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PAPER – 6E: GLOBAL FINANCIAL REPORTING STANDARDS

The question paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

Case Study-1

Innovative Harmony Limited (IHL or the Company) is a listed entity that prepares its financial statements as per IFRS. Its functional and presentation currency is PC. The draft financial statements for the year ended 31st March 2021 have been prepared and are under review by the management.

During the month of July 2020, the Company stumbled upon the opportunity to serve families looking for 'staycations' or short stay vacations away from their homes during the lockdowns due to COVID-19 pandemic, Quite swiftly, IHL identified and purchased 15 fully-furnished residential cottages along the Sahyadri hills. The Company also purchased from the same vendor, a shopping complex (containing 20 shops and two cafeterias) in the vicinity. At the time of purchase, all shops and all of the cottages were already fully booked (leased out). The fair value of the consideration paid for the shopping complex is almost equal to the aggregate fair value of the 15 cottages purchased.

The shopping complex and the cottages consist of and include land, building, property improvements, furnishings, the lease contracts. Additionally, the shopping complex includes contracts for outsourced cleaning, security and building maintenance. None of the employees or any other assets or any processes or other activities are transferred. The floor area of each of the cottages is the same, but the interiors are based on different themes. However, the profile of the lessees (tenants) is similar i.e., young families with children. The risk associated with operating the cottages on an aggregated manner is similar to that of the real estate market of the individual cottages and is not significantly different. The processes performed through the contracts for outsourced cleaning, security and building maintenance are ancillary or minor within the context of all the processes required to create outputs. Any of these services can be easily replaced.

During the financial year 2020-2021, the Company acquired 70% ordinary shares of Super Express Limited a private company for PC 9.75 million. The fair value of its identifiable net assets is PC 13.00 million. The fair value of the 30% of the ordinary shares owned by non-controlling shareholders is PC 4.88 million. Carrying amount of Super Express Limited's net assets is PC 12.00 million.

In October 2020, IHL also acquired 75% of Very Relevant Limited by paying cash consideration of PC 0.80 million. The fair value of non-controlling interest on the date of acquisition is PC 0.20 million. The value of Very Relevant Limited's identifiable net assets as per IFRS 3 is PC 1.10 million.

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IHL, Super Express Limited and Very Relevant Limited are engaged in different lines of business. These companies are using the following cost formulas for their valuation in accordance with IAS 2 inventories:

Name of the Company	***Cost formula used***
Innovative Harmony Limited	*Weighted average cost*
Super Express Limited	*FIFO*
Very Relevant Limited	*FIFO*

IHL has issued 10,00,000 PC 1 ordinary shares and 1,000 PC 100 10% convertible bonds (issued at par) each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period. IHL's share price is PC 5.00 per share and earnings after tax for the period are PC 6.00 million. The tax rate applicable to the entity is 22%.

IHL plans to raise funds through External Commercial Borrowings for the purpose of future expansion. The borrowings would be USD-denominated with a floating interest rate payable on a quarterly basis. The tenor of such borrowings is expected to be 3 to 5 years. The lenders have recommended that the Company should also consider doing a 'back-to-back' Cross Currency Interest Rate Swap (CCIRS) on the same date, amount and tenor as the borrowings, which would ensure that the foreign currency and interest rate exposure is managed. The management wants to apply cash flow hedge accounting.

IHL had presented certain material debtors and creditors on a net basis in its financial statements for periods upto 31st March, 2020. However, while preparing draft financial statements for the year ended 31st March, 2021, management discovers that these assets and liabilities cannot be netted off as per the applicable guidance under IFRS. Therefore, management intends to gross up the comparative amounts for the prior period in order to present the correct amount of debtors and creditors.

Questions:

1.1 With respect to acquisition of Super Express Limited, what is the amount of goodwill, if non-controlling interest is measured at fair value?

(A) PC 1.63 million

(B) PC 0.65 million

(C) PC 0.35 million

(D) PC 2.63 million. ***(2 Marks)***

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1.2 With respect to acquisition of Super Express Limited, what is the amount of goodwill if non-controlling interest is measured at proportionate share of net identifiable assets?

(A) PC 1.63 million

(B) PC 0.65 million

(C) PC 0.35 million

(D) PC 2.63 million. ***(2 Marks)***

1.3 Calculate the basic EPS and diluted EPS of IHL for the financial year ended 31st March, 2021.

(A) Basic EPS is PC 6.01 per share and diluted EPS is PC 5.88 per share

(B) Bais EPS is PC 6.02 per share and diluted EPS is PC 5.89 per share

(C) Basic EPS is PC 6.00 per share and diluted EPS is PC 5.89 per share

(D) Basic EPS is PC 6.00 per share and diluted EPS is PC 6.02 per share. ***(2 Marks)***

1.4 Which of the following statements is incorrect if the Company needs to achieve an effective cash flow hedge in the books of account?

(A) The CCIRS must be fair valued at each period end

(B) Cash flow hedge effectiveness testing must be performed at each period end

(C) The CCIRS should not be separated from the ECB loan but accounted as a single instrument

(D) ECB loans must be re-measured at each period end for foreign currency translation.

(2 Marks)

1.5 What is the consequence of grossing up of material debtors and creditors in the comparative amounts presented in the financial statements for the year ended 31st March, 2021?

(A) This is considered to be correction of an error under IAS 8 and the Company would need to present a third statement of financial position as at 1st April, 2019

(B) This is not an error under IAS 8 but the reclassifications must be disclosed in the notes to accounts in the financial statements as at 31st March, 2021

(C) This is a change in accounting policy under IAS 8 with retrospective change to be presented from 1st April, 2020

(D) This is considered to be correction of an error under IAS 8 and IHL would need to present a third statement of financial position as at 1st April, 2020. ***(2 Marks)***

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1.6 Analysis whether IHL has acquired a business with respect to acquisition of cottages and shopping complex. Present your arguments whether IHL could elect to apply the business concentration test. ***(6 Marks)***

1.7 Explain with appropriate references whether IHL is required to value the inventories of Super Express Limited and Very Relevant Limited using the weighted average cost formula in preparing its consolidated financial statements. ***(5 Marks)***

1.8 With respect to acquisition of Very Relevant Limited, determine the value of gain on bargain purchases as per:

(a) Fair value method

(b) Proportionate share method ***(4 Marks)***

Answer to Case Study 1

1.1 Option (A) : PC 1.63 million

1.2 Option (B) : PC 0.65 million

1.3 Option (C) : Basic EPS is PC 6.00 per share and diluted EPS is PC 5.89 per share

1.4 Option (C) : The CCIRS should not be separated from the ECB loan but accounted as a single instrument

1.5 Option (A) : This is considered to be correction of an error under IAS 8 and the company would need to present a third statement of financial position as at 1st April, 2019

1.6 IHL elects to apply the optional concentration test set out in paragraph B7B of IFRS 3 "Business Combinations" and concludes that the fully furnished residential cottages and the shopping complex differ significantly in the risks associated with operating the assets, obtaining tenants and managing tenants. In particular, the scale of operations and risks associated with the two classes of tenants are significantly different. Consequently, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets, because the fair value of the shopping complex is similar to the aggregate fair value of the 15 fully furnished residential cottages. Thus, IHL assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8 – B12D.

The set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, IHL applies the criteria in paragraph B12C to determine whether any processes acquired are substantive.

IHL concludes that the criterion in paragraph B12C(a) is not met because:

(a) the set does not include an organised workforce; and

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(b) IHL considers that the processes performed by the outsourced cleaning, security and maintenance personnel (the only processes acquired) are ancillary or minor within the context of all the processes required to create outputs (see paragraph B12D(c)) and, therefore, are not critical to the ability to continue producing outputs.

After considering the only processes acquired, those performed by the outsourced cleaning, security and maintenance personnel, IHL also concludes that the criteria in paragraph B12C(b) are not met. Either of the following reasons justifies that conclusion:

(a) the processes do not significantly contribute to the ability to continue producing outputs.

(b) the processes are readily accessible in the marketplace. Thus, they are not unique or scarce. In addition, they could be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

Since none of the criteria in paragraph B12C is met, IHL concludes that the acquired set of activities and assets is not a business.

1.7 Paragraph 19 of IFRS 10 "Consolidated Financial Statements" states that a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

Paragraph B87 of IFRS 10 states that if a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

It may be noted that the above-mentioned paragraphs require an entity to apply uniform accounting policies "for like transactions and events in similar circumstances". If any member of the group follows a different accounting policy for like transactions and events in similar circumstances, appropriate adjustments are to be made in preparing consolidated financial statements.

Paragraph 5 of IAS 8 defines accounting policies as "the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements."

IAS 2 requires inventories to be measured at the lower of cost and net realisable value.

Paragraph 25 of IAS 2 states that the cost of inventories shall be assigned by using FIFO or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

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Elaborating on the requirements of paragraph 25, paragraph 26 of IAS 2 illustrates that inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

Paragraph 36(a) of IAS 2 requires disclosure of "the accounting policies adopted in measuring inventories, including the cost formula used". Thus, as per IAS 2, the cost formula applied in valuing inventories is also an accounting policy.

As mentioned earlier, as per IAS 2, different cost formulas may be justified for inventories of a different nature or use. Thus, if inventories of Super Express Limited and Very Relevant Limited differ in nature or use from inventories of Innovative Harmony Limited, then use of cost formula (FIFO) different from that applied in respect of inventories of Innovative Harmony Limited (weighted average cost) in consolidated financial statements may be justified. In other words, in such a case, no adjustment needs to be made to align the cost formula applied by subsidiaries Super Express Limited and Very Relevant Limited to cost formula applied by holding company ie. Innovative Harmony Limited.

1.8 (a) Fair value method

	PC in million
Fair value of consideration transferred	0.80
Fair value of non-controlling interest	0.20
	1.00
Value of Very Relevant Limited's identifiable net assets as per IFRS 3	(1.10)
Gain on bargain purchase	0.10

(b) Proportionate share method

Proportionate share method	**PC in million**
Fair value of consideration transferred	0.80
Proportional share of non-controlling interest in the net identifiable assets of acquiree (1.10 x 25%)	0.275
	1.075
Value of subsidiary's identifiable net assets as per IFRS 3	(1.10)
Gain on bargain purchase	0.025

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Case Study-2

Sigma Limited is engaged in manufacture of cold beverages. The promoters of the Company are very optimistic about this business and have expanded the sale of beverages across India, Africa and Europe. The Board of Directors of the Company has also decided to get the Company listed on one of the European stock exchanges. Additionally, the management is in talks with the companies in the Middle East in order to acquire a controlling stake. The Company is already preparing its financial statements under IFRS.

Sigma Limited has two major plants - one in Bikaner, India and the other outside of Berlin. In 2015, the property prices had fallen significantly, and the Company had purchased land adjoining the Berlin plant. Management has been debating on the use of the land i.e., whether to build an additional plant or to lease it out but has not yet decided as yet. The purchase price of the land was EUR 2,50,000 as at 1st April, 2015. The real estate market is flourishing in Europe and the fair value of the land was EUR 6,00,000 as on 31st March, 2020. The EUR : INR exchange rate was 1:75 as on 1st April, 2015 and 1:95 as on 31st March, 2020. The Company believes that the cost approach would be most appropriate so that frequent remeasurement of the property value is not required.

The Bikaner plant has Machinery Alpha, which is used for the purpose of bottling. The life of this machine is 10 years. The sealing of bottle caps is done by Machinery Beta. Machinery Alpha can individually have an output and can also be sold independently in the open market. However, Machinery Beta, cannot be sold in isolation and without clubbing with Machinery Alpha. Sigma Limited considers this group of assets as a Cash Generating Unit (CGU) and an inventory amounting to ₹ 2 lakh is also allocated to this CGU. Earlier, the Company had completed an acquisition and the goodwill resulting from the acquisition amounted to ₹ 100 lakh. Out of this goodwill, ₹ 15 lakh has been allocated to the CGU.

Machinery Alpha was purchased on 1st April, 2015 for ₹ 90 lakh and residual value is ₹ 5 lakh. Machinery Beta was purchased on 1st April, 2016 for ₹ 50 lakh with no residual value. The life of the Machinery Beta is 10 years. The inventory has been recognised and valued in accordance with the respective accounting standards. The recoverable value of Cash Generating Unit is ₹ 81 lakh as at 31st March, 2019.

The Company has estimated the following cash flows as at 31st March, 2019 in the next 5 years pertaining to Machinery Alpha. The incremental borrowing rate of the Company is 10%.

Year	***Cash Flows (₹)***
1	*15,00,000*
2	*10,00,000*
3	*10,00,000*

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4	*15,00,000*
5	*10,00,000 (excluding RV)*
Total	***60,00,000***

Professional valuers have estimated that the current market value of Machinery Alpha is ₹ 60 lakh. There is a need to dismantle the machinery before delivering it to buyer. Dismantling costs of ₹ 5 lakh would need to be paid by the Company. Specialised packaging cost would be ₹ 2 lakh and legal fees to be incurred will be ₹ 2 lakh. The recoverable value of Machinery Alpha is ₹ 48 lakh as at 31st March, 2020.

Additional information

The Company purchased a machine "Hi-Tech" for packaging purposes but the management has changed its intention of use of this machine and decided to rent out the machinery. The life of this machinery is 8 years. The Company has changed the method of depreciation on this machinery from SLM to WDV method in the 3rd year of acquisition. The accountant is unsure about the accounting treatment arising from this change.

At a recent meeting, the Board of Directors has discussed legal cases which two customers A and B have filed against the Company in respect of the supply of products which were allegedly faulty which the Company supplied in the last three months of the financial year. The management has estimated that if the actions succeed, the Company is likely to have to pay out ₹ 20 lakh in damages to customer A and ₹ 18 lakh in damages to customer B. The legal advisers of the Company have reliably estimated that there is a 60% chance that customer A's claim will be successful and a 75% chance that customer B's claim will not be successful. For such claims, the Company has insurance in place to cover against claims. It is highly probable that any claims of customer which were successful would be covered under this policy. Therefore, the management believes that if any liability will arise then the claim will be recovered from the insurance company.

On 1st April, 2018, the Company had granted its CEO an option to take 900 shares or cash amount equivalent to 750 shares. The minimum service requirement is 2 years. There is a condition to hold the shares for a period of three years if shares are opted. The CEO exercises his cash option as on 31st March, 2020.

Particulars	***₹ per share***
Fair value of share alternative (with restrictions)	*210*
Grant date fair value on 1st April, 2018	*211*
Fair value as on 31st March, 2019	*220*
Fair value as on 31st March, 2020	*232*

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Questions:

2.1 For the purpose of recognition, measurement and presentation, what is the appropriate classification of land adjoining the Berlin plant?

(A) The land will be classified as Property, Plant and Equipment

(B) The land will be classified as Investment Property

(C) The land will be classified as Long term Investments

(D) The classification will depend on the use and intention of the management.

(2 Marks)

2.2 How should the Company reflect in its financial statements the legal claims pursued by customer A and Customer B?

(A) Provision for legal claims amounting to ₹ 38 lakh needs to be recognised in financial statements

(B) Provision for legal claims amounting ₹ 20 lakh needs to be disclosed in financial statements

(C) Provision for legal claims amounting to ₹ 38 lakh needs to be disclosed in the financial statements

(D) Provision for legal claims amounting to ₹ 20 lakh needs to be recognised and ₹ 18 lakh needs to be disclosed in the financial statements. ***(2 Marks)***

2.3 What will be the classification of the "Hi-tech" machinery acquired by Sigma Limited?

(A) This will be classified as Property, Plant and Equipment

(B) This will be classified as Investment Property

(C) This will be classified as Long-term Investment

(D) The classification will depend on the use and intention of the management.

(2 Marks)

2.4 The change in depreciation method from Straight-line to written down value method on "Hi-tech" in the 3rd year will be treated as:

(A) Retrospectively, as a change in accounting policy

(B) Prospectively, as a change in accounting estimate

(C) Retrospectively, as correction of an error

(D) Prospectively, as correction of an error. ***(2 Marks)***

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2.5 With respect to the option granted to its CEO, the ESOP expense recognised in the Company's profit and loss for each year was:

(A) ₹ 97,875 for the year ended 31st March, 2019 and ₹ 1,06,875 for the year ended 31st March, 2020

(B) ₹ 1,02,375 for the year ended 31st March, 2019 and ₹ 1,06,875 for the year ended 31st March, 2020

(C) ₹ 94,500 for the year ended 31st March, 2019 and ₹ 79,125 for the year ended 31st March, 2020

(D) ₹ 79,125 for the year ended 31st March, 2019 and ₹ 94,500 for the year ended 31st March, 2020. ***(2 Marks)***

2.6 The CFO has asked you to explain the concept of Cash Generating Unit and compute the following with all the relevant working notes:

(A) Impairment loss on CGU for the year ending 31st March, 2019

(B) Carrying value of each asset of CGU post impairment charge for the year ending 31st March, 2019 and 31st March, 2020. ***(10 Marks)***

2.7 You are required to draft a note for the accounting treatment for provision for legal claims in case of Customer A and Customer B with relevant principles from IFRS. For future reference, the CFO has also asked you to clarify how provisions are treated differently from contingent liabilities. ***(5 Marks)***

Answer to Case Study 2

2.1 Option (B) : The land will be classified as Investment Property

2.2 Option (D) : Provision for legal claims amounting to ₹ 20 lakh needs to be recognised and ₹ 18 lakh needs to be disclosed in the financial statements

2.3 Option (A) : This will be classified as Property, Plant and Equipment

2.4 Option (B) : Prospectively, as a change in accounting estimate

2.5 Option (A) : ₹ 97,875 for the year ended 31st March, 2019 and ₹ 1,06,875 for the year ended 31st March, 2020

2.6 **Concept of cash generating unit;**

A *cash-generating unit* is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

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If there is any indication that an asset may be impaired and it is not possible to estimate the recoverable amount of the individual asset, an entity is required to determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit)

(A) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss as on 31st March, 2019

(i) Calculation of carrying value of Machinery Alpha and Beta before impairment

Machinery Alpha		
Cost as on 1st April, 2015	(A)	₹ 90,00,000
Residual value		₹ 5,00,000
Useful life		10 years
Useful life already elapsed		4 years
Yearly depreciation [(90,00,000 – 5,00,000) /10]	(B)	₹ 8,50,000
WDV as at 31st March, 2019 [A- (B x 4)]		₹ 56,00,000
Machinery Beta		
Cost as on 1st April, 2016	(C)	₹ 50,00,000
Residual value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation [50,00,000 /10]	(D)	₹ 5,00,000
WDV as at 31st March, 2019	[C- (D x 3)]	₹ 35,00,000

(ii) Calculation of Value-in-use of Machinery Alpha as on 31st March, 2019

Period	Cash Flows (₹)	PVF	PV
1	15,00,000	0.909	13,63,500
2	10,00,000	0.826	8,26,000
3	10,00,000	0.751	7,51,000
4	15,00,000	0.683	10,24,500
5	10,00,000	0.621	6,21,000
5	5,00,000	0.621	3,10,500
Value in use	60,00,000		48,96,500

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(iii) Calculation of Fair Value less cost of disposal of Machinery Alpha as on 31st March, 2019

	₹
Fair Value	60,00,000
Less: Dismantling cost	(5,00,000)
Packaging cost	(2,00,000)
Legal Fees	(2,00,000)
Fair value less cost of disposal	51,00,000

(iv) Calculation of Impairment loss on Machinery Alpha as on 31st March, 2019

	₹
Carrying Value	56,00,000
Less: Recoverable Value ie higher of Value-in-use and Fair value less cost of disposal	51,00,000
Impairment Loss	5,00,000

(v) Calculation of Impairment loss of CGU as on 31st March, 2019

	₹
Carrying Value of CGU	1,08,00,000
Less: Recoverable Value of CGU	81,00,000
Impairment Loss	27,00,000

1. First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery Alpha and Beta.
2. After deduction of value of goodwill from total impairment loss of CGU of ₹ 27,00,000, remaining impairment loss would be ₹ 12,00,000. If we allocate remaining impairment loss to Machinery Alpha and Beta on pro-rata basis, it would come to ₹ 7,38,462 on Machinery Alpha. However, the impairment loss of Machinery Alpha cannot exceed ₹ 5,00,000 since its recoverable value is ₹ 51,00,000. Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery A	56,00,000	5,00,000	51,00,000
Machinery B	35,00,000	7,00,000*	28,00,000
Inventory	2,00,000	--	2,00,000

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Goodwill	15,00,000	15,00,000	-
Total	1,08,00,000	27,00,000	81,00,000

* Balancing figure.

(B) Calculation of carrying value of each asset of CGU as on 31st March, 2020

(i) Carrying value after adjustment of depreciation of 2019-2020 as on 31st March, 2020

	₹
Machinery Alpha [51,00,000 – {(51,00,000 – 5,00,000)/6}]	43,33,333
Machinery Beta [28,00,000 – (28,00,000/7)]	24,00,000
Inventory	2,00,000
Goodwill	-
Total	69,33,333

(ii) Calculation of carrying value of each asset of CGU post impairment charge as on 31st March, 2020

As per the question, recoverable value of Machinery Alpha has been given as ₹ 48,00,000. This implies that there is reversal of impairment charge of previous year for Machinery Alpha.

Further, impaired goodwill cannot be reversed. The individual assets cannot be increased above the lower of Recoverable Value or Carrying Value as if the assets were never impaired.

Accordingly, first of all we have to find out the carrying value as on 31st March, 2020 assuming that the impairment loss had never incurred, which will be as follows:

	Carrying Value (CV) without impairment loss	Recoverable Value	Final CV as at 31st March, 2020
Machinery Alpha	(56,00,000 – 8,50,000) 47,50,000	48,00,000	47,50,000
Machinery Beta	(35,00,000 – 5,00,000) 30,00,000	Could not determine	Could not determine
Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-		
Total	79,50,000	Missing in the question	Could not determine

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Hence, the impairment loss for Machinery Alpha to be reversed will be limited to ₹ 4,16,667 only (₹ 47,50,000 – ₹ 43,33,333).

Note:

Since, recoverable value of CGU as on 31st March, 2020 is missing in the question, the value of Machinery Beta and CGU post impairment charge as on 31st March, 2020 could not be calculated. Only carrying value of Machinery Alpha has been computed.

For this question 2.6, scenario is given at page 8 and page 9. In second sentence of 3rd paragraph of page 8, it is mentioned that useful life of Machinery Alpha is 10 years. Later in 4th para of page 8, it is mentioned that Machinery Alpha was purchased on 1st April, 2015 and in 5th para it is stated that on 31st March, 2019, the company estimated the future cashflows of next 5 years pertaining to Machinery Alpha.

According to these facts, 1st April, 2015 to 31st March, 2019 is 4 years. Estimated future cashflows are given for 5 years. So, in total it comes to (4 + 5) 9 years. However, the useful life of the Machinery Alpha is 10 years.

Hence, the data given for number of years post purchase plus value in use for the remaining years does not match with the remaining useful life of Machinery Alpha.

The above solution has been prepared strictly based on the facts given in the solution.

However, on account of the difference in the data given, there is possibility of two more alternate solutions based on following assumptions:

(i) Useful life of Machinery Alpha is 9 years instead of 10 years.

(ii) Date of purchase of Machinery Alpha is 1st April, 2014 instead of 1st April, 2015.

<u>When useful life of Machinery Alpha is 9 years instead of 10 years</u>

(A) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss as on 31st March, 2019

(i) Calculation of carrying value of Machinery Alpha and Beta before impairment

Machinery Alpha		
Cost as on 1st April, 2015	(A)	₹ 90,00,000
Residual value		₹ 5,00,000
Useful life		9 years
Useful life already elapsed		4 years
Yearly depreciation [(90,00,000 – 5,00,000) /9]	(B)	₹ 9,44,444

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WDV as at 31st March, 2019	[A- (B x 4)]	₹ 52,22,224
Machinery Beta		
Cost as on 1st April, 2016	(C)	₹ 50,00,000
Residual value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation [50,00,000 /10]	(D)	₹ 5,00,000
WDV as at 31st March, 2019	[C- (D x 3)]	₹ 35,00,000

(ii) Calculation of Value-in-use of Machinery Alpha as on 31st March, 2019

Period	Cash Flows (₹)	PVF	PV
1	15,00,000	0.909	13,63,500
2	10,00,000	0.826	8,26,000
3	10,00,000	0.751	7,51,000
4	15,00,000	0.683	10,24,500
5	10,00,000	0.621	6,21,000
5	5,00,000	0.621	3,10,500
Value in use	60,00,000		48,96,500

(iii) Calculation of Fair Value less cost of disposal of Machinery Alpha as on 31st March, 2019

	₹
Fair Value	60,00,000
Less: Dismantling cost	(5,00,000)
Packaging cost	(2,00,000)
Legal Fees	(2,00,000)
Fair value less cost of disposal	51,00,000

(iv) Calculation of Impairment loss on Machinery Alpha as on 31st March, 2019

	₹
Carrying Value	52,22,224
Less: Recoverable Value ie higher of Value-in-use and Fair value less cost of disposal	51,00,000
Impairment Loss	1,22,224

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(v) Calculation of Impairment loss of CGU as on 31st March, 2019

	₹
Carrying Value of CGU	1,04,22,222
Less: Recoverable Value of CGU	81,00,000
Impairment Loss	23,22,222

1. First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery Alpha and Beta.
2. After deduction of value of goodwill from total impairment loss of CGU of ₹ 23,22,222, remaining impairment loss would be ₹ 8,22,222. If we allocate remaining impairment loss to Machinery Alpha and Beta on pro-rata basis, it would come to ₹ 4,92,286 on Machinery Alpha. However, the impairment loss of Machinery Alpha cannot exceed ₹ 1,22,224 since its recoverable value is ₹ 51,00,000. Hence, impairment loss to CGU will be allocated as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery Alpha	52,22,224	1,22,224	51,00,000
Machinery Beta	35,00,000	7,00,000*	28,00,000
Inventory	2,00,000	--	2,00,000
Goodwill	15,00,000	15,00,000	-
Total	1,04,22,224	23,22,224	81,00,000

* Balancing figure.

(B) Calculation of carrying value of each asset of CGU as on 31st March, 2020

(i) Carrying value <u>after adjustment of depreciation</u> of 2019-2020 as on 31st March, 2020

	₹
Machinery Alpha [51,00,000 – {(51,00,000 – 5,00,000)/5}]	41,80,000
Machinery Beta [28,00,000 – (28,00,000/7)]	24,00,000
Inventory	2,00,000
Goodwill	-
Total	67,80,000

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(ii) Calculation of carrying value of each asset of CGU post impairment charge as on 31st March, 2020

> **Note:**
>
> Since, recoverable value of CGU as on 31st March, 2020 is missing in the question, the value of Machinery Beta and CGU post impairment charge as on 31st March, 2020 could not be calculated. Only carrying value of Machinery Alpha has been computed.

As per the question, recoverable value of Machinery Alpha has been given as ₹ 48,00,000. This implies that there is reversal of impairment charge of previous year for Machinery Alpha.

Further, impaired goodwill cannot be reversed. The individual assets cannot be increased above the lower of Recoverable Value or Carrying Value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March, 2020 assuming that the impairment loss had never incurred, will be:

	Carrying Value (CV) without impairment loss	Recoverable Value	Final CV as at 31st March, 2020
Machinery Alpha	(52,22,224 – 9,44,444) 42,77,780	48,00,000	42,77,780
Machinery Beta	(35,00,000 – 5,00,000) 30,00,000	Could not determine	Could not determine
Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-		
Total	74,77,780	Missing in the question	Could not determine

Hence, the impairment loss for Machinery Alpha to be reversed will be limited to ₹ 97,780 only (₹ 42,77,780 – ₹ 41,80,000).

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When date of purchase of Machinery Alpha is considered as 1st April, 2014 instead of 1st April, 2015.

(A) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss as on 31st March, 2019

(i) Calculation of carrying value of Machinery Alpha and Beta before impairment

Machinery Alpha		
Cost as on 1st April, 2014	(A)	₹ 90,00,000
Residual value		₹ 5,00,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation [(90,00,000 – 5,00,000) /10]	(B)	₹ 8,50,000
WDV as at 31st March, 2019	[A- (B x 5)]	₹ 47,50,000
Machinery Beta		
Cost as on 1st April, 2016	(C)	₹ 50,00,000
Residual value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation [50,00,000 /10]	(D)	₹ 5,00,000
WDV as at 31st March, 2019	[C- (D x 3)]	₹ 35,00,000

(ii) Calculation of Value-in-use of Machinery Alpha as on 31st March, 2019

Period	Cash Flows (₹)	PVF	PV
1	15,00,000	0.909	13,63,500
2	10,00,000	0.826	8,26,000
3	10,00,000	0.751	7,51,000
4	15,00,000	0.683	10,24,500
5	10,00,000	0.621	6,21,000
	5,00,000	0.621	3,10,500
Value in use	60,00,000		48,96,500

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(iii) Calculation of Fair Value less cost of disposal of Machinery Alpha as on 31st March, 2019

	₹
Fair Value	60,00,000
Less: Dismantling cost	(5,00,000)
Packaging cost	(2,00,000)
Legal Fees	(2,00,000)
Fair value less cost of disposal	51,00,000

(iv) Calculation of Impairment loss on Machinery Alpha as on 31st March, 2019

	₹
Carrying Value	47,50,000
Less: Recoverable Value ie higher of Value-in-use and Fair value less cost of disposal	51,00,000
Impairment Loss	Nil

(v) Calculation of Impairment loss of CGU as on 31st March, 2019

	₹
Carrying Value of CGU (47,50,000 + 35,00,000 + 15,00,000 + 2,00,000)	99,50,000
Less: Recoverable Value of CGU	81,00,000
Impairment Loss	18,50,000

1. First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery Alpha and Beta.
2. After deduction of value of goodwill from total impairment loss of CGU of ₹ 18,50,000, remaining impairment loss would be ₹ 3,50,000. However, no impairment loss can be allocated to Machinery Alpha since its recoverable value is ₹ 51,00,000 ie more than its carrying value. Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery Alpha	47,50,000		47,50,000
Machinery Beta	35,00,000	3,50,000*	31,50,000

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Inventory	2,00,000	--	2,00,000
Goodwill	15,00,000	15,00,000	-
Total	99,50,000	18,50,000	81,00,000

* Balancing figure.

(B) Calculation of carrying value of each asset of CGU as on 31st March, 2020

(i) Carrying value after adjustment of depreciation of 2019-2020 as on 31st March, 2020

	₹
Machinery Alpha [47,50,000 – 8,50,000]	39,00,000
Machinery Beta [31,50,000 – (31,50,000/7)]	27,00,000
Inventory	2,00,000
Goodwill	-
Total	68,00,000

(ii) Calculation of carrying value of each asset of CGU post impairment charge as on 31st March, 2020

Note:

Since, recoverable value of CGU as on 31st March, 2020 is missing in the question, the value of Machinery Beta and CGU post impairment charge as on 31st March, 2020 have not been computed. Only carrying value of Machinery Alpha has been computed.

As per the question, recoverable value of Machinery Alpha has been given as ₹ 48,00,000. This implies that there is no impairment loss in the year ended 31st March, 2020 as well.

Further, impaired goodwill cannot be reversed. The individual assets cannot be increased by lower of recoverable value or Carrying Value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March, 2020 assuming that the impairment loss had never incurred, will be:

	Carrying Value (CV) without impairment loss	Recoverable Value	Final CV as at 31st March, 2020
Machinery Alpha	(47,50,000 – 8,50,000) 39,00,000	48,00,000	39,00,000

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Machinery Beta	(35,00,000 – 5,00,000) 30,00,000	Could not determine	Could not determine
Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-		
Total	71,00,000	Missing in the question	Could not determine

Hence, the carrying value of Machinery Alpha as on 31st March, 2020 would be ₹ 39,00,000.

2.7 Features of Provisions:

Provisions are **liability of uncertain timing or amount and** recognised when **all** the following conditions are satisfied i.e.

(a) there should be present obligation arising out of past events;

(b) the outflow should be probable; and

(c) a reliable estimate can be made.

Difference between 'Provisions' and 'Contingent Liabilities':

Contingent liabilities are possible obligation the outcome of which will be depending upon the happening or non-happening of future events which is not within the control of the entity or contingent liabilities are present obligation where either outflow is not probable or reliable estimate cannot be made. At the same time 'Provisions' are also present obligation but outflow is probable and reliable estimate can be made. Hence, contingent liabilities are those present obligation which cannot be recognised as a provision because either outflow is not probable or reliable estimate cannot be made.

Contingent liabilities are required to be disclosed in the notes to accounts whereas Provisions are recognised in the financial statements shown under 'Current / Non-current liability' (as the case may be).

Applicability of provision to the given case:

Conditions	Customer A	Customer B
Present obligation arising out of past events	Yes	Yes
Outflow should be probable	Yes, it is probable	Not probable, it is possible
Reliable estimate can be made	Yes, ₹ 20 lakh	Yes, ₹ 18 lakh

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In case of legal claim raised by Customer A, all the conditions for provision are met and hence provision is required whereas in case of B, all the conditions are not met, and hence contingent liability needs to be disclosed

With respect to accounting treatment for provisions for legal claims in case of Customer A and Customer B, Sigma Ltd. should give following Note:

"Two Customers A and B have filed legal cases against the Company in respect of supply of faulty products for ₹ 20 lakh and ₹ 18 lakh respectively. The legal advisors of the company have reliably estimated that in case of Customer A, company has 60% chance to lose the case. Hence applying most likely outcome basis, ₹ 20 lakh has been provided for. However, at the same time, it is pertinent to note that, the entity has insurance in place to cover against such claims."

However, for Customer B, the legal advisors have reliably estimated that the entity has 75% chance to win the case. Applying most likely outcome basis, nothing has been provided for since it is more likely that possibility of outflow of resources will not take place. Despite a contingent liability of ₹ 18 lakh has been disclosed in the notes." Here also the entity has insurance in place to cover against such claims.

Case Study - 3

H Limited is engaged in trading of kitchenware products, with distributorship of various branded products. The Company has a strong dealership network and has decided to take warehouses on lease basis. While exploring the options for leased premises, the management found certain properties in Northern and Western India that were available on distress sale. For these locations, the management analyses that the best option was to buy the property instead of obtaining it on a lease.

Accordingly, H Limited purchased a warehouse in Northern India for ₹ 50 lakh as on 1st June, 2017. Further, the Company incurs stamp duty charges of ₹ 5 lakh and court fee for ₹ 2 lakh on registration of title of the property in the name of the Company. H Limited had to incur major renovation expenses of ₹ 20 lakh to ensure that the warehouse is ready for use i.e., storage of high quality branded kitchenware. The renovation expenses were met by obtaining a bank loan as on 1st June, 2017 at a fixed interest rate of 12% per annum. The warehouse is ready for intended use as on 1st April, 2018. The useful life of the renovated property is estimated to be 10 years.

H Limited also purchased a property in Western India for ₹ 70 lakh as at 1st July, 2017. The Company paid a consultancy fee of ₹ 2 lakh to a real estate expert for an opinion on whether the property can be acquired or not. Further, the Company incurred stamp duty charges of ₹ 7 lakh and court fee for ₹ 3 lakh on registration of title of the property in the name of the Company. The useful life of the renovated property is estimated to be 10 years.

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For the other locations, H Limited entered into lease agreement for 4 years as at 1st April, 2017 on the following terms:

- *Eastern India warehouse: Annual lease rent ₹ 10 lakh payable at the end of every year.*
- *Southern India warehouse: Annual rent of ₹ 15 lakh payable at the beginning of every year.*

The Company had applied IAS 17 for leases in the past. The financial controller of H Limited has ascertained that the transition date to the new leases standard IFRS 16 will be 1st April, 2018. However, due to the complexity of the new standard, she has sought assistance to determine its implications on the financial statements of the Company.

The Credit rating of H Limited rated by the credit agency is AA+. The Company is in discussion with a bank for a term loan for 4 years and 5 years and the bank has offered an interest rate of 10% and 12% respectively for the said term. As per the risk matrix, the bank charges such rates for borrowers with a credit rating of AA+. If the credit rating of the borrower is lower than AA+ then bank increases the interest rate by 100 basis points.

Although H Limited primarily trades in kitchenware, the Company has now decided to make a low-key entry into manufacturing, by launching a niche silicone product that seems to have become popular with home bakers. The development expenditure incurred during FY 2019-2020 totalled ₹ 3,50,000, of which ₹ 1,75,000 was incurred prior to 31st October, 2019, the date on which it became clear that the silicone product was technically viable. The new product will be launched shortly, and the recoverable amount is estimated at ₹ 1,40,000.

On 5th April, 2020, a fire broke out in H Limited's godown in Eastern India. The godown had been under lockdown due to the onset of COVID-19 pandemic and there were no staff present. The neighbouring villagers informed the Fire brigade almost three hours later by which time most of the inventory had been destroyed. The inventory was estimated at ₹ 20 lakh. The financial statements as at and for the year ended 31st March, 2020 are authorized for issue on 30th April, 2020.

Questions:

3.1 What is the deprecation charge of Northern India warehouse for financial year 2017-2018 and financial year 2018-2019 to be debited to Statement of Profit and Loss?

(A) The depreciation charge for both years financial year 2017-2018 and financial year 2018-2019 is ₹ 5,70,000

(B) The depreciation charge for financial year 2017-2018 is ₹ 4,75,000 and for financial year 2018-2019 is ₹ 5,70,000

(C) The depreciation charge for financial year 2017-2018 is Nil and financial year 2018-2019 is ₹ 7,90,000

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(D) The depreciation charge for financial year 2017-2018 is ₹ 6,58,333 and financial year 2018-2019 is ₹ 7,90,000. ***(2 Marks)***

3.2 What is the depreciation charge of Western India warehouse for financial year 2017-2018 and financial year 2018-2019 to be debited to Statement of Profit and loss?

(A) The depreciation charge for financial year 2017-2018 is ₹ 6,00,000 and for financial year 2018-2019 is ₹ 7,90,000

(B) The depreciation charge for financial year 2017-2018 ₹ 6,00,000 and for financial year 2018-2019 ₹ 8,00,000

(C) The depreciation charge for financial year 2017-2018 and for financial year 2018-2019 is ₹ 8,20,000

(D) The depreciation charge for financial year 2017-2018 is ₹ 6,15,000 and for financial year 2018-2019 is ₹ 8,20,000. ***(2 Marks)***

3.3 What is the discount rate relevant for application of new leases standard for the two warehouse properties taken on lease?

(A) The interest rate of 10% is taken as a discount rate

(B) The interest rate of 11% is taken as a discount

(C) The interest rate of 13% is taken as a discount

(D) The interest rate of 12% is taken as a discount rate. ***(2 Marks)***

3.4. In its financial statements for the year ended 31st March, 2020, how should H Limited recognize the development expenditure in relation to the silicone product?

(A) Recognise the expenditure of ₹ 1,75,000 in the profit and loss account

(B) Recognise the expenditure of ₹ 1,40,000 in the profit and loss account

(C) Recognise an intangible asset of ₹ 1,75,000

(D) Recognise an intangible asset of ₹ 1,40,000. ***(2 Marks)***

3.5 In its financial statements for the year 31st March, 2020, how should H Limited reflect the loss of inventory due to fire in the godown?

(A) Credit inventory by ₹ 20 lakh and debit loss of inventory in the Statement of Profit and Loss

(B) Disclose the loss of inventory in the notes to accounts

(C) Credit inventory by ₹ 20 lakh and debit loss of inventory in the Statement of Profit and Loss, with additional disclosures in the notes to accounts

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(D) Disclose of the loss of inventory as a footnote on the face of the Balance sheet.

(2 Marks)

3.6 In regard to the warehouse property taken on lease for Eastern and Southern India:

(A) Calculate the transition impact under the full retrospective approach at the date of transition and the comparative year. (2018-2019) ***(4 Marks)***

(B) Pass journal entries at the date of transition and the comparative year using the full retrospective approach. (2018-2019) ***(4 Marks)***

(C) Show the deferred tax impact on transition assuming rate tax rate of 20%. ***(3 Marks)***

3.7 For all warehouses used by H Limited, summarise the impact on specific P&L line items (excluding deferred tax) for the year ended 31st March, 2020. ***(4 Marks)***

Answer to Case Study 3

3.1 Option (C) : The depreciation charge for financial year 2017-2018 is Nil and for financial year 2018-2019 is ₹ 7,90,000

3.2 Option (B) : The depreciation charge for financial year 2017-2018 is ₹ 6,00,000 and for financial year 2018-2019 is ₹ 8,00,000

3.3 Option (A) : The interest rate of 10% is taken as a discount rate

3.4 Option (D) : Recognise an intangible asset of ₹ 1,40,000

3.5 Option (B) : Disclose the loss of inventory in the notes to accounts

3.6 (A) Full Retrospective Approach:

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1 April 2017 in this case) using the incremental borrowing rate at lease commencement date (i.e., 10% p.a.). The lease liability is accounted for by the interest method subsequently and the ROU asset is assumed to be depreciated on the straight-line basis over the lease term of 4 years.

I. Calculation of Lease Liability and ROU Asset of Eastern India warehouse (Annual lease rental paid at the end of every year)

Year	*Payments (Cash flows)*	*Present Value Factor @ 10%*	*Discounted Cash flows / Present Value*
31st March, 2018	10,00,000	0.909	9,09,000
31st March, 2019	10,00,000	0.826	8,26,000

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31st March, 2020	10,00,000	0.751	7,51,000
31st March, 2021	10,00,000	0.683	6,83,000
	40,00,000		31,69,000

Lease Liability Schedule of Eastern India warehouse:

Year	*Opening*	*Interest Expense @ 10%*	*Payments*	*Closing*
	a	*b = a x 10%*	*c*	*d = a+b-c*
31st March, 2018	31,69,000	3,16,900	(10,00,000)	24,85,900
31st March, 2019	24,85,900	2,48,590	(10,00,000)	17,34,490
31st March, 2020	17,34,490	1,73,449	(10,00,000)	9,07,939
31st March, 2021	9,07,939	92,061*	(10,00,000)	-

*Difference is due to approximation.

ROU Asset Schedule of Eastern India warehouse:

Year	*Opening*	*Depreciation*	*Closing*
31st March, 2018	31,69,000	(7,92,250)	23,76,750
31st March, 2019	23,76,750	(7,92,250)	15,84,500
31st March, 2020	15,84,500	(7,92,250)	7,92,250
31st March, 2021	7,92,250	(7,92,250)	-

Table showing account balances impacted under full retrospective method beginning at lease commencement in case of Eastern India warehouse:

Date	*ROU Asset*	*Lease Liability*	*Interest Expense*	*Depreciation Expense*	*Retained Earnings*
1st April, 2017	31,69,000	31,69,000	-	-	-
31st March, 2018	23,76,750	24,85,900	-	-	-
1st April, 2018	*23,76,750*	*24,85,900*			*(1,09,150)*
31st March, 2019	15,84,500	17,34,490	2,48,590	7,92,250	-
1st April, 2019	15,84,500	17,34,490	-	-	-
31st March, 2020	7,92,250	9,07,939	*1,73,449*	*7,92,250*	-
31st March, 2021	-	-	92,061	7,92,250	

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II. Calculation of Lease Liability and ROU Asset of Southern India warehouse (Annual lease rental paid at the beginning of every year)

Year	Payments (Cash flows)	Present Value Factor @ 10%	Discounted Cash flows / Present Value
31st March, 2018	15,00,000	1	15,00,000
31st March, 2019	15,00,000	0.909	13,63,500
31st March, 2020	15,00,000	0.826	12,39,000
31st March, 2021	15,00,000	0.751	11,26,500
	60,00,000		52,29,000

Lease Liability Schedule of Southern India warehouse:

Year	Opening	Payments	Interest Expense @ 10%	Closing
	a	b	c = (a-b) x 10%	d = a-b+c
31st March, 2018	52,29,000	(15,00,000)	3,72,900	41,01,900
31st March, 2019	41,01,900	(15,00,000)	2,60,190	28,62,090
31st March, 2020	28,62,090	(15,00,000)	1,37,910*	15,00,000
31st March, 2021	15,00,000	(15,00,000)	-	-

*Difference is due to approximation.

ROU Asset Schedule of Southern India warehouse:

Year	Opening	Depreciation	Closing
31st March, 2018	52,29,000	(13,07,250)	39,21,750
31st March, 2019	39,21,750	(13,07,250)	26,14,500
31st March, 2020	26,14,500	(13,07,250)	13,07,250
31st March, 2021	13,07,250	(13,07,250)	-

Table showing account balances impacted under full retrospective method beginning at lease commencement in case of Southern India warehouse:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
1st April, 2017	52,29,000	52,29,000	-	-	-
31st March, 2018	39,21,750	41,01,900	-	-	-

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1st April, 2018	*39,21,750*	*41,01,900*			*(1,80,150)*
31st March, 2019	26,14,500	28,62,090	2,60,190	13,07,250	
1st April, 2019	26,14,500	28,62,090			
31st March, 2020	13,07,250	15,00,000	1,37,910	13,07,250	
31st March, 2021	-	-	-		

(B) Journal entries on transition date i.e. 1st April, 2018

ROU Asset (23,76,750 + 39,21,750) Dr.	62,98,500	
Retained Earnings [(1,09,150 + 1,80,150) - 57,860] Dr.	2,31,440	
Deferred tax Asset (Refer point C below) Dr.	57,860	
To Lease Liability (24,85,900 + 41,01,900)		65,87,800
To initially recognise the lease-related asset and liability as on 1st April 2018 wrt both lease assets		

Journal entries for comparative year 2018-2019

Interest expense (2,48,590 + +2,60,190) Dr.	5,08,780	
To Lease Liability		5,08,780
To record interest expense and accrete the lease liability using the interest method		
Depreciation expense (7,92,250 + 13,07,250) Dr.	20,99,500	
To ROU Asset		20,99,500
To record depreciation expense on the ROU asset		
Lease Liability (10,00,000 + 15,00,000) Dr.	25,00,000	
To Cash		25,00,000
To record lease payment		

(C) A temporary difference effectively arises between the ROU Asset for accounting purposes and the amount of lease liability, since the rent payment is eligible for tax deduction.

Tax base of the ROU Asset is nil as the amount is not eligible for deduction for tax purposes.

Tax base of the lease liability is nil as it is measured at carrying amount less any future tax deductible amount.

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Recognition of deferred tax on the date of transition:

Carrying amount in balance sheet

RoU Asset	₹ 62,98,500
Lease Liability	₹ 65,87,800
Net Amount	₹ 2,89,300
Tax Base	₹ Nil
Temporary Difference (deductible)	₹ 2,89,300
Deferred Tax asset to be recognized (2,89,300 x 20%)	₹ 57,860

3.7 Impact on specific Profit and Loss line item for the year ended 31st March, 2020

	Northern India warehouse	Western India warehouse	Eastern India warehouse	Southern India warehouse	Total
Finance cost on PPE (20,00,000 x 12%)	2,40,000*	-			2,40,000
Finance cost on lease liability			1,73,449	1,37,910	3,11,359
Depreciation expenses on PPE	7,90,000	8,00,000			15,90,000
Depreciation expenses on ROU Assets			7,92,250	13,07,250	20,99,500

Assumption:

*It is assumed that loan to meet renovation expenses for Northern India warehouse is still appearing in the books with full amount.

Case Study - 4

S Limited is engaged in the manufacturing of customised heavy-duty equipment and allied products. The Company is already listed on the London Stock Exchange (LSE) and plans to expand into automotive industry, with a particular focus on electric vehicles. To fund the expansion, the CFO and his team are evaluating several financing options. After detailed discussions with the Board of Directors, S Limited decides to issue bonds with a conversion option in order to maintain its debt-equity ratio. Accordingly, on 1st April, 2020, the Company

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issued 20,000 convertible bonds at par. The bonds are redeemable five years later at a par value of ₹ 700 per bond, which is the nominal value. The bonds pay interest annually in advance at an interest rate of 6%. At the option of the holder, each bond can be converted at the maturity date into 40 shares of ₹ 1 each. The market rate for five years bond with no right of conversion is 10%.

Out of above proceeds, on 1st April, 2020 the Company acquired a land in Mewat, a backward area in the state of Haryana, to set up a manufacturing plant for electric vehicles. S Limited paid ₹ 50,00,000 for the land and ₹ 5,00,000 for stamp duty and legal fees. The Architect fees and site preparation fees were ₹ 3,50,000 and ₹ 2,00,000 respectively. On 1st June, 2020, Company started constructing the plant and incurs the below mentioned costs for the year ended 31st March, 2021. In the opinion of the management, the construction will take at least 2 years to be completed.

Material	*₹ 15,00,000*
Direct Labour costs	*₹ 5,00,000*
General Overheads	*₹ 2,00,000*

In order to be environment friendly, the Company establishes solar panels worth ₹ 10,00,000 to supply solar electricity to its manufacturing plant. The solar panels have a useful life of 10 years. The government promotes and encourages industries to use sustainable and renewable energy by giving subsidies to such companies. Accordingly, S Limited received a government subsidy of ₹ 4,00,000 upon installing the solar panels. S Limited has organized an inauguration ceremony on the opening of its manufacturing plant. The Company has invited various ministers, government officials and industrialists. The total cost of ₹ 6,00,000 was incurred on inauguration ceremony.

Balance proceeds were used to acquire a building in Gurgaon for business purposes, however it has been recently determined that the building could be converted into a shopping mall. The building's market value would be higher if converted into shopping mall.

As part of staff welfare measures, the Company has contracted to lend to its employees sums of money at 6% per annum rate of interest. The loan amount is to be repaid in five equal instalments along with interest. The Company had lent ₹ 800,000 to its employees on 1st April, 2020. The market rate of interest is 10% per annum for comparable loans.

On 1st April, 2020, S Limited enters into a contract with Corp Limited to construct heavy-duty equipment for a promised consideration of ₹ 20,00,000 with a bonus of ₹ 2,50,000 if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with IFRS 15. At the inception of the contract, the Company expects the costs

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to be ₹ 11,00,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 2021, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with IFRS 15. However, on 4th June, 2021, the contract is modified with the result that the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract still remains a single performance obligation.

Questions:

4.1 How should S Limited account for 20,000 convertible bonds issued at par as on 1st April, 2020?

(A) The value of liability portion of convertible bonds as on 1st April, 2020 will be ₹ 1,40,00,000 and Equity portion will be Nil

(B) The value of liability portion of convertible bonds as on 1st April, 2020 will be ₹ 1,18,77,159 and Equity portion will be ₹ 21,22,841

(C) The value of liability portion of convertible bonds as on 1st April, 2020 will be ₹ 1,30,64,875 and Equity portion will be ₹ 9,35,125

(D) The value of liability portion of convertible bonds as on 1st April, 2020 will be ₹ 1,48,40,000 and Equity portion will be NIL. ***(2 Marks)***

4.2 What is the interest expense to be booked by S Limited on convertible bonds in year 4?

(A) ₹ 14,33,091

(B) ₹ 13,49,091

(C) ₹ 14,60,895

(D) ₹ 8,40,000. ***(2 Marks)***

4.3 What will be the carrying amount of the Mewat plant as on 31st March 2021?

(A) ₹ 80,50,000

(B) ₹ 92,72,448

(C) ₹ 94,72,488

(D) ₹ 92,72,488. ***(2 Marks)***

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4.4 The Mewat plant could not have been set up without the support of the ministers and government officials. The CFO of S Limited is of the view that cost incurred for the inauguration of the plant should be capitalized as part of its cost. What is your view?

(A) The CFO is incorrect, the cost incurred in inauguration of manufacturing plant should be charged to Statement of Profit and Loss

(B) The CFO is correct, the cost incurred in inauguration of manufacturing plant should be capitalised as cost of plant

(C) The CFO is correct, however the cost incurred in inauguration of manufacturing plant should be accounted separately by setting up a deferred expenditure account

(D) The CFO is incorrect, the cost of inauguration may be capitalised or charged to Statement of Profit and Loss applied consistently an accounting policy choice.

(2 Marks)

4.5 How should S Limited account for the government subsidy received on purchase of solar panels?

(A) By deducting from the cost of Solar panels; Cost of solar panels will be ₹ 6,00,000 and depreciation will be charged on ₹ 6,00,000 for 10 years

(B) By setting up a deferred income of ₹ 4,00,000; it will be amortized to P&L over a period of 10 years

(C) By recognizing an income of ₹ 4,00,000 immediately on receipt of subsidy

(D) Either (A) or (B). ***(2 Marks)***

4.6 The CFO of S Limited is unclear whether the fair value of building purchased in Gurgaon should be determined based on the market value under its current use or the building's potential market value if it was converted into a mall. The CFO has sought your opinion in determining the fair value of building. ***(2 Marks)***

4.7 How should S Limited account for the loans given to staff? Prepare the tabular computations necessary for initial recognition. Also determine the interest income to be recognised in each year as per the effective interest rate method. ***(4 Marks)***

4.8 The CFO of S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of IFRS 15. (for the year 2020-2021 and 2021-2022) ***(9 Marks)***

Answer to Case Study 4

4.1 No correct option (Correct answer will be the value of liability portion of convertible bonds as on 1st April, 2020 will be ₹ 1,21,95,960 and Equity portion will be ₹ 18,04,040)

4.2 No correct option (Correct answer will be ₹ 12,33,440)

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4.3 Option (A) : ₹ 80,50,000 (based on assumption 1)

Assumption 1: Proceeds received from issuance of convertible bonds is used only for acquisition of land and not for construction of whole Mewat plant project. Land is considered to be ready for use. Hence, it is not a qualifying asset. Accordingly, no borrowing cost incurred on acquisition of land should be capitalised.

No correct Option (based on assumption 2)

Assumption 2: Proceeds from convertible bonds are used for the whole Mewat Project. In such a situation, the borrowing cost to the extent of finance cost on unwinding of bond liability ie ₹ 11,35,596 [(₹ 1,21,95,960-8,40,000) x 10%] should be capitalised as borrowing cost to the cost of the Mewat plant project. Accordingly, the correct answer should be ₹ 91,85,596 (80,50,000 + 11,35,596).

4.4 Option (A) : The CFO is incorrect, the cost incurred in inauguration of manufacturing plant should be charged to Statement of Profit and Loss

4.5 Option (D) : Either (A) or (B)

4.6 As per IFRS 13, a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the building could be for a shopping mall. Its current use is not the highest best use as the building has the potential of being used for a shopping mall. Therefore, the fair value of the building is the price that would be received when sold to a market participant who is interested in developing a shopping mall.

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4.7 Method of accounting for the loans given to staff:

From the information given in the question, it is obvious that loan has been disbursed to the employees at concessional rate of 6%. In such a situation, disbursement of loans to employees will be recognised in the books at its present value computed on the basis of market rate of interest of 10% for comparable loans. Any excess loan proceed over present value thereof should be booked as prepaid staff cost, which should be amortised over the tenure of the loan.

Calculation of present value of the loan to its employees for initial recognition purpose

Year	Opening balance	Cash outflow		Closing balance	Total value of instalment	PV factor @10%	Present value
		Principal	Interest @ 6%				
	a	b	c=a x 6%	d=a-b	e=b+c		f=e x 10%
1st April, 2020	8,00,000			8,00,000			
31st March, 2021	8,00,000	1,60,000	48,000	6,40,000	2,08,000	0.909	1,89,072
31st March, 2022	6,40,000	1,60,000	38,400	4,80,000	1,98,400	0.826	1,63,878
31st March, 2023	4,80,000	1,60,000	28,800	3,20,000	1,88,800	0.751	1,41,789
31st March, 2024	3,20,000	1,60,000	19,200	1,60,000	1,79,200	0.683	1,22,394
31st March, 2025	1,60,000	1,60,000	9,600	-	1,69,600	0.621	1,05,322
Total at initial recognition							7,22,455

Calculation of interest income to be recognised each year and amortised cost of loan to employees

Year end	Amortised cost (opening balance)	Interest to be recognised @10%	Repayment (including interest)	Amortised cost (closing balance)
	a	b=ax10%	c	d=a+b-c
2021	7,22,455	72,246	2,08,000	5,86,701
2022	5,86,701	58,670	1,98,400	4,46,971
2023	4,46,971	44,697	1,88,800	3,02,868

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2024	3,02,868	30,287	1,79,200	1,53,955
2025	1,53,955	15,645*	1,69,600	-

*Difference of ₹ 249 (15,645 – 15,396) is due to approximation.

4.8 **<u>For the year 2020-2021</u>**

S Limited accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with IFRS 15. At the inception of the contract, S Limited expects the following:

Transaction price – ₹ 20,00,000

Expected costs – ₹ 11,00,000

Expected profit (45%) – ₹ 9,00,000

At contract inception, S Limited excludes ₹ 2,50,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the heavy-duty equipment is highly susceptible to factors outside the entity's influence.

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore ₹ 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 31st March, 2021, the following would be recognised:

Revenue (A) – ₹ 13,00,000 (₹ 20,00,000 x 65%)

Costs (B) – ₹ 7,15,000 (₹ 11,00,000 x 65%)

Gross profit (C) i.e. (A-B) – ₹ 5,85,000

<u>For the year 2021-2022</u>

On 4th June, 2021, the contract is modified. As a result, the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000, respectively.

The total potential consideration after the modification is ₹ 24,00,000 which is ₹ 21,50,000 fixed consideration + ₹ 2,50,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with IFRS 15. Therefore, the bonus of ₹ 2,50,000 can be included in the transaction price.

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S Limited also concludes that the contract remains a single performance obligation. Thus, S Limited accounts for the contract modification as if it were part of the original contract. Therefore, S Limited updates its estimates of costs and revenue as follows:

S Limited has satisfied 60.60% of its performance obligation (₹ 7,15,000 actual costs incurred compared to ₹ 11,80,000 total expected costs). The entity recognises additional revenue of ₹ 1,54,400 [(60.60% of ₹ 24,00,000) – ₹ 13,00,000 revenue recognised to date] at the date of modification i.e. on 4th June, 2021 as a cumulative catch-up adjustment.

Case Study-5

PQR Ltd. is a Company incorporated in India is following IFRS for preparation of its financial statements. The management of the Company is in the process of finalising its accounts for the year ended 31st March, 2019. The following is a summary of the draft Statement of Profit and Loss for the year ended 31st March, 2019:

Summarised Statement of Profit and Loss for the year ended 31st March, 2019 ₹ in lakh

Particulars		*2018-2019*	*2017-2018*
Revenue from operations		294	212
Other income		45	34
Total Revenue	***(A)***	**339**	**246**
Expenses			
Cost of materials consumed		91	67
Employee benefits		63	64
Finance costs		11	13
Depreciation and amortisation		38	37
Total expenses	***(B)***	**203**	**181**
Profit/ (loss) after taxes	***(A-B)***	**136**	**65**
Tax expenses		(38)	(18)
Profit/ (loss) after taxes		**98**	**47**
Other comprehensive income		25	20
Total comprehensive Income		**123**	**67**

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In the process of finalization, the following issues were discussed between the auditors and management:

(a) The company had appointed ABC Pvt. Ltd for carrying out job work on certain intermediate products. The amount invoiced by ABC Pvt. Ltd. for such work during the year was ₹ 350 lakh. To carry out the said job work, PQR Ltd has let out its premises to ABC Pvt. Ltd. for the whole year for which rentals of ₹ 5 lakh per month were agreed to be charged. The management contends that since the job work is carried out by ABC Pvt. Ltd. in the premises let out by the company itself, the disclosure of job work charges in the statement of profit and loss account can be on net basis.

(b) Details of Equity Share Capital (all shares are on pari-passu basis) of the company and its movement during the year is as under:

(i) Opening balance: 10 lakh shares @ ₹ 10 each

(ii) 50,000 shares issued and allotted on 1st October 2018 @ ₹ 25 each

(iii) 75,000 shares issued and allotted on 1st February 2019 @ ₹ 35 each the same are only paid up to the extend of 50% and the remaining amount is due on 1st May 2019.

(c) During financial year 2018-2019, PQR Ltd. has issued following financial instruments:

(i) Perpetual bonds (i.e., a bond that does not have a maturity date) that pays 5% interest each year.

(ii) Mandatorily redeemable preference shares with a fixed redemption amount (i.e., a share that will be redeemed by the entity at a future date)

(iii) Preference Shares redeemable at the option of the holder for a fixed amount of cash.

(iv) Written call option that allows the holder to purchase a fixed number of ordinary shares from the company for affixed amount of cash.

(d) Legal cases have been filed against the Company for following alleged infringements of law:

(i) Unauthorized use of a trademark where the amount of claim is ₹ 80 lakh

(ii) Non-payment of termination pay and gratuity to 50 employees who were terminated without giving any reason where the employees union is claiming ₹ 30 lakh

(iii) Unlawful environmental damage for dumping waste in the river near its factory; environmentalists are claiming unspecified damages as clean-up costs.

The legal counsel of the company is of the opinion that the legal cases are not tenable in law and has communicated this assessment of the three lawsuits:

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Lawsuit 1: *The chances of the company having to pay ₹ 80 lakh is remote*

Lawsuit 2: *It is probable that the company would have to pay the terminated employees, but the best estimate of the mount that would be payable if the plaintiff succeeds against the entity is ₹ 20 lakh*

Lawsuit 3: *There is no current law that would compel the entity to pay for such damages. there may be a case for constructive obligation, but the amount of damages cannot be estimated with any reliability.*

(e) PQR Ltd has made investment in a subsidiary, B Ltd., with the view to dispose of this investment within six months. The investment in the subsidiary has been classified as held for sale;

(f) PQR Ltd has carried out impairment testing for its financial and non-financial assets while finalizing accounts for the year ended 31st March, 2018. During the year ended 31st March 2019, the management believes that there is a case for reversal of such impairment losses as provided for in previous years.

(g) Copper is one of the main raw materials of PQR Ltd whose price is highly fluctuating. In order to hedge price fluctuations in the price of copper, PQR Ltd has entered into derivative contracts. The company does not want to classify the said derivatives as a cash flow hedge and instead wants to classify the same as fair value hedge.

As an expert on IFRS you are requested to give your opinion on the following:

Part A (select any 1 out of A, B, C, or D)

5.1 Regarding the contention of the management in (a) above, the correct treatment as per the applicable IFRS would be:

(A) Disclose Job work charges of ₹ 350 lakh and rent income of ₹ 60 lakh separately

(B) Disclose Job work charges ₹ 290 lakh along with necessary disclosure in notes to accounts

(C) Disclose Job work charges of ₹ 290 lakh with no additional disclosure in notes to accounts

(D) Disclose Job work charges of ₹ 290 lakh along with necessary disclosure in Directors' Report. ***(2 Marks)***

5.2 While preparing standalone financial statements, investment in B Ltd is to be initially measured by PQR Ltd at:

(A) Cost

(B) Fair Value less costs to sell

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(C) Option available between Cost or Fair Value

(D) Net Realisable value. **(2 Marks)**

5.3 *In Consolidated financial statements of PQR Ltd., Non-controlling Interest should be presented:*

(A) Within long-term liabilities

(B) In between long-term liabilities and current liabilities

(C) Within the parent shareholders' equity

(D) Within equity but separate from the parent shareholders' equity. **(2 Marks)**

5.4 *Accounting treatment as per the applicable IFRS to be followed for copper derivatives is as under:*

(A) The hedging instrument is measured at fair value, and the hedged item is measured at fair value with respect to the hedged risk. Changes in fair value are recognized in profit or loss

(B) The hedging instrument is measured at fair value, and the hedged item is measured at fair value with respect to the hedged risk. Changes in fair value are recognized directly in equity to the extent the hedge is effective

(C) The hedging instrument is measured at fair value with changes in fair value recognized directly in equity to the extent the hedge is effective. The accounting for the hedged item is not adjusted

(D) The hedging instrument is accounted for in accordance with the accounting requirements for the hedged item (i.e., at fair value, cost or amortized cost, as applicable), if the hedge is effective. **(2 Marks)**

5.5 *As mentioned in para (f) above, which of the following impairment losses can never be reversed as per the applicable IFRS ?*

(A) Loss on property, plant, and equipment

(B) Loss on goodwill

(C) Loss on a business segment

(D) Loss on inventory. **(2 Marks)**

Part-B Answer the following:

5.6 *Based on draft Statement of Profit and Loss and details as per para (b) above, calculate the Basic and Diluted Earnings per share. Ignore information in other paras for the same.* **(5 Marks)**

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5.7 *You are required to state classification and presentation of financial instruments stated in (c) above, in the standalone financial statements of PQR Ltd.* ***(5 Marks)***

5.8 *You are requested to give your views on requirement of necessary provisions to be made and disclosures in respect of contingent liabilities for matters stated in (d) above in the books of PQR Ltd.* ***(5 Marks)***

Answer to Case Study 5

5.1 Option (A) : Disclose Job work charges of ₹ 350 lakh and rent income of ₹ 60 lakh separately.

5.2 Option (B) : Fair Value less costs to sell

5.3 Option (D) : Within equity but separate from the parent shareholders' equity.

5.4 Option (A) : The hedging instrument is measured at fair value, and the hedged item is measured at fair value with respect to the hedged risk. Changes in fair value are recognized in profit or loss.

5.5 Option (B) : Loss on goodwill

5.6 Computation of weighted average number of shares for calculation of EPS for the year 2018-2019:

S. No.	Date	Particulars	No. of shares	No. of days shares were outstanding	Weighted average no. of shares
1	1st April, 2018	Opening balance of outstanding equity shares	10,00,000	365	10,00,000
2	1st October, 2018	Issue of equity shares	50,000	182	24,932
3	1st February, 2019	Issue of partly paid-up shares	(75,000 x 17.5) / 35 = 37,500	59	6,062
4	31st March, 2019	Closing balance of outstanding equity shares	10,87,500		10,30,994

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Calculation of Earnings per Share

	Earnings	*Shares*	*EPS*
	₹		₹
Profit attributable to ordinary equity shareholders of the entity for the year 2018-2019 (A)	98,00,000		
Weighted average shares outstanding during the year 2018-2019 (B)		10,30,994	
Basic earnings per share (A)/(B)			9.51
Diluted earnings per share (A)/(B)			9.51

5.7 A. Classification of financial instruments:

(i) Perpetual bonds: There is contractual obligation to pay cash in future ie to pay interest till maturity. Hence, it will be classified as a financial liability.

(ii) Mandatorily redeemable preference shares: There is contractual obligation to pay fixed redemption amount. Hence, it will be classified as a financial liability.

(iii) Preference shares redeemable at the option of the holder: This contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. Since the entity cannot avoid settlement through delivery of cash when the holder demand redemption, the preference shares meet the definition of a financial liability. Hence, classified as 'financial liability'.

(iv) Written call options: It allows the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset are 'Equity instruments'.

B. Presentation of financial instruments in the standalone financial statements:

Extract of Balance Sheet of PQR Ltd. as at 31st March, 2019

Particulars	**(₹)**
EQUITY AND LIABILITIES	
Equity	
Equity share capital	XX
Other equity (written call option)	XX

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Non-current liabilities	
Financial liabilities	
5% Perpetual bonds	XX
Mandatorily redeemable preference shares	XX
Redeemable preference shares (Holder's option)	XX
TOTAL EQUITY AND LIABILITIES	XX

5.8 As per para 10 of IAS 37, a provision is a liability of uncertain timing or amount.

Further, para 14 says, a provision shall be recognised when:

(a) An entity has a present obligation (legal or constructive) as a result of a past event;

(b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provisions should be recognised.

Where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability.

Where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

Furthermore, a contingent liability should be disclosed, if the possibility of an outflow of resources embodying economic benefits is not remote. An entity should not recognise a contingent liability.

In light of the above provisions of IAS 37, the treatment of stated issues should be as follows:

Lawsuit 1:

There are remote chances of the company to pay claim of ₹ 80 lakh for the unauthorized use of a trademark. Hence there is no possible obligation from past event which would result in outflow of resources.

Conclusion- Provision is not to be recognised for unauthorised use of trademark.

Disclosure- Entity would not need to disclose the contingent liability at the end of the financial year.

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Lawsuit 2:

There is present obligation as a result of a past obligating event since there is demand from employee union for non-payment of termination pay and gratuity to 50 employees. Further, there is probability for outflow of resources embodying economic benefits in settlement and a reliable estimate can also be made of the obligation.

Conclusion- A provision is to be recognised at the end of the financial year for the best estimate of the amount that equals to ₹ 20 lakh.

Lawsuit 3:

There is present obligation as a result of a past obligating event since there is contamination of the land and environment, which gives rise to a constructive obligation because the conduct of the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.

Although there are probable chances for outflow of resources embodying economic benefits in settlement, however no reliable estimate can be made of the obligation.

Conclusion- A provision is not to be recognised for the costs of clean-up.

Disclosure- However, the entity would need to disclose the contingent liability at the end of the financial year.

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