31st March 20X2, Natasha Ltd. carried trade receivables of ` 280 crores in its balance sheet. At that date, Natasha Ltd. entered into a factoring agreement with Samantha Ltd., a financial institution, according to which it transferred the trade receivables in exchange for an immediate cash payment of ` 250 crores. As per the factoring agreement, any shortfall between the amount collected and ` 250 crores will be reimbursed by Natasha Ltd. to Samantha Ltd. Once the trade receivables have been collected, any amounts above ` 250 crores, less interest on this amount, will be repaid to Natasha Ltd. The directors of Natasha Ltd. are of the opinion that the trade receivables should be derecognized.

You are required to explain the appropriate accounting treatment of this transaction in the financial statements for the year ending 31st March 20X2, and also evaluate this transaction in the context of the Conceptual Framework. **(5 Marks)**

(c) Under new legislation, an entity is required to fit smoke filters to its factories by 30th September, 20X1. The entity has not fitted the smoke filters. It is assumed that a reliable estimate can be made of any outflows expected.

Determine whether any provision is required to be made by the entity on

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

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

(4 Marks)

Mock Test Paper - Series II

Date of Paper: 30th September, 2024

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FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

ANSWER TO PART – I CASE SCENARIO BASED MCQS

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

ANSWERS OF PART – II DESCRIPTIVE QUESTIONS

1. **Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd. as at 31st March, 20X2**

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

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

Notes to Accounts

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

Statement of Changes in Equity:

1. Equity share Capital

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

2. Other Equity

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

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

Working Notes:

1. Adjustments of Fair Value

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

2. Acquisition date profits of XYZ Ltd. ₹

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

3. Post-acquisition profits of XYZ Ltd. ₹

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

4. Consolidated total comprehensive income ₹

DEF Ltd.	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1	(0)
Profits for the year 20X1-20X2	5,72,000
Less: Elimination of intra-group dividend	(2,00,000)
Adjusted profit for the year	3,72,000
XYZ Ltd.	
Adjusted profit attributable to DEF Ltd. (W.N.3)	3,35,000
Consolidated profit or loss for the year	7,07,000

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

5. Gain on Bargain Purchase ₹

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

6. Value of Plant & Machinery ₹

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

7. Consolidated retained earnings ₹

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

Assumptions:

1. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.
2. Appreciation of ₹10 lakhs in land & buildings is entirely attributable to land element only.
3. Depreciation on plant and machinery is on WDV method.
4. Acquisition-date fair value adjustment to inventories of XYZ Ltd. existing at the balance sheet date does not result in need for any write-down.

2. (a) On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

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

a. 1 January 20X1 –

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

b. 31 December 20X1 –

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

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

Particulars	(₹)	(₹)
Interest expense (profit and loss Dr.	45,534,807	
To Loan from bank A/c		1,534,807
To Bank A/c		44,000,000
(Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)		

Upon receiving the new terms of the loan, Wheel Co. Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind

AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @ 15%	Discount factor	PV of cash flows
31-Dec-20X2	(400,000,000)			
31-Dec-20X3	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-20X4	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-20X5	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-20X6	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-20X7	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-20X8	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-20X9	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-20Y0	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-20Y1	40,000,000	12,000,000	0.3754	19,522,235
31-Dec-20Y3	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650
Difference				54,033,141
Percentage of carrying amount				13.59%

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

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

d. 31 December 20X2 – accounting for extinguishment

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

e. 31 December 20X3

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

(b) Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.

(a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

(b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

3. (a) Assessing whether the manufacturing unit can be classified as held for sale

1. The manufacturing unit can be classified as held for sale due to the following reasons:

(i) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is 31st October, 20X1, i.e., the date at which management becomes committed to the plan.

(ii) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(iii) A firm purchase agreement has been entered with the buyer.

(iv) The sale is expected to be complete by 30th June, 20X2, i.e., within one year from the date of classification.

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

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

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

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

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

Thus, the assets will be measured as under:

Particulars	Carrying value – 31st October, 20X1	Impairment	Carrying value as per Ind AS 105 – 31st October, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	-	1,050
Inventory	400	-	400
Creditors	(250)	-	(250)
Loans	(1,850)	-	(1,850)
	2,600	(850)	1,750

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

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

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

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

(b) Journal Entries

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

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

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

	₹	₹
Profit & Loss A/c [($ 5,000 x ₹ 65) – ($ 5,000 x ₹ 60)] Dr.	25,000	
To Creditors-Machinery A/c		25,000
Machinery A/c Dr.	30,000	
To Revaluation Surplus (OCI)		30,000
[Being Machinery revalued to USD 5,500; (₹ 60 x ($ 5,500 - $ 5,000)]		
Machinery A/c Dr.	27,500	
To Revaluation Surplus (OCI)		27,500
(Being Machinery measured at the exchange rate on 31.3.20X1 [$ 5,500 x (₹ 65 - ₹ 60)]		
Revaluation Surplus (OCI) Dr.	17,250	
To Deferred Tax Liability		17,250
(DTL created @ of 30% of the total OCI amount)		

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

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

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

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

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

Buildings	[₹1,50,00,000 – (₹ 10,00,000 × 3)] / 10	₹ 12,00,000
Plant and machinery	[₹ 1,00,00,000 – (₹ 10,00,000 × 3)] / 7	₹ 10,00,000
Furniture and fixtures	[₹ 35,00,000 – (₹ 5,00,000 × 3)] / 5	₹ 4,00,000
Total		₹ 26,00,000 (B)

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

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

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

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

Journal entries in the books of P Ltd

(with modification of service period of stock appreciation rights)

(₹ in lakhs)

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

Working Notes:

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

For the year ended 31st March 20X2

= ₹ 210 x 400 awards x 75 employees x 1 year /4 years of service = ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years /4 years of service - ₹ 15,75,000 previous recognised

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

For the year ended 31st March 20X4

= ₹ 215 x 400 awards x 75 employees x 3 years/4 years of service - ₹ 33,00,000 previously recognised

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

For the year ended 31st March, 20X5

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

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

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

For the year ended 31st March 20X2

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

= ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years / 3 years of service - ₹ 15,75,000 previous recognised

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

For the year ended 31st March 20X4

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

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

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

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

Bonus %	**Amount of bonus (₹ in crore)**	**Probability**	**Probability-weighted amount (₹ in crore)**
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

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

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

(b) **Players' Registrations**

Acquisition

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

Sale of registrations

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

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

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

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

Impairment review

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

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

(1) Integrity – to be straightforward and honest in all professional and business relationships.

(2) Objectivity – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

(3) Professional Competence and Due Care – to:

(i) attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(ii) act diligently and in accordance with applicable technical and professional standards.

(4) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.

(5) Professional Behaviour – to comply with relevant laws and regulations and avoid any conduct that the Chartered Accountant knows or should know might discredit the profession.

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

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

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

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

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

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

(b) **Either**

Calculation of Net Worth:

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

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

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

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

Or

Accounting Treatment:

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

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

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

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

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

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

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

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

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

Present obligation as a result of a past obligating event – There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

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

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

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

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

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