

Case study 1

Mr. H is a Chartered Accountant and is working in GHI & Co., Chartered Accountants as a Manager. GHI & Co. has recently been approached by A Ltd. for providing advice on certain accounting matters (discussed below). A Ltd. is in the business of manufacturing industrial chemicals. It has a registered office in New Delhi and is listed on the Bombay Stock Exchange (BSE). It is considering the possibilities of listing its securities at London Stock Exchange for which it needs to submit its financial statements prepared under International Financial Reporting Standards (IFRS).

Following is the brief facts about the transactions entered into by the company for which an accounting advice is sought:

- (a) Under the scheme of demerger of B Ltd. effective from 1 April 2013, pharma division of B Ltd. has been demerged into C Ltd. The main intention of setting up C Ltd. is to construct and maintain various pharma projects demerged from B Ltd. A Ltd. holds 51% stake ownership and B Ltd. holds 49% stake ownership in C Ltd. The operations of C Ltd. are conducted through the Board of Directors who are nominated by A Ltd. and B Ltd. in equal proportion. A Ltd. has the exclusive right over the construction/structural design of the pharma projects. B Ltd. does not have any control over making structural changes. Further, all the cheques irrespective of value are processed and approved by A Ltd. Also, all product pricing decisions and marketing strategy are solely undertaken at the discretion of A Ltd. and do not require any approval from B Ltd.
- (b) A trust named "ABC Foundation" has been formed on 1 April 2005. This trust has been recognised under Section 80G of the Income-tax Act, 1961. The core objectives of the trust are promoting education, training and research. Decision will be taken by the majority and the composition of trustees has effectively only three members (namely Mr. X, Mr. Y and Mr. Z) who are closely related to A Ltd. and who actively participate in the operations and management of A Ltd. Apart from them, the other seven trustees are independent to A Ltd. and does not have any relation with Mr. X and Mr. Y.

A Ltd. has constructed five schools and transferred the same to ABC Foundation on an arm's length price. A Ltd. has been benefited from economies of scale and synergy

benefits by selling these schools. There are no continuing benefits from these schools.

A Ltd. has contributed INR 10 crores during the financial year 2016-17 to the trust on account of statutory compliances namely Section 135 of the Companies Act, 2013 and claimed 50% eligible deduction under Section 80G of the Income-tax Act, 1961. Employees of A Ltd. get a discount of 20% on school fees paid by them towards education of their children at these schools. The discount is not provided by ABC Foundation, instead the cost is borne by A Ltd.

Also the trustees may dissolve the trust by a unanimous decision and on dissolution, the assets of the trust will be transferred to a recognised trust under Section 80G of the Income-tax Act, 1961.

- (c) A Ltd. has a wholly owned subsidiary D Ltd. D Ltd. faces financial crisis now and then. A Ltd. being a parent company, often helps D Ltd. by providing interest free loan. During the year, A Ltd. has provided INR 10 lacs interest-free loan to D Ltd. The current market rate of interest for similar loan is 10% p.a. These loans are provided by A Ltd. either to be repaid on demand or after fixed term depending upon the agreement.
- (d) A Ltd. manufactures wide range of industrial chemicals. A Ltd. always strives to purchase machines with latest technology which can result in an efficient production of these chemicals so as to minimise wastages, manufacture more quantities from existing inputs, or reduce input consumption for manufacturing same quantities of output. Estimated useful lives of machineries purchased, vary significantly from 5 years to 25 years. On purchase of new machines, old machines have to be disposed of. For disposing old machines and equipment, which can be further used by some other party, A Ltd. invites bids. If machine can be used in other countries and can fetch good value, global tender is also floated. Details of such invitations are published on the company's website and in leading newspapers, for interested parties to view details of such bids invited by the company.

A synthesis gas compressor along with auxiliaries and spares pertaining to mechanical instrument installed in one of the plant costing INR 13 crores was purchased in 1982 and was used for 25 years. After being decommissioned, compressor was kept as a stand-by for a further period of 2 years and continued to be classified under 'plant and machinery'. However, the asset had reached its

residual value before 2007 itself and no further depreciation was charged on compressor. In March 2009, it was decided to sell the compressor and as a result, it was reclassified to 'assets held for disposal'. As on 31 March 2009, details of compressor are as follows:

Particulars	Amount
Gross Block	INR 130,453,617
Accumulated depreciation as on 31 March 2009	INR 123,930,936
Written down value as on 31 March 2009	INR 6,522,681

Following entries were passed in books of A Ltd. on 31 March 2009, to reclassify the asset into 'assets held for disposal':

Assets held for disposal A/c	Dr.	INR 6,522,681
Accumulated depreciation A/c	Dr.	INR 123,930,936
Plant and machinery A/c	Cr.	INR 130,453,617

Since 31 March 2009, this compressor is classified as 'assets held for disposal'. Simultaneously, management floated a Global e-auction, inviting bids from potential parties specifically in USD. As on 31 March 2009, fair value of such asset was estimated to be INR 1.61 crores. U Ltd. quoted USD 54 lacs. Based on such high bid, A Ltd. proceeded to sell the compressor to U Ltd. At a later stage, U Ltd. claimed that bid amount was in INR and not in USD, consequently, A Ltd. refused to sell the compressor to him. This resulted in dispute between A Ltd. and U Ltd. and consequently A Ltd. filed a case in the Court against U Ltd. in 2012. U Ltd. is of the view that since A Ltd. committed to sell the asset to him, such asset should be sold to it only, whereas A Ltd. contends that since market value of such compressor is approximately INR 1.65 crores, then it cannot sell such asset for INR 54 lacs only, which is approximately 1/3rd of market value of the compressor. The Court directed both the parties to approach the arbitrator and issued a stay order on A Ltd., restricting it to sell the concerned asset to any other party, till the matter is resolved. Arbitrator is expected to give his verdict in July 2018.

- (e) A Ltd. has 500 units of chemicals in stock at the balance sheet date, i.e., 31 March 2018. These units are currently valued at net realisable value since their

cost of manufacturing is very high. A Ltd. has entered into an agreement with the Government on 1st February 2018 to sell 400 units at INR 10,000 each on 5th April 2018. Remaining 100 units are expected to be sold in the following month when the price is expected to be at INR 9,600 each. The sale price of these chemicals as on 31 March 2018 is INR 9,000 per unit.

- (f) A Ltd. is installing a new machinery in its plant. The machinery was purchased from R Ltd. It has incurred these costs:
- Basic price (as per supplier's invoice plus taxes)- INR 20,00,000
 - Initial delivery and handling costs- INR 4,00,000
 - Cost of site preparation- INR 2,00,000
 - Interest charges paid to supplier of plant for deferred credit- INR 50,000
 - Present value of estimated dismantling costs to be incurred after 10 years- INR 1,00,000
 - Operating losses before commercial production- INR 2,00,000
- (g) An asset was acquired at a cost of INR 1,50,000. The carrying amount is INR 70,000 after an impairment write down of INR 30,000 and cumulative depreciation of INR 50,000. Depreciation rate for accounting and tax laws is equal. Impairment loss is not deductible to tax. Tax rate applicable to A Ltd. is 30%.
- (h) A Ltd. has taken an unsecured general purpose loan on 1 April 2016. The loan was utilised to finance the construction of a new building (to be used as store) which meets the definition of a qualifying asset in IAS 23. Construction of the store building commenced on 1 May 2016 and it was completed and ready for use on 28 February 2018, but did not open for trading until 31 March 2018. During the year, A Ltd. suspended the construction of the new building for a two-month period during July, 2017 – August, 2017.
- (i) The carrying amount of one of the cash-generating unit of A Ltd. is INR 10,00,000 and the recoverable amount is INR 9,00,000. The goodwill allocated to the cash-generating unit is INR 50,000. The other assets in the cash-generating unit comprise of the plant and machinery and technical know-how with carrying amounts of INR 5,00,000 and INR 4,50,000, respectively.

- (j) A Ltd. is developing a new process. During 2017, expenditure incurred was INR 10,00,000, of which INR 8,00,000 were incurred before 1st June 2017 and INR 2,00,000 were incurred between 1st June 2017 and 31st March 2018. At 1st June 2017, the process met the criteria for recognition as an intangible asset. The fair value of the know-how in the process is INR 5,00,000 on 31st March, 2018.
- (k) A Limited submits two bids to Chemical Limited for two contracts that are closely related and will be performed in a continuous sequence. One bid is for the patent of the chemical plant and the second bid is for the manufacture of same chemical. If successful, A Limited (or any other bidder) has to accept both the contracts or reject both the contracts. However, two different contracts should be signed even though they are negotiated as a single package.
- (l) A Ltd. has granted certain share options to one of its director on the condition that the director will not work with the competitor of the reporting entity (i.e. non-compete clause) for a period of at least three years. The fair value of the award at the date of grant, including the effect of the 'non-compete' clause, is INR 1,50,000.
- (m) A Ltd. has a long-term loan arrangement containing a debt covenant. The specific requirements in the debt covenant have to be met as at 31 March every year. The loan is due for more than 12 months. A Ltd. breaches the debt covenant at or before the period end. As a result, the loan becomes payable on demand.
- (n) A Ltd. acquired 60% equity shares of S Ltd. for INR 60 lacs. At the date of acquisition, fair value of net assets of S Ltd. is INR 80 lacs and fair value of non-controlling interest is INR 45 lacs.

Based on the facts given above, CFO of A Ltd. wants advice from GHI & Co., Chartered Accountants on the below accounting matters:

I. Descriptive questions

Question 1

Whether the following entities are subsidiaries of A Ltd. to be consolidated?

- (a) C Ltd.
- (b) ABC Foundation

Provide appropriate reasoning for your answer considering the guidance under IFRS.

Question 2

How the interest-free loan should be accounted for under IFRS financial statements of A Ltd. and D Ltd. in the following scenarios:

- (a) The loan is repayable on demand.
- (b) The loan is repayable after 3 years.

Provide necessary journal entries in both cases.

Question 3

What will be the accounting implication under IFRS on A Ltd. in relation to the asset 'synthesis gas compressor' held by the company, i.e.,

- (a) Whether such compressor can be classified under 'non-current assets held for sale' in A Ltd.'s IFRS financial statements?
- (b) How non-current assets held for sale should be measured?

Provide appropriate reasoning for your answer considering the guidance under IFRS. Take necessary assumptions, if required.

II. Objective type questions

1. What will be the value of inventory of 500 units of chemicals on 31 March 2018?
 - (a) INR 45,00,000
 - (b) INR 49,60,000
 - (c) INR 49,00,000
 - (d) INR 50,00,000

2. At what amount the new machinery purchased from R Ltd. should be recognised?
- (a) INR 20,00,000
 - (b) INR 29,50,000
 - (c) INR 27,50,000
 - (d) INR 27,00,000
3. What should be the deferred tax on asset referred to in (g) above?
- (a) Deferred tax asset of INR 9,000
 - (b) Deferred tax liability of INR 9,000
 - (c) No deferred tax should be recognised
 - (d) More information required to assess deferred tax implications
4. In case of construction of new building, for how many months, the interest should be capitalised in accordance with the principles of IFRS?
- (a) 23 months
 - (b) 22 months
 - (c) 21 months
 - (d) 20 months

5. How should A Ltd. account for the impairment loss of one of its cash-generating unit mentioned in (i) above?
- (a) Impairment loss for the cash-generating unit of INR 1,00,000 should be allocated on a pro-rate basis among goodwill, plant and machinery and know-how on the basis of their carrying amount.
 - (b) Impairment loss for the cash-generating unit of INR 1,00,000 should be first allocated to goodwill (i.e., INR 50,000) and remaining to technical know-how (i.e., INR 50,000).
 - (c) Impairment loss for the cash-generating unit of INR 1,00,000 should be first allocated to goodwill (i.e., INR 50,000) and balance impairment loss of INR 50,000 should be allocated on a pro-rata basis between the plant and machinery and technical know-how based on their carrying amounts, at INR 26,000 and INR 24,000, respectively.
 - (d) A Ltd. has a free choice for determining the method of allocation of impairment loss of INR 1,00,000 to the assets in the cash-generating unit.
6. What should be the accounting for expenditure incurred on developing new process by A Ltd. under IFRS?
- (a) Intangible asset of INR 5,00,000; expense of INR 5,00,000
 - (b) Intangible asset of INR 10,00,000; expense of Nil
 - (c) Intangible asset of INR 2,00,000; expense of INR 8,00,000
 - (d) Intangible asset of INR 5,00,000; expense of INR 8,00,000

7. Suppose A Ltd. is successful in winning the bid of Chemical Limited. Then in such a situation, as per IAS 11, both the contracts should be accounted by A Limited as:
- (a) Two different contracts.
 - (b) Single Contract.
 - (c) Either (a) or (b) at the option of A Limited.
 - (d) Either (a) or (b) as directed by Chemical Limited.
8. Which of the following accounting treatment is correct in relation to the share options given to one of the director of A Ltd.?
- (a) A Ltd. should recognise an expense of INR 1,50,000 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) A Ltd. should recognise an expense of INR 1,50,000 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) A Ltd. should recognise an expense of INR 1,50,000 immediately and cannot reverse the expense recognised even if the director goes to work for a competitor and loses the share options.
 - (d) A Ltd. should recognise an expense of INR 1,50,000 immediately and can reverse the expense recognised in case the director goes to work for a competitor and loses the share options.
9. How should the loan be classified at year end for which A Ltd. has breached the debt covenant?
- (a) Current liability only if the lender demands payment as a consequence of breach.

- (b) Non-current liability even if the lender demands payments as a consequence of breach.
 - (c) Current liability even if the lender agreed after reporting date and before authorisation of financial statements for issue, not to demand payment as a consequence.
 - (d) Non-current liability if the lender agreed after reporting date and before authorisation of financial statements for issue, not to demand payment as a consequence.
10. Determine the amount of goodwill arising on acquisition of S Ltd. if non-controlling interest is measured using fair value method.
- (a) INR 25 lacs
 - (b) INR 20 lacs
 - (c) INR 15 lacs
 - (d) INR 12 lacs