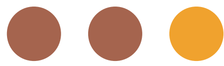

PAPER – 1: FINANCIAL REPORTING

QUESTIONS

Case Scenario I

X Ltd. prepares its financial statements based on Indian Accounting Standards.

X Ltd. (lessee) enters into an agreement with Y Ltd. (lessor) to lease an entire floor of a building for a period of 10 years with an option to extend the lease for five years. At the commencement date, X Ltd. is not reasonably certain to exercise the option to extend the lease. Lease payments are ₹ 50,000 per year during the initial term and ₹ 55,000 per year during the optional period. As per the terms of contract, lease payments are required to be paid at the beginning of each year. To obtain the lease, X Ltd. incurred initial direct costs of ₹ 20,000, out of which ₹ 15,000 relates to a payment to a former tenant occupying that floor of the building and ₹ 5,000 relates to commission paid to the real estate agent that arranged the lease. As an incentive to X Ltd. for entering into the lease, Y Ltd. agrees to reimburse to X Ltd. the real estate commission of ₹ 5,000. The interest rate implicit in the lease is not readily determinable by X Ltd. X Ltd.'s incremental borrowing rate is 10%. (Consider discounting factor upto 2 decimals)

X Ltd. has deferred tax assets, recognised in the balance sheet at 31st March, 20X2 in respect of unused tax losses that can be used to reduce taxable income in future years. The income tax rate used to calculate the deferred tax asset was 40%, which was the current rate of tax applicable at the balance sheet date. A new government came to power on 1st April, 20X2 and passed legislation that, on 17th April, 20X2, the income tax rate was reduced to 33% with immediate effect.

Based on the facts given above, choose the most appropriate answer to Questions 1 to 5 below as per the relevant Ind AS.

1. What would be the lease term in the given case?

   (a) 10 years

   (b) 5 years

   (c) 15 years

   (d) Cannot be determined

2. At what value does the lease liability be recognized initially?

   (a) ₹ 3,07,000

   (b) ₹ 2,87,500

   (c) ₹ 3,37,500

   (d) ₹ 3,52,500

3. At what value the right of use assets be recognized initially?

   (a) ₹ 3,07,000

   (b) ₹ 3,57,500

   (c) ₹ 3,52,500

   (d) ₹ 3,62,500

4. What would be the amount of depreciation to be charged annually on ROU asset?

   (a) ₹ 30,700

   (b) ₹ 35,750

   (c) ₹ 35,250

   (d) ₹ 36,250

5. At what rate, would defer tax be calculated for the year ended 31st March, 20X2?

   (a) 40%

   (b) 33%

(c) 7%

(d) Nil

Case Scenario II

A Ltd. enters into a 3-year contract to provide 1,000 hours of standard call center operator time per annum for ₹ 6,00,000 (₹ 2,00,000 per year); the stand-alone selling price at inception. At the end of the 1st Year, the contract is extended for another three years @ ₹ 6,60,000 as follows:

(i) in accordance with the contractual provisions the fee for the 1st year is reduced by ₹ 90,000 because of highly defective service; and

(ii) the contract is extended for another 3 years for ₹ 7,50,000 (₹ 2,50,000 per year); when the stand-alone selling price is ₹ 2,30,000.

Further, Government G has significant influence over L Ltd. L Ltd. has significant influence over A Ltd. and controls K Ltd. All the entities have transactions with each other.

On the basis of the facts given above, choose the most appropriate answer to Questions 6 to 10 below based on the relevant Ind AS.

6. What amount of revenue be recognized for Year 1?

(a) ₹ 2,00,000

(b) ₹ 2,25,000

(c) ₹ 2,30,000

(d) ₹ 1,10,000

7. What will be the accounting treatment for the contract extended at the end of year 1 with respect to its revenue recognition?

(a) The modification in the contract will be accounted for prospectively by allocating remaining revenue equally for 5 years

(b) The modification in the contract will be accounted for retrospectively by allocating total revenue equally for 6 years

(c) The modification in the contract will be accounted for as two separate contract for 3 years each

(d) The modification in the contract does not fall under the purview of Ind AS 115

8. What would be the remaining total revenue of the contract for 5 years?

(a) ₹ 11,50,000

(b) ₹ 10,60,000

(c) ₹ 12,40,000

(d) ₹ 13,50,000

9. What amount of revenue be recognized for Year 2?

(a) ₹ 2,00,000

(b) ₹ 2,25,000

(c) ₹ 2,30,000

(d) ₹ 1,10,000

10. State which of the following statements is correct with respect to transactions between A Ltd. and K Ltd. and between A Ltd. and L Ltd. under Ind AS 24?

(a) Transactions between both A Ltd. and L Ltd. and A Ltd. and K Ltd. are not disclosable.

(b) Transactions between A Ltd. and L Ltd. are not disclosable but transactions between A Ltd. and K Ltd. are disclosable.

(c) Transactions between A Ltd. and L Ltd. are disclosable but transactions between A Ltd. and K Ltd. are not disclosable.

(d) Transactions between both A Ltd. and L Ltd. and A Ltd. and K Ltd. are disclosable.

Ind AS 102 : Share-based Payment

11. H Ltd. is a parent company and has a subsidiary S Ltd. H Ltd. and S Ltd. are unlisted entities. Following arrangements with respect to ESOP scheme took place between them:

1. Original ESOP scheme by H Ltd. (Parent ESOP scheme)

At the beginning of year 1, H Ltd. granted 1,500 options in its own shares to its own employees as well as S Ltd.'s employees (i.e. 1,000 to H Ltd.'s employees and 500 to S Ltd.'s employees) with a fair value of ₹ 15 per options, conditional upon the completion of 3 years' service. H Ltd. will settle in its own equity shares. All the options are expected to vest. H Ltd. doesn't recharge to S Ltd. for ESOP expenses.

2. New ESOP scheme by S Ltd. (Subsidiary ESOP scheme)

H Ltd. and S Ltd. are unlisted entities. However, at the end of Year 1, S Ltd. gets listed.

At the beginning of year 2, S Ltd. offers 1,500 options in its own shares to H Ltd.'s employees and its own employees (i.e. 1,000 to H Ltd.'s employees and 500 to S Ltd.'s employees), conditional upon H Ltd. and S Ltd.'s employees surrendering the right over parent ESOP scheme.

Remaining vesting period is same as H Ltd.'s ESOP scheme i.e. conditional upon the completion of remaining 2 years' service.

Incremental fair value of new ESOP scheme is ₹ 6. All the options are expected be vest. All H Ltd. and S Ltd.'s employees have opted for new ESOP scheme.

S Ltd. doesn't recharge to H Ltd. for ESOP expenses.

Required:

Analyze the above arrangements from the perspective of Consolidated Financial Statements and Individual Financial Statements of both parent and subsidiary. Also show the accounting treatment of the above arrangements in the Consolidated Financial Statements and Individual Financial Statements of both parent and subsidiary.

Ind AS 21: The Effects of Changes in Foreign Exchange Rates

12. Parent A Ltd. is the reporting entity that has net investment in foreign operations in its two foreign Subsidiaries, B Ltd. and C Ltd.

In all the following scenarios, loans made between group entities are permanent in nature (that is, settlement is neither planned nor likely to occur):

Scenario 1

Parent A Ltd., with sterling as its functional currency, is preparing its financial statements to 31st March, 20X5. It has a loan receivable of US$ 1 million from its Subsidiary C Ltd. that has been outstanding for some time. The parent notified the subsidiary at the beginning of the financial year that no repayment of the amount will be requested for the foreseeable future.

The relevant exchange rate are as follows:

	31st March, 20X5	31st March, 20X4
£1=	US$1.82	US$1.45

Scenario 2

The facts are the same as in the above Scenario 1, except that Parent A Ltd. has a loan receivable from Subsidiary C Ltd. of £ 2,00,000 that has been outstanding for some time. The loan is treated by Parent A Ltd. as forming part of its net investment in Subsidiary C Ltd.

Required:

Determine the treatment of exchange differences in Standalone Financial Statements of both subsidiary and parent company and in Consolidated Financial Statements of parent company under both the scenarios.

Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors

13. During 20X3, T Ltd. discovered that prepayments of ₹ 680 made during 20X1 had not been recognised in profit or loss as the related expenses were incurred. The prepayments should have been recognised as an expense of ₹ 170 in 20X1; ₹ 425 in 20X2; and ₹ 85 in 20X3. The misstatement is material.

Extract from draft 20X3 Statement of Profit and Loss before correction of error

	Draft 20X3	***20X2***
Revenue	10,200	6,800
Less: Expenses	(9,350)	(6,120)
Net profit	850	680

Extract from Statement of Changes in Equity

	Draft 20X3	***20X2***
Opening retained earnings	24,480	23,800
Add: Current-year net profit	850	680
Closing retained earnings	25,330	24,480

The opening balance of retained earnings is adjusted and comparatives are restated when practicable to reflect the correction of the error. Assume there are no tax effects.

Required:

Draw the revised Statement of Profit and Loss (extract) and Statement of Changes in Equity (extract) after rectifying the above error.

Ind AS 115: Revenue from Contracts with Customers

14. A Ltd. enters into a contract with a customer for the exclusive supply of paint for a three-year period. A Ltd. makes a ₹ 50,000 upfront payment, which the customer will use to customize its paint sprayers for A Ltd.'s product. A Ltd. determines the upfront payment is not in respect of or for a distinct good or service.

A Ltd. estimates ₹ 10,00,000 in sales with the customer over the three-year period. Sales for Quarter 1 is ₹ 1,00,000 and for Quarter 2 is ₹ 1,25,000. However, A Ltd. updated its estimate of total sales over the contract to ₹ 15,00,000 during Quarter 2.

Required:

Determine the net revenue to be recognized in Quarter 1 and Quarter 2 by A Ltd.

Ind AS 32 : Financial Instruments – Presentation

15. A Ltd. has issued Optionally Convertible Debentures (OCD) amounting to ₹ 300 crores to B Ltd. on following terms:

    - Tenor : 4 years
    - Coupon : Nil
    - IRR : 15% p.a.

    During the tenor of OCDs, A Ltd. can call the OCD and redeem it with stated IRR.

    The market rate for similar debt without conversion features is 17% p.a.

    B Ltd. can also ask for conversion at any time before maturity based on following formula:

    No of equity shares = (Investment amount + applicable IRR) / (Face value of equity share; i.e. ₹ 10)

    If redemption or conversion doesn't happen before maturity, then OCDs will be redeemed mandatorily at maturity in same manner as for conversion.

    Required:

    How is this instrument accounted for in the books of A Ltd. in the following two scenarios:

    Scenario A – When B Ltd. opts for conversion before maturity at the end of year 1

    Scenario B – When B Ltd. doesn't opt for conversion and OCDs are redeemed at maturity.

Ind AS 24 : Related Party Disclosures

16. Mr. A, Mr. B and Mr. C have direct interests of 40%, 10% and 10% respectively, of Trust T. The remaining 40% interest in Trust T is held by 20 unrelated investors.

    Mr. A, Mr. B and Mr. C wish to control the trust, and so they enter into a contractual arrangement to act together. In this situation, assume that 1% interest constitutes one voting right.

S Ltd. is a wholly owned subsidiary of P Ltd. and P Ltd. is wholly owned by Trust T.

Required:

Should a group of persons be disclosed as the ultimate controlling party where they have a contractual arrangement to act together?

Ind AS 2 : Inventories

17. An entity manufactures a equipment in three stages. There is a market for semi-finished product for each state, but the entity only sells the completed equipment. The following are details of the cost structure of the equipment as at the year-end:

	Conversion Cost/unit ₹	***Selling price /unit*** ₹
Stage 1	170	130
Stage 2 – Incremental cost	35	
	205	195
Stage 3- Incremental cost	62	
	267	275

Required:

Assuming that the selling cost are zero, what is the NRV of the semi-finished product in stage 1 and stage 2 at the year end?

Ind AS 23 : Borrowing Costs

18. An entity has borrowed ₹ 10,00,000 specifically to finance the cost of constructing a new head office. The loan was availed on 1st May 20X8. Interest was payable at 12% per annum up to 1st February 20X9, after which the rate was revised to 13% owing to an increase in the Secured Overnight Financing Rate (SOFR). Construction of the building does not begin until 1st December 20X8 and continues, without interruption, until after the year end on 31st March 20X9. During the period of construction, the entity incurs directly attributable costs of ₹ 1,00,000

in December 20X8 and ₹ 250,000 in each month from January 20X9 to March 20X9 (for simplicity, it is assumed that these costs are incurred on the first day of each month). Each month, the borrowings (less any amount that is to be expended for the building works in that month) are re-invested and earn interest at a rate of 5% per annum.

For the year ended 31st March, 20X9, the entity incurred interest expense of ₹ 1,11,667 on the ₹ 10,00,000 loan and earned ₹ 37,917 as interest on the re-invested portion.

Required:

Determine the amount of borrowing cost to be capitalized to the qualifying asset for the year ended 31st March, 20X9.

Ind AS 7 : Statement of Cash Flows

19. Z Ltd. had acquired a subsidiary V Ltd. during the year 20X1-20X2. Summarized information from the consolidated statement of profit and loss and balance sheet together with some supplementary information have been provided:

Consolidated Statement of Profit and Loss for the year 20X1-20X2

	₹
Revenue	4,56,000
Cost of sales	(2,64,000)
Gross profit	1,92,000
Depreciation	(36,000)
Other operating expenses	(67,200)
Interest cost	(4,800)
Profit before taxation	84,000
Taxation	(18,000)
Profit after taxation	66,000

Consolidated Balance Sheet as at 31st March

	20X2	***20X1***
	₹	₹
Assets		
Non-current assets		
Property, plant and equipment	1,92,000	96,000
Goodwill	21,600	-
Current assets		
Inventories	36,000	42,000
Financial assets		
Trade receivables	64,800	60,000
Cash and cash equivalents	9,600	6,000
Total	**3,24,000**	**2,04,000**
Equity and Liabilities		
Shareholders' equity	1,08,000	42,000
Non-current liabilities		
Long term debt	1,20,000	76,800
Current liabilities		
Income tax payables	14,400	13,200
Financial liabilities		
Trade payables	81,600	72,000
Total	**3,24,000**	**2,04,000**

Other information

All of the shares of V Ltd. were acquired for ₹ 88,800 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	₹
Inventories	4,800
Trade receivables	9,600

Cash	2,400
Property, plant and equipment	1,32,000
Trade payables	(38,400)
Long-term debt	(43,200)
Goodwill	21,600
Cash consideration paid	88,800

Required:

Prepare a consolidated statement of cashflows for the year 20X1-20X2 under indirect method.

Ind AS 16 : Property, Plant and Equipment

20. A Ltd. exchanges car X with a book value of ₹ 13,000 and a fair value of ₹ 13,250 for cash of ₹ 150 and car Y which has a fair value of ₹ 13,100. The transaction lacks commercial substance, because the entity's cash flows are not expected to change as a result of the exchange; in other words, the entity is in the same position as it was before the transaction.

    Required:

    State the value at which Car Y should be recognized in the books of A Ltd.

SUGGESTED ANSWERS

Answer to Multiple Choice Questions

1.	**Option (a) : 10 years**
2.	**Option (b) : ₹ 2,87,500**
3.	**Option (c) : ₹ 3,52,500**
4.	**Option (c) : ₹ 35,250**
5.	**Option (a) : 40%**

6.	**Option (d) : ₹ 1,10,000**
7.	**Option (a) : The modification in the contract will be accounted for prospectively by allocating remaining revenue equally for 5 years**
8.	**Option (a) : ₹ 11,50,000**
9.	**Option (c) : ₹ 2,30,000**
10.	**Option (d) : Transactions between both A Ltd. and L Ltd. and A Ltd. and K Ltd. are disclosable.**

11. Analysis of new ESOP scheme given on surrendering options under original ESOP scheme as replacement scheme

The original ESOP scheme was issued by H Ltd. to its own employees as well as S Ltd.'s employees.

S Ltd. has issued new ESOP scheme to its own and H Ltd.'s employees, conditional upon employees of S Ltd. and H Ltd. surrendering the right over original ESOP scheme.

Since obtaining the options under new ESOP scheme is conditional on surrendering the employee's entitlement under original ESOP scheme, the new scheme S Ltd. would be designated as replacement scheme for original scheme by S Ltd.

Accordingly, in the current fact pattern, the original ESOP scheme of H Ltd. has been replaced with the new ESOP scheme of S Ltd. Hence, according to para 28(c) of Ind AS 102, modification accounting would apply.

Classification of new ESOP scheme

(i) Consolidated Financial Statements (CFS):

The award is settled in equity shares of the group and therefore treated as an equity-settled share-based payment.

(ii) Individual (Stand-alone) Financial Statements (SFS) of H Ltd.:

From H Ltd.'s perspective, the award is treated as an equity-settled share-based payment. This is because H Ltd. does not have an obligation to settle the award.

(iii) Individual (Stand-alone) Financial Statements (SFS) of S Ltd.

ESOP will be settled against issue of S Ltd.'s own shares. Therefore, ESOP are classified as 'Equity settled'.

To the extent S Ltd. provides ESOP to H Ltd.'s employees, the same will be treated as dividend distribution to H Ltd.

Accounting for change in settlor from H Ltd. (parent) to S Ltd. (subsidiary)

(i) Consolidated Financial Statements (CFS) of H Ltd.:

(a) As on the date of new ESOP scheme by S Ltd., there is ESOP reserve standing in CFS. This ESOP reserves is classified as 'Equity' in CFS considering that under original scheme, equity shares of H Ltd. are given.

(b) ESOP reserve as per (a) above in CFS will continue even after new scheme. Since new scheme is accounted as modification of original scheme, grant date fair value as per original scheme plus incremental fair value as per new scheme is recognised as ESOP cost in CFS. Incremental fair value is accounted prospectively.

(c) ESOP reserve as per (a) above in CFS is reclassified from 'Equity' to "Non-controlling interest' (NCI) due to change in settlor from H Ltd. (Parent) to S Ltd. (Subsidiary). This is because the definition of NCI refers to the equity in a subsidiary not attributable, directly or indirectly to a Parent.

(ii) Stand-alone financial statements (SFS) of parent H Ltd. and subsidiary S Ltd.:

(a) Ind AS 102 doesn't contain any specific guidance on accounting for change in settlor.

(b) Under original ESOP scheme, Parent H Ltd. was settlor. Therefore, on the date of new ESOP scheme, in the SFS of Parent H Ltd., there is 'ESOP reserves which would have been utilised in case Parent continued as settlor.

(c) However, under the new ESOP scheme, Subsidiary S Ltd. is settlor. 'ESOP reserves' standing in SFS of Parent H Ltd. is no longer required as H Ltd. has passed on its responsibility of settling ESOP scheme to S Ltd. Therefore, 'ESOP reserves' in SFS of Parent H Ltd. is reversed.

(d) Subsidiary S Ltd. under new ESOP scheme become settlor for an existing ESOP plan. However, in SFS of S Ltd. there is no 'ESOP reserves' standing. Therefore 'ESOP reserves' relating to period already elapsed under original ESOP scheme is to be recognised in SFS of Subsidiary S Ltd.

Journal Entries

Years	**ESOP scheme references**	**Parent (H Ltd.) Standalone Financial Statement (P SFS)**			**Subsidiary (S Ltd.) Standalone Financial Statements (S SFS)**		
		Particular	**Debit**	**Credit**	**Particular**	**Debit**	**Credit**
Year 1	Original ESOP scheme by Parent H Ltd.	Employees expenses* Dr.	5,000		Employees expenses# Dr.	2,500	
		Investment in Subsidiary** Dr.	2,500		To Equity (Capital Contribution from Parent)		2,500
		To Equity (ESOP reserves)		7.500			
		(Recognition of employees expenses/ investment in subsidiary under ESOP scheme by Parent for Year 1)			(Recognition of employees expenses under ESOP scheme by Parent for Year 1)		
		[*Parent employees = 1,000 options x ₹ 15 x 1/3 = ₹ 5,000] [**Subsidiary employees = 500 options x ₹ 15 x 1/3 = ₹ 2,500]			[#Subsidiary employees = 500 options x ₹ 2,500]		

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<tr>
<td>Year 2- Beginning</td>
<td>Accounting for change in settlor from Parent to Subsidiary – at the beginning of Year 2</td>
<td>
<table>
<tr><th>Particular</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Equity (ESOP reserves) Dr.</td><td>7,500</td><td></td></tr>
<tr><td>To Investment in Subsidiary</td><td></td><td>2,500</td></tr>
<tr><td>To Dividend Income (Deemed Distribution from Subsidiary)</td><td></td><td>5,000</td></tr>
<tr><td colspan="3">(Parent is no longer required to settle ESOP for its own employees as well as subsidiary employees under New ESOP scheme by Subsidiary)</td></tr>
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<table>
<tr><th>Particular</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Equity (Distribution to Parent) Dr.</td><td>5,000</td><td></td></tr>
<tr><td>Equity (capital contribution from Parent) Dr.</td><td>2,500</td><td></td></tr>
<tr><td>To Equity (ESOP reserves)</td><td></td><td>7,500</td></tr>
<tr><td colspan="3">(Accounting of obligations taken by Subsidiary under New ESOP scheme by Subsidiary for parent employees as well as its own employees. This entry is passed since subsidiary has taken obligation of existing scheme)</td></tr>
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<tr>
<td>Year 2- End</td>
<td>Modifications accounting – New ESOP scheme by Subsidiary</td>
<td>
<table>
<tr><th>Particular</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Employees expenses* Dr.</td><td>8,000</td><td></td></tr>
<tr><td>To Dividend Income (Deemed Distribution from Subsidiary)</td><td></td><td>8,000</td></tr>
<tr><td colspan="3">(Recognition of employee expenses for parent employees under Old ESOP scheme and incremental fair value under New ESOP scheme for Year 2)</td></tr>
</table>
[*Parent employees =
A. Original ESOP scheme = (1000 options x ₹ 15 x 2/3 – 5,000) = ₹ 5,000
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<table>
<tr><th>Particular</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Equity (Distribution to Parent)# Dr.</td><td>8,000</td><td></td></tr>
<tr><td>Employees expenses## Dr.</td><td>4,000</td><td></td></tr>
<tr><td>To Equity (ESOP reserves)</td><td></td><td>12,000</td></tr>
<tr><td colspan="3">(Recognition of employees' expenses for parent employees as well as subsidiary employees under Old ESOP scheme and incremental fair value under New ESOP scheme for Year 2)</td></tr>
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[#Parent employees = ₹ 8,000 (i.e. computation same as parent)
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<td>B. Incremental fair value – New ESOP scheme = (1000 options x ₹ 6 x ½) = ₹ 3,000 Total = ₹ 8,000]</td>
<td>##Subsidiary employees =
A. Original ESOP scheme = (500 options x ₹ 15 x 2/3 – 2,500) = ₹ 2,500
B. Incremental fair value – New ESOP scheme = (500 options x ₹ 6 x ½) = ₹ 4,000]</td>
</tr>
<tr>
<td>Year 3- End</td>
<td>Modifications accounting – New ESOP scheme by Subsidiary</td>
<td>
<table>
<tr><th>Particular</th><th>Debit</th><th>Credit</th></tr>
<tr><td>Employees expenses Dr.</td><td>8,000</td><td></td></tr>
<tr><td>To Dividend Income (Deemed Distribution from Subsidiary)</td><td></td><td>8,000</td></tr>
<tr><td colspan="3">(Recognition of employee expenses for parent employees under New ESOP scheme for Year 2)</td></tr>
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<tr><td colspan="3">(Recognition of employees' expenses for parent employees as well as subsidiary employees under under New ESOP scheme for Year 2)</td></tr>
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12. Scenario 1

The following exchange differences will arise in the financial statements of the individual entities if the loan is re-translated at the closing rate:

	31st March, 20X5
Standalone Financial Statements of Subsidiary C Ltd. No exchange difference arises in the foreign subsidiary because the loan payable is denominated in its functional currency	
Standalone Financial Statements of Parent A Ltd. Exchange difference on long-term loan receivable: On closing rate - US$ 1 million / $ 1.82/£	£ 5,49,450

On opening rate - US$ 1 million / $ 1.45/£	6,89,655
Exchange loss	1,40,205

In Parent A Ltd.'s separate financial statements, the loan is regarded as a monetary item and any exchange difference is taken to profit or loss.

On consolidation, the re-translated long-term loan is regarded as part of the net investment in Subsidiary C Ltd., so the related exchange loss is recognised in other comprehensive income and accumulated as a separate component of equity as per para 32 of Ind AS 21. There would also be a corresponding exchange gain included in other comprehensive income, arising as part of the re-translation of the net assets (which include the US dollar loan creditor) of Subsidiary C Ltd. under the closing rate/net investment method.

Scenario 2

In the financial statements of the individual entities, the following exchange differences will arise if the loan is re-translated at the closing rate.

Parent A Ltd.

There is no exchange difference in the parent's financial statements in respect of the loan because it is denominated in sterling.

Subsidiary C Ltd.

Exchange difference on long-term loan payable:

	US $
On closing rate – £ 2,00,000 @ $ 1.82/£	3,64,000
On opening rate - £ 2,00,000 @ $ 1.45/£	2,90,000
Exchange loss	74,000
Exchange loss translated in £ at the closing rate @ $ 1.82/£	£ 40,659

The exchange loss of US $ 74,000 on the sterling loan is recognised in Subsidiary C Ltd.'s income statement, because the subsidiary is exposed to the foreign currency risk.

On consolidation, the inter-company loan will be cancelled. However, because the long-term loan is regarded as part of the net investment

in the subsidiary, the exchange loss of £ 40,659 is recognised in other comprehensive income and accumulated as a separate component of equity in the consolidated financial statements. There is a corresponding exchange gain included in other comprehensive income, arising as part of the re-translation of the net assets of Subsidiary C Ltd. The effect is that the consolidated income statement will not reflect any exchange difference on the loan, which is consistent with the fact that the loan has no impact on group cash flows, unless the investment is sold.

13. In restating the comparatives, the adjustment will be included in the appropriate line item. In addition, the financial statements will include full disclosure regarding the error and the adjustments made to correct it as per para 49 of Ind AS 8. The restated comparative financial statements should be accompanied with the heading 'restated' to highlight for users the fact that the comparative financial statements are not the same as the financial statements previously published.

Statement of Profit and Loss after correction of error (Extract)

	20X3 ₹	***20X2 (Restated)*** ₹
Revenue	10,200	6,800
Less: Expenses (9,350 + 85)	(9,435)	(6,545)
Net profit	765	255

Statement of Changes in Equity (Extract)

	20X3 ₹	***20X2 (Restated)*** ₹
Opening retained earnings as reported previously	-	23,800
Correction of an error related to previous years	-	(170)
Opening retained earnings (restated)	23,885	23,630
Current-year net profit	765	255
Closing retained earnings	24,650	23,885

14. Treatment of upfront payment of ₹ 50,000

Upfront payment of ₹ 50,000 would be accounted for as a reduction of the transaction price. It would be deferred and recognised as a reduction of revenue (in proportion to estimated sales) over the contract term.

Accounting for Quarter 1 and Quarter 2 is as follows:

For the first quarter

- Quarter 1 sales = ₹ 1,00,000
- Entity estimates ₹ 10,00,000 sales over the three-year period
- Percentage of Quarter 1 sale to total estimated sale

  = (₹ 1,00,000 / ₹ 10,00,000) x 100 = 10%
- Share of upfront payment to be recognised in Quarter 1

  = 10% x ₹ 50,000 = ₹ 5,000

Hence, in Quarter 1, A Ltd. recognizes revenue of ₹ 95,000 (₹ 1,00,000 actual sales – ₹ 5,000 consideration paid to the customer)

For the second quarter

- Quarter 2 sales = ₹ 1,25,000
- A Ltd. updates its estimate of total sales over the contract to ₹ 15,00,000
- Total sales to date till Quarter 2

  = ₹ 1,00,000 +₹ 1,25,000 = ₹ 2,25,000
- Percentage of sale till Quarter 2 to total estimated sale

  = (₹ 2,25,000 / ₹ 15,00,000) x 100 = 15%
- Share of upfront payment to be recognised in Quarter 2

  = (15% x ₹ 50,000 upfront payment) – Upfront payment recognized in Quarter 1

  = ₹ 7,500 – ₹ 5,000 = ₹ 2,500

Hence, A Ltd. would recognize revenue of ₹ 1,22,500 for Quarter 2 (₹ 1,25,000 actual sales – ₹ 2,500 upfront payment made to the customer).

15. OCD issued by A Ltd. is a compound financial instrument. The host instrument will be classified as liability, since there is contractual obligation to pay cash towards interest (i.e. guaranteed IRR of 15% p.a.) and principal repayment that issuer A Ltd. cannot avoid. The equity conversion option is accounted as equity.

Date	***Particulars***	***Amount (rounded off in crores)***	
Day 1	Bank Dr.	300	
	To Equity (balancing figure representing residual interest)		20
	To Debentures (future cash flows discounted @17%)		280
	(Initial recognition of the financial instrument in the nature of a compound instrument comprising of elements of debt and equity)		
Subsequent Accounting			
End of Year 1	Interest on Debentures Dr.	48	
	To Debentures (classified under "Liability component of compound financial instrument")		48
	(Interest recognised in P&L @17% i.e. 280 x 17%)		

Scenario A – When B Ltd opts for conversion at end of year 1

Since conversion was allowed under the original terms of instrument, the entity should determine the amortised cost of liability component using the original IRR till the conversion date. It will derecognise the liability component and recognises it as equity.

There is no gain or loss on early conversion.

Date	***Particulars***	***Amount (rounded off in crores)***	
End of Year 1	Debentures [280 + 48] Dr. To Equity Share Capital *(Conversion of OCD into equity shares of the Company)*	328	328

Scenario B – When B doesn't opt for conversion and OCDs are redeemed at maturity

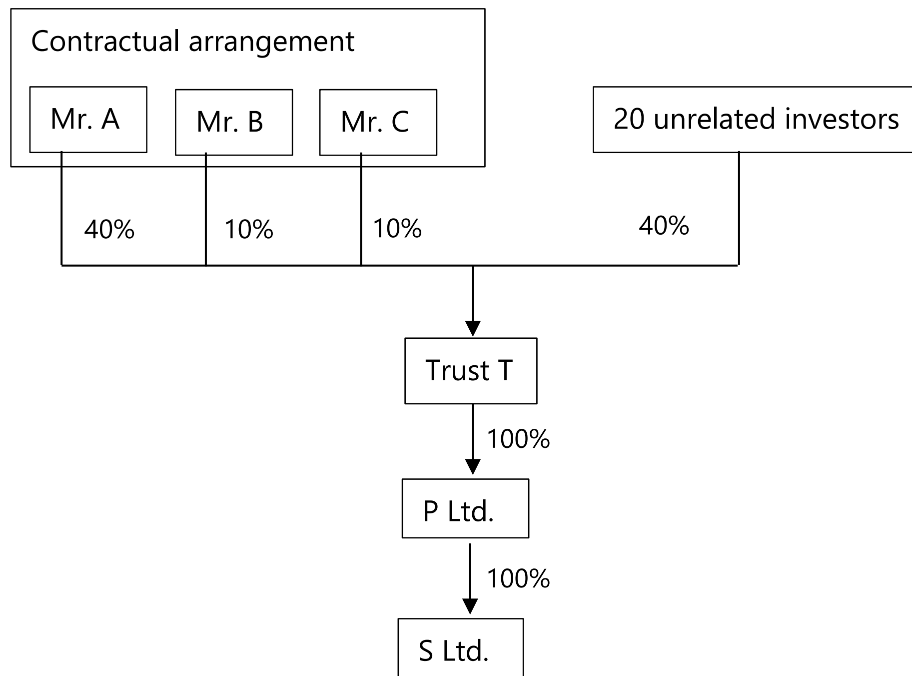
Date	***Particulars***	***Amount (rounded off in Crores)***	
End of Year 1-4	Interest on debentures Dr. (cumulative interest for 4 years) To Debentures *(Interest recognised in P&L @ 17%)*	245	245
End of Year 4	Debentures [280 + 245] Dr. To Bank *(Being debentures redeemed)*	525	525

Working Note:

Computation of maturity value of OCD as per the formula stated by B Ltd.:

Year	**Opening balance (In crores)**	**Interest @15% IRR (In crores)**	**Closing balance (In crores)**
1	300	45	345
2	345	51.75	396.75
3	396.75	59.5125	456.2625
4	456.2625	68.439	524.7015 or 525
		224.7015 or 225	

16. The following diagram shows the structure of the Group:



S Ltd.'s management should disclose Mr. A, Mr. B and Mr. C as the ultimate controlling party (as a group) of S Ltd. where they have a contractual arrangement to act together, irrespective of whether there were transactions between them and S Ltd. during the year.

The agreement between Mr. A, Mr. B and Mr. C provided them with a collective control over 60% (40%+10%+10%) of Trust T's voting rights. Mr. A, Mr. B and Mr. C form a group that controls Trust T, which controls P Ltd. and S Ltd.

Trust T should also be disclosed as the ultimate parent entity of S Ltd. in the notes to the financial statements, if this information is not disclosed elsewhere in information published with the financial statements.

Trust T would be the ultimate controlling party of S Ltd. and only Mr. A would be a related party of S Ltd. if the contractual arrangement to act together did not exist. Mr. A is related to S Ltd. because his 40% interest in Trust T gives him significant influence over S Ltd.

17. No impact for lower of cost and NRV provision is made at stage 1 and stage 2 because the final equipment will be sold at a profit. The profit margin on the estimated cost of completion should, therefore, be considered when calculating the net realisable value of work in progress if the entity has the ability to dispose of the finished product at a price that exceeds the production cost. The net realisable value of the semi-finished product at stage 1 is:

	₹
Selling price of completed product	275
Less: Stage 3 conversion costs	(62)
Less: Stage 2 conversion costs	(35)
Net realisable value at stage1	178

At stage 1, inventory will be valued at ₹ 170 (lower of cost i.e. ₹ 170 and NRV i.e. ₹ 178). The inventory at stage 1 will be valued at ₹ 170, though the selling price at stage 1 is ₹ 130.

18. Statement showing the interest paid and received during the period of construction

	₹
Interest payable for December 20X8 at 12% (10,00,000 x 12% x 1/12)	10,000
Interest payable for January 20X9 at 12% (10,00,000 x 12% x 1/12)	10,000
Interest for February 20X9 at 13% (10,00,000 x 13% x 1/12)	10,833
Interest payable for March 20X9 at 13% (10,00,000 x 13% x 1/12)	10,834
Total interest payable during the construction period till March 20X9 (A)	41,667
Interest receivable on re-invested funds of ₹ 9,00,000 in September 20X9 [(10,00,000 – 1,00,000) x 5% x 1/12]	3,750
Interest receivable on re-invested funds of ₹ 6,50,000 in October 20X9 [(9,00,000 – 2,50,000) x 5% x 1/12]	2,708
Interest receivable on re-invested funds of ₹ 4,00,000 in November 20X9 [(6,50,000 – 2,50,000) x 5% x 1/12]	1,667

Interest receivable on re-invested funds of ₹ 1,50,000 in December 20X9 [(4,00,000 – 2,50,000) x 5% x 1/12]	625
Total interest receivable till March, 20X9 (B)	8,750
Net interest cost (A) - (B)	32,917

The borrowing is specific to the qualifying asset and the borrowing costs eligible for captialisation are the actual cost incurred during the construction period less any investment income on the temporary investment of the borrowings. The amount of borrowing costs that can be capitalised is ₹ 32,917.

Commencement of capitalization of borrowing costs will be said from the period when all the three criteria as mentioned in para 17 of Ind AS 23 are met. Although the funds were drawn down under the borrowings on 1st May 20X8, the construction started from 1st December, 20X8. Hence, the borrowing costs incurred prior to 1st December, 20X8 cannot be said to be directly attributable to the asset's construction, as no expenditure on the asset is being incurred.

19. Consolidated Statement of Cash Flows for the 20X1-20X2

	₹	₹
Cash flows from operating activities		
Profit before taxation		84,000
Adjustments for non-cash items:		
Depreciation	36,000	
Interest paid to be included in financing activities	4,800	40,800
		1,24,800
Adjustments for working capital changes:		
Decrease in inventories (W.N.1)	10,800	
Decrease in trade receivables (W.N.2)	4,800	
Decrease in trade payables (W.N.3)	(28,800)	(13,200)
		1,11,600
Less: Taxation (13,200 + 18,000 – 14,400)		(16,800)

Net cash generated from operating activities		94,800
Cash flows from investing activities		
Cash paid to be acquired subsidiary (88,800 – 2,400)	(86,400)	
Net cash outflow from investing activities		(86,400)
Cash flows from financing activities		
Interest paid	(4,800)	
Net cash outflow from financing activities		(4,800)
Increase in cash and cash equivalents		3,600
Cash and cash equivalents at the beginning of the year		6,000
Cash and cash equivalents at the end of the year		9,600

Working Notes:

1. **Computation of increase/decrease in inventory of the Group for the year**

	₹
Total inventory of the Group at the end of the year	36,000
Inventory acquired during the year from subsidiary	(4,800)
Closing inventory	31,200
Less: Opening inventory	(42,000)
Decrease in inventory	(10,800)

2. **Computation of increase/decrease in trade receivables of the Group for the year**

Total trade receivables of the Group at the end of the year	64,800
Trade receivables acquired during the year from subsidiary	(9,600)
Closing trade receivables	55,200
Less: Opening trade receivables	(60,000)
Closing trade receivables	(4,800)

3. Computation of increase/decrease in trade payables of the Group for the year

Trade payables at the end of the year	81,600
Trade payables of the subsidiary assumed during the year	(38,400)
Closing trade payables	43,200
Less: Opening trade payables	(72,000)
Closing trade payables	(28,800)

20. Para 24 of Ind AS 16 *inter alia* states that in case of all exchange of item of property, plant and equipment, the cost of an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognise the asset given up. **If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.**

Further, para 25 of Ind AS 16 states that an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) **the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or**

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

Since in the given case, there is no commercial substance, the entity recognizes the assets received at the book value of car X. Therefore, it recognizes cash of ₹ 150 and car Y as property, plant and equipment with a carrying value of ₹ 12,850.