Final New P 6E

Roll No. .... NOV 2019

Total No. of Case Study Questions – 5 **Final New Syllabus** Total No. of Printed Pages – **31**

Paper - 6 E

Time Allowed – **4 Hours** **Global Financial Reporting Standards** Maximum Marks – **100**

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Answer to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

The Question Paper comprises five case study questions. The candidates are required to answer any four case study questions out of five.

Answer in respect of Multiple Choice Questions are to be marked on the OMR answer sheet only.

Answers to other questions to be written on the descriptive type answer book.

Answers to MCQs, if written in the descriptive type answer book will not be evaluated.

Candidates may use calculator.

Marks

Case Study 1.

Rainbow Limited is a large manufacturing company that has already adopted Ind AS during the financial year 2017-18. The company is in the process of preparing its financial statements as per Ind AS for the financial year 2018-19. Some new developments have taken place during the year and the company is keen that the appropriate accounting treatment and disclosures under Ind AS are determined and highlighted to the Board of Directors early on. Rainbow Limited's CFO has sought your assistance and shared the following details with you.

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ₹ 1,00,000 each, relating to the following ongoing research and development projects :

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

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

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

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

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

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

Marks

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

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

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

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

Marks

Questions : **2 × 5 = 10**

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

(A) ₹ 30,00,000.

(B) ₹ 2,40,000.

(C) ₹ 6,00,000.

(D) ₹ 24,00,000.

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

(A) ₹ 1 crore capital reserve.

(B) ₹ 80 lakhs of capital reserve.

(C) ₹ 20 lakhs goodwill.

(D) ₹ 41 lakhs of goodwill.

1.3 The three year term loan obtained from the bank contains an option to extend the period of the loan at market rates prevailing at that date. State which of the following is correct: 2

(A) It is not an embedded derivative.

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

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

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

Marks

1.4 What is the annual depreciation charge on equipment P for years 3 to 10, and what is the amount of revaluation surplus that can be transferred to retained earnings annually? 2

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

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

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

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

1.5 The CFO of Rainbow Limited is concerned that there may be an impairment of goodwill in one of the subsidiary companies. Clarify how impairment, if any, will be accounted for by the Parent company: 2

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

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

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

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

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

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

1.8 How should Rainbow Limited account for the interest-free loan given to Canyons Limited, under the following scenarios: 5

Scenario A : The loan is repayable on demand.

Scenario B : The loan is repayable after 5 years.

Provide necessary journal entries under both scenarios, in the books of Rainbow Limited and Canyons Limited.

Case Study 2.

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

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

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

– 1st April, 2018 – FCY 1 = ₹ 2.50.

– 31st March, 2019 – FCY 1 = ₹ 2.75.

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

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

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

Makers Limited also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by D Limited exceeds ₹ 1 crore over the next three years. On the date of acquisition, D Limited assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000.

D Limited incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

Marks

Additional information :

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

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

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

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

Marks

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

Questions : $2 \times 5 = 10$

2.1 Based on the quantitative threshold, which of the above segments A to E would be considered as reportable segments ? 2

(A) Segment C.

(B) Segments C, D and B.

(C) Segments B, C, D and E.

(D) All are reportable segments.

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

(A) ₹ 8,57,935.

(B) ₹ 9,97,989.

(C) ₹ 5,87,935.

(D) ₹ 11,75,869.

Marks

2.3 For the identifiable asset QR, what would be the impact on the deferred tax asset/ liability at the end of the period? 2

(A) Nil impact.

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

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

(D) Deferred tax assets will have a balance of ₹ 45,000.

2.4 In respect of the trademark with indefinite life, Makers Ltd. seeks your advice on the appropriate treatment from following: 2

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

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

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

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

2.5 Makers Ltd. is evaluating a proposal to acquire the shares of C Ltd., a competitor. The company will proceed only if they will have a controlling stake, in accordance with the applicable accounting standards. Help them identify which one of the following situations will fail their objective, i.e., they are unlikely to have control over C Ltd. ? 2

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

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

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

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

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

2.7 What would be the appropriate accounting treatment for the Foreign Currency loan in the books of Makers Ltd. for the FY: 2018-19? Calculate the Initial Measurement amount for the loan, Finance Cost for the year, Closing Balance and Exchange gain/loss. 5

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

Marks

Case Study 3.

Your advisory client Gamma Limited is engaged in manufacturing and retail activities. The group holds investments in different entities as follows :

- Gamma Limited holds 100% Investment in G Limited and D Limited;
- G Limited and D Limited hold 60% and 40% in GD Limited respectively.
- Delta Limited is a 100% subsidiary of GD Limited

Gamma Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 2019 and the extract of the same is as follows :

Particulars	Attributable to Gamma Limited	Non-controlling interest	Total (₹ In '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

The long-term finance of the company comprises of the following :

(i) 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 2018 at full market value.

(ii) 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 2019. The dividend on these preference shares is discretionary.

(iii) ₹ 18 crores of 6% Convertible Debentures issued on 1st April, 2017 and repayable on 31st March, 2021 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their Convertible Debentures for 10 crores ordinary shares in the company. On 1st April, 2017, the prevailing market interest rate for five-year Convertible Debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in five years is 0·68 and the cumulative present value of ₹ 1 payable at the end of years one to five is 3·99.

In the year ended 31st March, 2019, Gamma Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

While preparing the financial statements for the year ended 31st March, 2019, Gamma Limited has observed two issues in the previous year Ind As financial statements (i.e. 31st March, 2018) which are as follows:

Issue 1 :

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 2018. While preparing annual financial statements for the year ended 31st March, 2019, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 2018).

Issue 2 :

The company had charged off certain expenses as finance costs in the year ended 31st March, 2018. While preparing annual financial statements for the year ended 31st March, 2019, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 2018).

Additional information :

Gamma Ltd. granted share options to one of its technical directors on the condition that he will not work with a competitor (i.e., non-compete clause) for a period of three years. The fair value of the award at the date of the grant is ₹ 2,00,000, including the effect of the non-compete clause.

Gamma Ltd. has inventory of raw material Y of 10,000 units as at 31st March, 2019 with a carrying amount of ₹ 100 each. The current market value of that raw material is ₹ 95 each. Gamma Ltd. intends to use the raw material to manufacture a component to be used by a customer. Gamma Ltd. estimates costs to completion and sale of ₹ 50 each and a selling price for the component is estimated to be ₹ 160 each.

Gamma Limited sold a machinery Z for ₹ 9,00,000 to a new customer. To get into long term relationship with the customer, the terms of sale also include after sales

Marks

service to be provided for next three years free of cost. The company also sells the sales service contract separately where the customer buys it after the initial warranty period at ₹ 1,00,000.

The company has stores across India. It deals mainly with three products A. B, and C. The company has a policy of refunding the entire purchase money provided the buyer returns the product without any damage within a period of 15 days in respect of Product A and B, and 6 months in respect of Product C. This policy has not been mentioned in any their written documents nor has been communicated in any other media. However, it is widely known. The company has duly complied with this policy in the past. The accountant has made an estimate, based upon past experience and the average probability that the cost involved in relation to the product return policy for each of the product as follows:

	₹
Product A	1,50,000
Product B	2,50,000
Product C	5,00,000
Total	**9,00,000**

The management is of the view that no provision for returns needs to be created as there is no legal obligation on the part of the company.

Marks

Questions : **2 × 5 = 10**

3.1 What is the value of raw material Y of Gamma Ltd. as per applicable Ind AS ? 2

(A) ₹ 9,50,000.

(B) ₹ 11,00,000.

(C) ₹ 10,00,000.

(D) ₹ 16,00,000.

3.2 How should the revenue be recognised in the books of account for the sale of machinery Z ? 2

(A) ₹ 9,00,000 is to be recognised as revenue in the year of sale.

(B) ₹ 9,00,000 is to be recognised at the end of three years after sale.

(C) ₹ 9,00,000 is to be recognised in the year of sale and ₹ 1,00,000 to be spread over next three years.

(D) ₹ 8,10,000 is to be recognised in the year of sale and ₹ 90,000 to be spread over next three years.

3.3 Your advice is sought on the correct approach for Gamma Ltd's policy on return of Products A, B and C. 2

(A) The provision has to be created as conservative policy has to be followed in accounting.

(B) The provision need not be created as the company is under any legal obligation to return the purchase money.

(C) Provision has to be created for ₹ 9,00,000 (after adjustment of the time duration remaining) as there exists a possibility of a future liability.

(D) The entity has to create a liability for ₹ 9,00,000 (or such amount as may be determined after adjustment of the time duration remaining) as there exists a present obligation as a result of past event.

Marks

3.4 What is the correct accounting treatment under Ind AS for the share options granted to Gamma Ltd's. technical director? **2**

(A) Gamma Ltd. should recognise an expense of ₹ 2,00,000 over the period of three years and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

(B) Gamma Ltd. should recognise an expense of ₹ 2,00,000 over the period of three years and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.

(C) Gamma Ltd, should recognise an expense of ₹ 2,00,000 immediately and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.

(D) Gamma Ltd. should recognise an expense of ₹ 2,00,000 immediately and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.

3.5 The CFO of Gamma Ltd. is trying her best to understand the high level differences between IFRS and US GAAP. Which of the following is the correct hierarchy under US GAAP hierarchy for determining the selling price of a deliverable? **2**

(A) First, the Vendor-Specific Objective Evidence must be used, if available. If not, then Third Party Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.

(B) First, the Best Estimate of Selling Price must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must obtain Third Party Evidence.

(C) First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must make its Best Estimate of Selling Price.

Marks

(D) First, Third Party Evidence must be used, if available. If not, then Vendor-Specific Objective Evidence is used. If neither prices are available, then the entity must use Cost plus a Reasonable Margin.

3.6 Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS? **4**

Secondly, consider this alternative scenario. All other facts remain the same as above, but G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited. Explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

3.7 Based on the details of long term finance provided above, help Gamma Limited compute the following : **7**

- the finance cost of convertible debentures and closing balance as on 31st March, 2019 to be presented in the consolidated financial statements.
- the basic and diluted earnings per share for the year ended 31st March 2019.

Assume that income tax is applicable to Gamma Limited and its subsidiaries at 25%.

3.8 What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 2018 ? **4**

Marks

Case Study 4.

Global Ltd. is a highly reputed private company that has been in the infrastructure and power business for three generations. The company's CFO has approached your advisory firm for assistance in applying Ind AS for the first time in 2018-19. The following brief details are provided to you.

Global Ltd. has two units (Unit 1 and Unit 2) of 600 MW each in its power plant. The plant was set up in the year 2010 and it is expected that it will be able to supply power till 2025. Global has entered into a Power Purchase Agreement with the State Government. The construction of the plant was funded using a debt-equity ratio of 70:30. The term loan carried an interest rate of 12% p.a. The total outlay on the plant was ₹ 4,000 crores which is also considered as its fair value. Some important features of the PPA are :

- The State Government has agreed to purchase 600 MW power generated by Unit 1.
- The term of the agreement is fixed as 10 years.
- The tariff for power supply agreed with the State Government is as follows:

Contract year	Capacity charges (₹ / kWh)	Energy charges (₹ / kWh)
1	1.10	2.00
2	1.10	2.10
3	1.10	2.30
4	1.10	2.50
5	1.10	2.60
6	0.78	2.80
7	0.78	3.00
8	0.78	3.20
9	0.78	3.40
10	0.78	3.70

(1MW = 1000 kW and the plant operates 24 hours a day, 365 days in the year).

Marks

Capacity charges are payable based on 85% capacity, irrespective of the actual units consumed. An incentive is payable for availability of plant beyond 85% capacity and a penalty is recoverable for availability of plant below 85% (for this case study, assume that exactly 85% was available).

Global Ltd. has been granted a 15-year license to extract coal from a mine situated at a remote location R. At the end of this term, Global is obligated to carry out certain prescribed activities in order to restore the ecological balance in location R.

The CFO has informed you that the company is in talks with specific target companies/ individuals in order to complement their operations. One of the key areas of focus is to bring in fresh thinking by buying out startups and research organisations in the infrastructure and power sectors. Global Ltd. has identified New Start Ltd. which is primarily into research and development of alternative energy sources. New Start Ltd. has not yet sold to any customers and therefore has not generated any revenues to date. However, Global Ltd. believes that New Start Ltd. has the right technology and a dedicated workforce that is well qualified in this field.

Global Ltd. owns 25% of the voting rights in Local Ltd. and is entitled to appoint one director to the Board, which consists of five members. The remaining 75% of the voting rights are held by two entities who are entitled to appoint two directors each. Decisions can be made by a quorum of four directors and a majority of those present at the Board meeting. Quite often, the other shareholders call Board meetings at short notice and make decisions in the absence of Global's representative. Although Global Ltd., has requested financial information from Local Ltd., but no information has been received. On the rare occasion that Global's representative attends the Board meeting of Local Ltd., his suggestions for agenda items are ignored and any concerns raised are vehemently opposed by the other directors.

Additional information :

Global Ltd had the following borrowings in place during 2018-19. Loan A of ₹ 5 crores at 8% and Loan B of ₹ 10 crores at 9%. The company constructed a new factory which cost ₹ 12 crores and was funded out of the existing borrowings. The factory took 7 months to complete.

The company purchased 1,000 equity shares in K Ltd. on 1st April, 2018. Since the investment was of a strategic nature, with no immediate plans to sell (or buy further), the management of Global decided to use the irrevocable election under Ind AS 109 to designate these investments at FVOCI.

Questions : **Marks**

2 × 5 = 10

4.1 Global Ltd., has invested in debt oriented mutual funds. The investment should be subsequently measured as : 2

(A) FVOCI.

(B) FVTPL.

(C) Amortised cost.

(D) Cost.

4.2 What is the cost of borrowings to be capitalised with the cost of constructing the new factory ? 2

(A) ₹ 66.67 lakhs.

(B) ₹ 1.04 crores.

(C) ₹ 1.67 crores.

(D) ₹ 60.66 lakhs.

4.3 For the equity investment in K Ltd., designated at FVOCI, the fair value gains and losses : 2

(A) will always be recorded through equity and never realised in profit and loss, even when it is sold.

(B) will be recorded through equity when it is held by the company, but realised in profit and loss when it is sold.

(C) will be recognised in profit and loss when it is held and when it is sold.

(D) will be recorded through profit and loss when it is held by the company, but in equity when it is sold.

Marks

4.4 The junior accountant at Global Ltd. needs clarifications on the various new terminology relating to fair value. What source should he refer to first, when measuring fair value of an asset/liability? 2

(A) Principal market.

(B) Most advantageous market.

(C) Foreign market.

(D) Participant specific market.

4.5 Global Ltd. is in talks with a target company based in the US and the CFO has messaged you for a quick clarification on certain differences between IFRS and US GAAP. Which of these sentences would be the correct response to your client? 2

(A) If certain criteria are met, US GAAP permits reversal of impairments of long lived assets held for use, whereas IFRS prohibits such reversals. IFRS requires the use of component approach for depreciation whereas US GAAP does not.

(B) If certain criteria are met, US GAAP permits reversal of impairments of long lived assets held for use, whereas IFRS prohibits such reversals. US GAAP requires the use of component approach for depreciation whereas IFRS does not.

Marks

(C) If certain criteria are met, IFRS permits reversal of impairments of long lived assets held for use, whereas US GAAP prohibits such reversals. IFRS requires the use of component approach for depreciation whereas US GAAP does not.

(D) If certain criteria are met, IFRS permits reversal of impairments of long lived assets held for use, whereas US GAAP prohibits such reversals. US GAAP requires the use of component approach for depreciation whereas IFRS does not.

4.6 Evaluate the Power Purchase Agreement under the requirements of Ind AS. How should the construction of power plant be classified in the financial statements of Global Ltd ? Support your answer with the necessary workings. Briefly comment on the site restoration costs for the mine at location R. 6

4.7 Analyse the relationship between Global Ltd. and Local Ltd. Also comment on the relationship between Local Ltd. and the other two shareholders. 4

4.8 Since Global Ltd. is considering the acquisition of New Start Ltd., they need your advice on whether this fulfils the criteria under business combinations, or should it be treated as an asset acquisition ? 5

Case Study 5.

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

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

During 2018-19, Main Bank Ltd's subsidiary Sub Bank Ltd. originates 2,000 bullet loans with a gross carrying amount of ₹ 50 Lakhs. It has decided that the portfolio would be segregated between Individual Housing Loans and Non-Individual Housing Loans, on the basis of shared credit risk characteristics at initial recognition. Individual housing loans portfolio comprises 1,000 loans with a gross carrying amount of ₹ 2,000 per client on average, and a total gross carrying amount of ₹ 20 Lakhs. The Non-Individual housing loans comprise 1,000 loans with a gross carrying amount of ₹ 3,000 per client. The historical default rate for next 12 months is 4 borrowers in Individual Housing Loan and 2 borrowers in Non-Individual Housing Loans. Assume that there are no transaction costs or fees, and that the loan contracts do not include any option for prepayment or call. Consider that the EIR is 10%.

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

Additional information :

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

Marks

Questions : **2 × 5 = 10**

5.1 The middle office of Main Bank Ltd. is examining the financial statements of its customers (i.e., borrowers) in order to ensure that loan covenants are being met, especially with respect to debt-equity ratios. Assist them in determining which of the instruments will qualify as equity in their entirety under Ind AS : **2**

(A) Redeemable debentures with discretionary dividend.

(B) Optionally convertible redeemable preference shares.

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

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

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

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

(B) Although the counterparty is the same, since the two loans are considered as separate financial instruments, the old loan must be

Marks

mandatorily derecognised and the renegotiated loan has to be recognised.

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

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

5.3 Disclosures of fair value are not required when : 2

(A) Fair value cannot be estimated.

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

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

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

5.4 Which of the following instruments is not an example of a derivative contract ? 2

(A) Total return swap.

(B) LIBOR linked debentures.

(C) Credit Default Swap.

(D) Written treasury bond option.

Marks

5.5 In respect of Main Bank's debt factoring arrangement for its customer A, which of the following statements is correct? **2**

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

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

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

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

5.6 You are required to assist Main Bank in analyzing the securitisation transaction. Compute the fair value of the securitised component of the loan and the amortisation of the carrying amount based on relating fair values. Pass journal entries to be passed in the books of Main Bank upon securitisation of these loans. **6**

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

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