SUGGESTED ANSWER

SUBJECT - FINANCIAL REPORTING

PAPER NAME - FR 35% TEST 1

PAPER CODE - AFR1

DURATION - 3 HOURS

Case study 1

Q1. Correct Answer: **A**

Explanation:

Net interest expense = (DBO - Plan assets) x Discount rate = (12,00,000 - 9,50,000) x 8% = INR 1,20,000

Q2. Correct Answer: **C**

Explanation:

As per Ind AS 19, remeasurements, including actuarial gains and losses, are recognized immediately in OCI and not recycled to profit or loss.

Q3. Correct Answer: **A**

Explanation:

Termination benefits are recognized when the entity is demonstrably committed to providing the benefits, which is typically when the termination plan is announced and the entity cannot withdraw it.

Q4. Correct Answer: **B**

Explanation:

Leave encashment expense

= Current service cost + Interest cost

= INR 1,50,000 + INR 28,000 = INR 1,78,000

Since leave encashment is a long-term benefit, the entire expense is charged to profit or loss.

Case study 2

Q5. Correct Answer: **B**

Explanation:

Initial estimate of employees expected to remain = 80% of 500 = 400 employees.

Total fair value = 400 employees x 1,000 options x INR 100 = INR 4,00,00,000.

Q6. Correct Answer: **B**

Explanation:

Revised estimate of employees expected to remain = 85% of (500 - 50) = 382.5 ≈ 383 employees.

Revised total fair value = 383 employees x 1,000 options x INR 100 = INR 4,25,00,000.

Q7. Correct Answer: **A**

Explanation:

Revised total fair value = INR 4,25,00,000.

Expense for 2023-24 (first year) = INR 4,25,00,000 / 3 years = INR 1,41,66,667.

Adjustment for employee attrition during the year = (17 employees x 1,000 options x INR 100) = INR 8,33,333.

Net expense = INR 1,41,66,667 - INR 8,33,333 = INR 1,33,33,333.

Q8. Correct Answer: **C**

Explanation:

After the vesting period, any forfeiture of options is accounted for by transferring the recognized value of those options to retained earnings. No adjustment is made to the profit or loss post-vesting.

Case study 3

Q9. Correct Answer: **B**

Explanation:

Since the investment is classified as FVOCI, the fair value gain of INR 5,00,000 is recognized in OCI, and the equity instrument is measured at fair value as on the reporting date.

Q10. Correct Answer: **C**

Explanation:

The EIR is calculated by amortizing the loan origination fee over the life of the loan, resulting in a rate slightly higher than the nominal interest rate of 10%.

Q11. Correct Answer: **A**

Explanation:

The forward rate (INR 85) is higher than the spot rate on 31st March 2024 (INR 84), resulting in a gain of INR 1,00,000 [(85 - 84) x 1,00,000]. Gains and losses on such forward contracts are recognized in profit or loss unless designated as a hedge.

Q12. Correct Answer: **C**

Explanation:

The interest expense is calculated using the effective interest rate method. The EIR includes the loan origination fee, resulting in an interest expense higher than the nominal rate of 10%.

Individual MCQs

Q13. Correct Answer: **B**

Explanation:

Deferred tax liability is not recognized for taxable temporary differences arising from the initial recognition of goodwill. This is an exception under Ind AS 12 because goodwill is generally not deductible for tax purposes, and recognizing deferred tax would lead to a mismatch in future tax effects. For other taxable temporary differences, deferred tax liabilities are typically recognized unless exceptions apply.

Q14. Correct Answer: **D**

Explanation:

Ind AS 108 requires an entity to identify reportable segments based on quantitative thresholds (e.g., revenue, profit/loss, or assets). However, if the total external revenue of all reportable segments is less than 75% of the entity's total revenue, additional segments must be identified and disclosed, even if they do not meet the quantitative thresholds, to ensure that at least 75% of the total revenue is covered.

Q15. Correct Answer: **C**

Explanation:

As per the Conceptual Framework, a liability is defined by three essential characteristics:

1. A present obligation exists as a result of past events.

2. The obligation is expected to result in an outflow of resources embodying economic benefits.

3. The obligation is enforceable legally or constructively.

The probability of settlement or having a specific future settlement date is not a defining characteristic of a liability, though it may affect measurement or recognition in specific standards.

Q1 (a).

1st April 2021

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the resent value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particulars	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)	Year 4 (₹)	Total (₹)
Cash flows based on interest rate of 14% (A)	3,50,000	3,50,000	3,50,000	3,50,000	14,00,000
Cash flows based on interest rate of 10% (B)	2,50,000	2,50,000	2,50,000	2,50,000	10,00,000
Interest on differential rate (C) = (A-B)	1,00,000	1,00,000	1,00,000	1,00,000	4,00,000
Discount factor @ 14%	0.877	0.769	0.675	0.592	
Interest on differential rate discounted @ 14%	87,700	76,900	67,500	59,200	2,91,300
Fair value of financial guaranteed contract (at inception)					2,91,300

Alternative manner of presentation for the calculation of fair value of financial guaranteed contract (at inception)

(i) Interest on loan @ 10% = ` 2,50,000

Present value of cash flow of loan at concessional rate with guarantee @ 14%

= ` 2,50,000 x 2.9138 + ` 25,00,000 x 0.5921

= ` 7,28,450 + ` 14,80,250 = ` 22,08,700

(ii) Interest on loan at normal rate of 14% = ` 3,50,000 Present Value of Cash flow of loan at 14%

= ` 3,50,000 x 2.9138 + ` 25,00,000 x 0.5921

= ` 25,00,080 or ` 25,00,000

Difference (ii) – (i) = ` 25,00,000 - ` 22,08,700

Fair value of financial guaranteed contract (at inception) = ` 2,91,300

Journal Entry

Particulars		Debit (₹)	Credit (₹)
Investment in subsidiary	Dr.	2,91,300	
To Financial guarantee (liability)			2,91,300
(Being financial guarantee initially recorded)			

<u>31st March 2022</u>

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- the amount of loss allowance; and

- the amount initially recognised less cumulative amortization, where appropriate.

At 31st March 2022, there is 2% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ` 50,000 (` 25,00,000 x 2%).

The initial amount recognised less amortisation is ` 2,32,082 (Refer table below). The unwound amount is recognised as income in the books of Surya Limited, being the benefit derived by Mohan Limited not defaulting on the loan during the period.

Year ended on 31st March	Opening balance (a) ₹	EIR @ 14% (b) = (a x 14%)	Benefits provided (c) ₹	Closing balance (d) = (a) + (b) -(c) ₹
2022	2,91,300	40,782	(1,00,000)	**2,32,082**
2023	2,32,082	32,491	(1,00,000)	1,64,573
2024	1,64,573	23,040	(1,00,000)	87,613
2025	87,613	12,387*	(1,00,000)	-

* Difference of ` 121 (` 12,387 – ` 12,266) is due to approximation.

The carrying amount of the financial guarantee liability after amortisation is therefore ` 2,32,082, which is higher than the 12-month expected credit losses of ` 50,000. The liability is therefore adjusted to ` 2,32,082 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	59,218	
To Profit and loss		59,218
(Being financial guarantee subsequently adjusted)		

<u>31st March 2023</u>

At 31st March 2023, there is 4% probability that Mohan Limited will default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ` 1,00,000 (` 25,00,000 x 4%).

The carrying amount of the financial guarantee liability after amortisation is ` 1,64,573, which is higher than the 12-month expected credit losses of ` 1,00,000. The liability is therefore adjusted to ` 1,64,573 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	67,509	
To Profit and loss		67,509
(Being financial guarantee subsequently adjusted)		

<u>31st March 2024</u>

At 31st March 2024, there is 5% probability that Mohan Limited will default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited. The 12-month expected credit losses are therefore ` 1,25,000 (` 25,00,000 x 5%).

The initial amount recognised less accumulated amortisation is ` 87,613, which is lower than the 12-month expected credit losses (` 1,25,000). The liability is therefore adjusted to ` 1,25,000 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	39,573*	
To Profit and loss (Refer Note below)		39,573*
(Being financial guarantee subsequently adjusted)		

Q1 (b).

Computation of goodwill impairment

	NCI at fair value	NCI at proportionate share of net assets
	₹ in 000	₹ in 000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Total Purchase Consideration (a)	70,500	70,500
Non-controlling interest on the date of acquisition: (b)		
Fair value – 3,000 x ₹ 5.50	16,500	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.) (c)	(68,000)	(68,000)
Goodwill on acquisition (a+b-c)	19,000	19,500
Impairment @ 12.50%	2,375.00	2,437.50

Working Note:

Net assets on the acquisition date	₹ in 000
Fair value at the acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

Q2 (a).

Journal entries in the books of P Ltd (without modification of service period of stock appreciation rights) **(Rs. In Lakhs)**

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

Journal entries in the books of P Ltd (with modification of service period of stock appreciation rights) **(Rs. In Lakhs)**

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

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

= ` 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

= ` 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

= ` 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

= ` 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

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

Q2 (b).

There are both 'equity' and 'debt' features in the instrument. An obligation to pay cash i.e. interest at 8% per annum and a redemption amount will be treated as 'financial liability' while option to convert the loan into equity shares is the equity element in the instrument. Therefore, convertible loan is a compound financial instrument.

Calculation of debt and equity component and amount to be recognised in the books:

S. No	Year	Interest amount @ 8%	Discounting factor @ 10%	Amount
Year 1	2020	96,000	0.91	87,360
Year 2	2021	96,000	0.83	79,680
Year 3	2022	96,000	0.75	72,000
Year 4	2023	12,96,000*	0.68	8,81,280
Amount to be recognised as a liability				11,20,320
Initial proceeds				(12,00,000)
Amount to be recognised as equity				79,680

* In year 4, the loan note will be redeemed; therefore, the cash outflow would be ` 12,96,000 (` 12,00,000 + ` 96,000).

Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 2020

Finance cost to be recognised in the Statement of Profit and Loss (11,20,320 x 10%)	₹ 1,12,032
Less: Already charged to the income statement	(₹ 96,000)
Additional finance charge required to be recognised in the Statement of Profit and Loss	₹ 16,032

In Balance Sheet as at 31 March 2020

Equity and Liabilities	
Equity	
Other Equity (8% convertible loan)	79,680
Non-current liability	
Financial liability [8% convertible loan – [(11,20,320 + 1,12,032 – 96,000)]	11,36,352

Q3 (a).

(A) Deferred Tax Liability as at 31st March 20X2

Investment in L Ltd:

Carrying Amount = ` 75 Cr

Tax base = ` 45 Cr (Purchase cost)

Temporary Difference = ` 30 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ` 6 Cr is recognized:

Charge to Statement of Profit or Loss for the year ended 31st March 20X2: Investment in L Ltd.

Particulars	Carrying amount	Tax Base	Temporary Difference
Opening Balance (1st April 20X1)	₹ 70 Cr	₹ 45 Cr	₹ 25 Cr
Closing Balance (31st March 20X2)	₹ 75 Cr	₹ 45 Cr	₹ 30 Cr
Net Change			₹ 5 Cr
Increase in Deferred Tax Liability (20% tax rate)			₹ 1 Cr

Considering the increase in the value of investment arising through Statement of Profit or Loss, the accounting for the increase in deferred tax liability is made as under:

Tax expense (Profit or Loss Statement)	Dr ` 1 Cr	
To Deferred Tax Liability		` 1 Cr

(Being increase in deferred tax liability recognized)

(B) Head office building

Carrying Amount = ` 45 Cr (Revalued amount on 31st of March 20X2)

Tax base = ` 20.75 Cr (22 Cr – 1.25 Cr)

Temporary Difference = ` 24.25 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ` 4.85 Cr is created.

Total Deferred Tax Liability ` 6 Cr + ` 4.85 Cr = ` 10.85 Cr

Head Office Building:

The deferred tax liability at 31 March 20X1 is ` 3.6 Cr (20% x {` 40 Cr – ` 22 Cr}).

At 31 March 20X2, prior to revaluation, the carrying amount of the property is ` 38 Cr and its tax base is ` 20.75 Cr (` 22 Cr – ` 1.25 Cr). The deferred tax liability at this point is ` 3.45 Cr (20% x {` 38 Cr – `20.75 Cr}).

The reduction in this liability is ` 0.15 Cr (` 3.6 Cr – ` 3.45 Cr). This would be credited to income tax expense in arriving at profit or loss.

Post revaluation, the carrying value of the building becomes ` 45 Cr and the tax base stays the same. Therefore, the new deferred tax liability is ` 4.85 Cr (20% x (` 45 Cr – ` 20.75 Cr)). The increase in the deferred tax liability of ` 1.4 Cr (` 4.85 Cr – ` 3.45 Cr) is charged to other comprehensive income.

Q3 (b).

Statement of Cash Flows for the year ended 31st March, 20X3

	(₹ in lakhs)	(₹ in lakhs)
Cash flows from operating activities		
Profit before taxation	200	
Adjustments for non-cash items:		
Depreciation [410 - (450 - 100)]	60	
	260	
Increase in inventories (800 - 700)	(100)	
Decrease in trade receivables (600 - 580)	20	
Increase in other non-current assets (95 - 85)	(10)	
Increase in other current assets (160 - 120)	(40)	
Increase in non-current liabilities (90 - 80)	10	
Increase in trade payables (455 – 25 - 450)	(20)	
Other current liabilities (Refer Note 1) [(90 + 40) - 45]	(85)	
Net cash generated from operating activities		35
Cash flows from investing activities		
Cash paid to purchase PPE (100-25)	(75)	
Cash paid to acquire investment (100-60)	(40)	
Net cash outflow from investing activities		(115)
Cash flows from financing activities		
Raising of equity share capital (280 - 250)	30	
Long-term borrowings raised during the year	120	
Long-term borrowings repaid during the year [(300 + 120) - 360]	(60)	
Net cash outflow from financing activities		90
Increase in cash and cash equivalents during the year		10
Cash and cash equivalents at the beginning of the year (420-300) (Refer Note 2)		(120)
Cash and cash equivalents at the end of the year (410-300) (Refer Note 2)		(110)

Q4 (a).

The decision to offer the division for sale on 1st January, 20X1 means that from that date the division is classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price, and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division will be measured at the lower of their existing carrying amounts (` 7.20 lakhs i.e. Goodwill ` 1.2 lakh + PPE ` 4 lakhs + Inventory ` 2 lakhs) and their fair value less costs to sell (` 6.40 lakhs). This implies that the assets of the division will be measured at ` 6.40 lakhs on 1st January, 20X1.

The reduction in carrying value of the assets of ` 0.80 lakhs (` 7.20 lakhs – ` 6.40 lakhs) will be treated as an impairment loss and allocated to goodwill, leaving a carrying amount for goodwill of ` 0.40 lakhs (` 1.20 lakhs – ` 0.80 lakhs).

The increased expectation of the selling price of ` 0.20 lakhs (` 6.60 lakhs – ` 6.40 lakhs) will be treated as a reversal of an impairment loss. However, since this reversal relates to goodwill, it cannot be recognised.

The assets of the division need to be presented separately from other assets in the balance sheet. Their major classes of assets classified as held for sale should be separately disclosed, either in the balance sheet or in the notes.

The property, plant and equipment should not be depreciated after 1 st January, 20X1, so it's carrying value at 31st March, 20X1 will be ` 4 lakhs. The inventories of the division will be shown at their year end cost of ` 1.80 lakhs.

The division will be regarded as a discontinued operation for the year ended 31st March, 20X1. It will represent a separate line of business and will be held for sale at the year end.

The statement of profit and loss should disclose, as a single amount, the post-tax profit or loss of the division and the impairment loss arising on the re-measurement of the division on classification as held for sale. Further analysis of this single amount may be presented in the notes or in the statement of profit and loss. If it is presented in the statement of profit and loss it shall be presented in a section identified as relating to discontinued operations, i.e. separately from continuing operations.

Q4 (b).

Paid Vacation:

Step 1: Calculation of Unused Vacation in man-days as on 31st March, 20X2:

A. No. of Employees in service for the whole year (94%):

Particulars	Man-days
Unused vacation as on 31st March, 20X1	3 days per employee
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**4 days per employee**
Total Unused vacation as on 31st March, 20X2 - (A) (350 employees x 94% x 4 days per employee)	**1,316 man-days**

B. Newcomers (6%):

Particulars	Man-days
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**1 day per employee**
Total Unused vacation as on 31st March, 20X2 - (B) (350 employees x 6% x 1 day per employee)	**21 man-days**
Total unused vacation as on 31st March, 20X2 (A + B)	1,337 man-days

Step 2: Calculation of average salary per day:

Particulars	Amount (₹)
Average salary per day as on 31st March, 20X1	15,000
Salary increase in 20X1-20X2	10%
Average salary per day as on 31st March, 20X2	**16,500**

Step 3: Calculation of provision for unused paid vacation:

Particulars	Amount (₹)
Calculation of provision for unused paid vacation 20X1-20X2: (1,337 man-days x ₹ 16,500)	2,20,60,500
Provision for unused paid vacation 20X0-20X1	65,00,000

Step 4: Accounting treatment

Provision for 20X1-20X2

Employee Benefits Expenses A/c	Dr. 2,20,60,500	
To Provision for Leave Encashment		2,20,60,500

Settlement of Liability of 20X0-20X1

Provision for Leave Encashment A/c	Dr. 65,00,000	
To Cash / Bank		65,00,000

Q5 (a).

In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the building would be:

Particulars	(₹)
Purchase amount	50,00,000
Non-refundable property tax	2,50,000
Direct legal cost	50,000
	53,00,000
Expenditures on redevelopment:	
Building plan approval	1,00,000
Construction costs (10,00,000 – 60,000)	9,40,000
Total amount to be capitalised at 1st October, 20X1	63,40,000

Treatment of abnormal wastage of material and labour:

As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. It will be charged to Profit and Loss in the year it is incurred. Hence, abnormal wastage of ` 40,000 will be expensed off in Profit & Loss in the financial year 20X1-20X2.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment Property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted for as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted for as per Ind AS 16.

As on 1st October, 20X1, the carrying value of building vis-à-vis its classification would be as follows:

(i) In the Separate Financial Statements: The Ground Floor of the building will be classified as investment property for ₹ 31,70,000, as it is property held to earn rentals. While First Floor of the building will be classified as item of property, plant and equipment for ₹ 31,70,000.

(ii) In the Consolidated Financial Statements: The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for ₹ 63,40,000.

Q5 (b).

The carrying amount of the debenture on the date of transition under previous GAAP, assuming that all interest accrued other than premium on redemption have been paid, will be ₹ 31,20,000 [(30,000 x 100) + (30,000 x 100 x 10/100 x 2/5)]. The premium payable on redemption is being recognised as borrowing costs as per para 4(b) of AS 16 ie under previous GAAP on straight-line basis.

As per para D18 of Ind AS 101, Ind AS 32, Financial Instruments: Presentation, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this Ind AS, a first -time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6 □ 3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110 □ 0.68 (Note 2)	74.80
Total liability component per debenture	93.82
Equity component per debenture (Balancing figure)	6.18
Face value of debentures	100.00
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of initial recognition, the amount of ` 30,00,000 being the amount of debentures will be split as under:

Debt = ` 28,14,600

Equity = ` 1,85,400

However, on the date of transition, unwinding of ` 28,14,600 will be done for two years as follows:

Year	Opening balance	Finance cost @ 10%	Interest paid	Closing balance
1	28,14,600	2,81,460	1,80,000	29,16,060
2	29,16,060	2,91,606	1,80,000	30,27,666

Therefore, on transition date, Sigma Ltd. shall –

a. recognise the carrying amount of convertible debentures at ` 30,27,666;

b. recognise equity component of compound financial instrument of ` 1,85,400;

c. debit ` 93,066 to retained earnings being the difference between the previous GAAP amount of ` 31,20,000 and ` 30,27,666 and the equity component of compound financial instrument of ` 1,85,400; and

d. derecognise the debenture liability in previous GAAP of ` 31,20,000.

Notes:

1. 3.17 is present value of annuity factor of ` 1 at a discount rate of 10% for 4 years.

2. On maturity, ` 110 will be paid (` 100 as principal payment + ` 10 as premium)

Q5 (c).

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 31 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.

Q6 (a).

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 equivalent to the repayment of a loan.

Under Ind AS 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%.

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

Accordingly, the closing balance of Preference shares at year end i.e. 31 st March, 20X6 would be ` 5,47,200. Accountant has inadvertently debited interest of ` 19,200 in the profit and loss . However, the interest of ` 86,400 should have been debited to profit and loss as finance charge.

Similarly, amount of ` 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by ` 480,000 proceeds of issue and ` 67,200 (86,400 – 19,200) i.e. total by 5,47,200.

Necessary adjusting journal entry to rectify the books of accounts will be:

		₹	₹
Preference share capital (equity) (Balance sheet)	Dr.	4,80,000	
Finance costs (Profit and loss)	Dr.	86,400	
To Equity – Retained earnings (Balance sheet)			19,200
To Preference shares (Long-term Borrowings) (Balance sheet)			5,47,200

Q6 (b).

An entity has eight segments and the relevant information is as follows:

Criteria 1: Segment revenue is 10% or more of total external + intersegment sales

Segments	A	B	C	D	E	F	G	H	Total
Total sales	100	315	45	15	15	50	25	35	600
% to total sales	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8	
Reportable segments	A	B	-	-	-	-	-	-	

Criteria 2: 10% or more of segment result

Consider segment profit and loss separately in absolute terms

Segments	A	B	C	D	E	F	G	H	Total
Profit	5	-	15	-	8	-	5	7	40
Segments loss	-	90	-	5	-	5	-	-	100

Since segment loss is greater, we select 100 as evaluating the segment percentage

Segments	A	B	C	D	E	F	G	H	Total
% to segment loss	5	90	15	5	8	5	5	7	
Reportable segments	-	B	C	-	-	-	-	-	

Criteria 3: 10% or more of segment assets

Segments	A	B	C	D	E	F	G	H	Total
Assets	15	47	5	11	3	5	5	9	100
%	15	47	5	11	3	5	5	9	100
Reportable segments	A	B	-	D	-	-	-	-	

Based on the above 3 criteria, the Reportable Segments are A, B, C & D

However, 75% test for external sales should also be checked.

Reportable Segments	A	B	C	D	TOTAL
External sales	0	255	15	10	280
Total entity's sales (external)					**405**
% of reportable segments external sales to entity's sales					**69.14%**
Required percentage					**75%**

Hence, in the above scenario, additional operating segments need to be identified as reportable segments, till the 75% test is satisfied, even if those segments do not satisfy the quantitative threshold limits.

Q6 (c).

As per Ind AS 10, the treatment of stated issues would be as under:

(i) **Adjusting event:** It is an adjusting event as it is the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. Even though winning of award is favorable to the company, it should be accounted in its books as receivable since it is an adjusting event.

(ii) **Adjusting event:** The sale of inventories after the reporting period may give evidence about their net realizable value at the end of the reporting period, hence it is an adjusting event as per Ind AS 10. Zoom Limited should value its inventory at ` 40,00,000. Hence, appropriate provision must be made for ` 15 lakh.

(iii) **Adjusting event:** As per Ind AS 10, the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. The bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period.

(iv) **Non – adjusting event:** Announcing or commencing the implementation of a major restructuring after reporting period is a non-adjusting event as per Ind AS 10. Though this is a non- adjusting event occurred after the reporting period, yet it would result in disclosure of the event in the financial statements , if restructuring is material. This would not require provision since as per Ind AS 37, decision to restructure was not taken before or on the reporting date. Hence, it does not give rise to a constructive obligation at the end of the reporting period to create a provision.