

GT Ind-AS Training

Practical application test - Solutions

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Practical Application Test under Ind AS

(Please select the most relevant option out of the four provided, each question carries 2 marks – (20 * 2 = 40 marks))

Question 1. Pulsak Ltd. is an Indian Software Company which makes software in India. 40% of its customers are situated in the India, 40% in United States of America, 10% in Europe and Other 10% in other parts of the world. Customers are billed in their respective local currency. The company normally borrows money from bank in USA in USD. Surplus cash is usually maintained in USD bank account. Employee and other costs are incurred in INR. What will be the functional currency of Pulsak?

| | |
|----------|-----------------------------|
| A | INR |
| B | USD |
| C | Both |
| D | Requires further assessment |

Question 2. Cocabola Ltd. has issued Foreign Currency Convertible Bonds (FCCBs) denominated in USD. The issue price (as well as the nominal value) was USD 100 per bond. The bond carries zero coupon interest. The bonds are convertible on maturity with the exercise price being USD 10 per share. What would be the classification of the FCCBs?

| | |
|----------|--|
| A | Equity |
| B | Financial liability |
| C | Financial liability with embedded derivative |
| D | Compound financial instrument (equity and liability) |

Question 3. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate how it is required to be treated?

| | |
|----------|---------------------------------------|
| A | Not required to distinguish |
| B | As a change in an accounting policy |
| C | As a change in an accounting estimate |
| D | Should be ignored |

Question 4. Cipmark Ltd. had acquired specialised machinery. Due to sudden change in market factors, it does not intend to use it for production as the machinery is not cost effective and intends to sell it. How it is required to classify it?

| | |
|----------|---|
| A | As part of PP&E |
| B | As Non-current asset held for sale |
| C | As PP&E but with additional disclosures |
| D | As investment property |

Question 5. Jazzlon Ltd. is starting a solar panel business in India and as per the government policy Jazzlon Ltd. receives land free of cost to set up the factory. How should the land be measured?

| | |
|----------|---|
| A | At nominal value |
| B | At fair value |
| C | Option to record at fair value or nominal value |
| D | At estimated cost |

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Question 6. CNC Ltd. sells customised cars at INR 1 crore. It also includes annual maintenance contract (AMC) (otherwise sold separately for INR 10 Lakhs) for 3 years in the price of such. Maintenance services are expected to be provided equally over the period of 3 years. How should the company recognise revenue?

| | |
|----------|--|
| A | Recognise INR 1 Crore at the time of sale of the car |
| B | Recognise INR 90 Lakhs based on on sale of goods criteria for sale of car and INR 10 Lakhs over a period of 3 years on straight line basis |
| C | Recognise INR 1 Crore over the period of 3 years |
| D | Recognise INR 90 Lakhs at the time of sale and INR 10 Lakhs at the end of 3 years |

Question 7. Moon Ltd. manufactures drugs and P Ltd. distributes such goods. Moon Ltd. will pay margin (variable) on such goods based on market competition. Cost per unit is INR 300 and generally P Ltd makes INR 100 per unit. If such drugs remain unsold till the expiry date, they are destroyed by P Ltd. and loss on account is born by it. P Ltd. got 7 lakhs units during the year and sold 5 lakhs, 2 lakhs were destroyed. How should P Ltd account for revenue on sale of such goods?

| | |
|----------|--|
| A | Revenue should be booked at the margin amount (net) i.e. 5 lakhs X 100 |
| B | Revenue should be booked at gross sale amount i.e. 5 lakhs X 300 |
| C | Revenue (net) to be deferred till the expiry date is passed |
| D | Revenue (gross) to be deferred till the expiry date is passed |

Question 8. Posa Ltd. has purchased bond yielding 12% interest. Company intends to earn interest and principle at the maturity. How is the instrument measured under Ind AS 39?

| | |
|----------|--|
| A | At fair value through profit or loss (FVTPL) |
| B | As available for sale financial asset (AFS) |
| C | At amortised cost |
| D | At cost |

Question 9. For liabilities carried at fair value, how should the change in fair value consequent to the change in the entities own credit risk be measured under Ind AS 39?

| | |
|----------|--|
| A | Change in fair value to be taken to income statement |
| B | Such change should be ignored |
| C | Change in fair value to be taken to other comprehensive income |
| D | Management has a policy choice |

Question 10. Prava Ltd. borrows INR 1,000,000 from a bank and pays INR 25,000 as processing fees. The loan has tenure of 5 years and carries fixed interest of 12% per annum. How should the entity account for the processing fees?

| | |
|----------|---|
| A | Include in effective interest rate calculation |
| B | Debit to income statement |
| C | Amortise on a straight line basis over the tenure of the loan |
| D | As per Management Policy on a consistent basis |

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Question 11. Desmond Pvt. Ltd. is constructing ultra-modern plant for producing low cost medicines. Which of the following shall not form part of cost at initial recognition of such plant?

| | |
|----------|--------------------------------------|
| A | Site preparation cost |
| B | Installation and assembly cost |
| C | Administrative and general overheads |
| D | Cost of testing |

Question 12. Jalandhar Ltd. provides depreciation as per Companies Act, 2013 based on the useful life and thus depreciation rate comes to 10%. However as per Income tax Act, 1961 it is allowed to depreciate such asset @ 25%. What would be the deferred tax impact?

| | |
|----------|--|
| A | Results into deferred tax liability |
| B | Results into deferred tax asset as well as liability |
| C | No deferred tax impact |
| D | Results into deferred tax asset |

Question 13. Kirla Ltd. has two subsidiaries Zolo Ltd. and Tolo Ltd. Tolo Ltd. is supplier of defense equipment to Government of India and the statute prohibits certain disclosures to be made under related party disclosure. What Kirla Ltd. is required to do under such circumstance in its consolidated financial statements?

| | |
|----------|---|
| A | Disclose all the information as accounting standard governs financial reporting |
| B | No need to disclose information which conflicts with the confidentiality requirements |
| C | Disclosure to be made as per the board of directors discretion |
| D | None of the above |

Question 14. Reliable Pvt. Ltd. has a financial year from April 2013 to March 2014. In the month of June 2014 the following events occurred:

- Bankruptcy of a customer who owed INR 25 lakhs
- Destruction of major production plant by a fire on 31 May 2014
- Discovery of fraud worth INR 50 lakhs by the production manager

Which event would require an adjustment in financial statement as 31 March 2014?

| | |
|----------|--------|
| A | Only a |
| B | a & c |
| C | Only c |
| D | All |

Question 15. Thams Ltd. consistently failed to record revenue worth INR 50 Lakhs (INR 10 Lakhs each from 2010 to 2014). How it should be recorded/ treated in the financials?

| | |
|----------|--|
| A | Restate comparative periods presented in which the error occurred |
| B | Restate the opening balances for the earliest prior period presented |
| C | Disclose nature and amount of any correction made |
| D | All of the above |

Question 16. Mata Steel Ltd acquired 100% shares of Corpus Steel Ltd (carrying value of net assets INR 250 lakhs) from another subsidiary. The consideration was paid as follows:

- INR 200 lakhs in equity shares
- INR 100 lakhs in cash

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How should the difference between the shares purchased and the consideration paid is required to be recorded in the books of Mata Steel Ltd?

| | |
|----------|--|
| A | Goodwill |
| B | Profit and loss statement |
| C | Common control transaction capital reserve (debit balance) |
| D | General reserve |

Question 17. ABCD Ltd. prepares financial statements in its functional currency i.e. Indian Rupee. It has incurred foreign exchange loss of INR 23 Lakhs on its long term foreign currency loan taken for construction of a qualifying asset. Interest cost on the same was INR 12 Lakhs. Had the entity borrowed the same amount in India, it would have incurred an interest cost of INR 18 Lakhs. What should be the treatment of the exchange difference?

| | |
|----------|--|
| A | Recognise the exchange loss of INR 23 Lakhs in P&L |
| B | Recognise INR 17 Lakhs in P&L and capitalise INR 6 Lakhs |
| C | Recognise INR 18 Lakhs in P&L and capitalise INR 5 Lakhs |
| D | Capitalise the full amount of INR 23 Lakhs |

Question 18. Zarrari Ltd. has machinery with a carrying value of INR 18 lakhs and fair value of INR 25 lakhs. What would be the acceptable starting point at the date of transition under Ind AS?

| | |
|----------|---|
| A | INR 25 Lakhs (fair Value) |
| B | INR 18 Lakhs (carrying value under previous GAAP) |
| C | A and B - both options available |
| D | None of the above |

Question 19. Which of the following rate is to be used to discount post-employment benefit?

| | |
|----------|---------------------------------------|
| A | The market yields on government bonds |
| B | Yield on high quality corporate bonds |
| C | Any of the above (A or B) |
| D | None of the above |

Question 20. ABC Limited owns two office buildings in Frankfurt. One of them is used as ABC's head office, while the other is rented out to a third party. How do you think that the company should account for the rented building?

| | |
|----------|--|
| A | As owner-occupied under Ind AS 16 |
| B | As investment property under Ind AS 40 |
| C | As either A or B |
| D | None of the above |

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Descriptive questions:

Question 1. – Control assessment (10 marks)

As on 31 March 2014, Company A holds 46% of the equity capital of Company B. During the year 2013-14, Company A had sold 8% of its stake in Company

The remaining share capital of Company B is held by dispersed investors, none of which own more than 0.5% individually. There are no separate arrangements between the shareholders to act in concert.

Company B has incurred significant losses during the year. The management of Company A believes that since it no longer holds more than 50% of the capital of Company B, it does not need to consolidate Company B.

Discuss and explain whether the management's opinion in the matter is appropriate or not?

Solution:

Ind-AS 110 states that an investor controls an investee if and only if the investor has:

Power over the investee. Given the size of its shareholding relative to the other shareholdings and the absence of any collective agreements between the other shareholders, it would appear that Company A does have power over Company B.

Exposure to variable returns from its involvement with the investee. Company A shareholding will entitle it to dividends which will vary with the level of Company B's profits.

Ability to use its power to affect those returns. Given its effective control of the voting power, Company A is able to control the operating and financial policies of Company B which will affect its profits and in turn its dividends.

Therefore Company B would be regarded as a subsidiary of Company A as on the reporting date.

Question 2. – Preference shares classification (10 marks)

Company A, a listed company, has issued four classes of convertible preference shares which are as follows:

Class X preference shares: The preference shares, with a nominal value of Rs. 100 amounting to Rs. 1 million, carry a cumulative dividend of 8%. The preference shares will be extinguished at the end of 10 years by issue of so that company may derecognize the Class X preference shares.

Class Y preference shares: The preference shares, with a nominal value of Rs.100, are redeemable at a premium of 20% after the period of five years. The shares carry a cumulative dividend of 8%.

Class Z preference shares: Entity A issued convertible preference shares for Rs.100 that pays no amount till maturity. At maturity, Entity A is required to deliver 5 ordinary shares against each class Z preference share.

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Class M preference shares: Entity A issued non-redeemable preference shares amounting to Rs. 1 million with a coupon rate of 8% per annum.

How should Company A classify the above preference shares? Give reasons for your conclusions.

Solution:

Class X: The preference shares will be classified as a financial liability. The number of equity shares issued on the date of conversion will depend on the fair value of Entity A's equity shares. Therefore, the fixed-for-fixed criterion is not met.

Class Y: There is an outright cash obligation on the company to redeem the preference shares at premium at the end of 5 years. Therefore, the preference shares are a financial liability.

Class Z: Since the amount of liability is fixed and the number of shares to be issued on maturity is also fixed, the preference shares meet the fixed-for-fixed criterion. Therefore, the same should be classified as equity.

Class M: The preference shares will be classified as a financial liability.

'Perpetual' debt instruments (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000. Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU 1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

Question 3. – Fair value measurement of non-financial asset (2+2+6=10 marks)

- a) Which three aspects of use of asset are considered in determining the highest and best use of non- financial asset?

Solution: The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible.

- b) From whose perspective highest and best possible use is determined if entity intends to use the financial asset differently?

Solution: Market participant's

- c) Determine the applicable bracket in the fair value hierarchy (level 1, 2 or 3) for the below mentioned items?

| Item | Level |
|--|-------|
| Investment in listed equity securities | |

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| | |
|---|--|
| Inventory | |
| Investments in unlisted securities | |
| Investment in listed debt securities | |
| Entity's own financial model for derivative | |

Solution:

| Item | Level |
|---|----------------|
| Investment in listed equity securities | Level 1 |
| Inventory | Not Applicable |
| Investments in unlisted securities | Level 2 |
| Investment in listed debt securities | Level 1 |
| Entity's own financial model for derivative | Level 3 |

Question 4. – Assessment of joint control (5 marks)

- a. Company A, B and C enter into an arrangement to construct a machine jointly. Company A and B specialise in construction while Company C specialises in arranging the requisite labour. All the construction equipment and assets are to be supplied by A and B. The cost of construction is to be borne jointly by the three companies. The machine is to be leased to a government agency after construction. The revenue from the machine is to be shared between the companies after setting aside some portion which is to be remitted for local taxes. Machine's value will be allocated in the proportion of equity if the same is sold.

A has 50% of the voting rights in the arrangement, B has 30% and C has 20%. In addition, C has *veto* rights on certain operational matters. The shareholders agreement between A, B and C specifies that at least 75% of the voting rights are required to make all decisions with respect to the operations of the company.

1. Whether the above arrangement will qualify as a joint arrangement?
2. If yes, whether the same would be a joint operation or a joint venture?

Give reasons for your conclusions.

Solution:

An arrangement to construct machine by Company A, B and C is a joint arrangement. Each party has right to the revenues arising out of construction.

Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing. C along with any company does not have a joint control since C's rights alone or combined with any other participants cannot influence the decisions taken in the arrangement.

- b. Three companies A Ltd., B Ltd. and C Ltd. jointly buy a 15-floor office building. Each floor in the building has a separate legal title, which allows a floor to be sold separately.

Each company takes title (ownership) of five of the floors.

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With the unanimous consent of all the participants, the joint-owners set up a company ABC Ltd and each transfers its ownership of five floors of the building to the company. All the floors are rented to third parties. ABC Ltd employs a management team to manage the rental business. The management team comprises of 3 members from each of the joint venturers. All decisions of the management team are to be approved by at least 7 of its members.

How would company A, B and C treat their respective stakes in ABC Ltd.?

Solution:

ABC Ltd is a joint venture. It is a jointly controlled entity by A, B and C. The contractual arrangement between the companies establishes joint control over the economic activity of ABC Ltd.

The venturers have an interest in the profit generated by the operations of the company. They do not have a present obligation for costs nor do they have rights to the individual assets of the venture.

They each have exchanged their rights to five floors of the building for an interest in the company. Each partner recognises its investment in the joint venture, using the equity method.

Question 5. – Embedded Derivative (4+6=10 marks)

a. Loan prepayment option:

An entity borrows INR 1,000,000 from a bank on 1 January 2014. Interest is charged at 10% payable quarterly in arrears. The loan is repayable in 5 years. The loan includes an option to prepay on 1 January each year including a prepayment penalty of INR 50,000.

The bank indicates that, without the prepayment option, it would have lent the same amount to an entity with an equivalent credit score at 9%. Transaction costs are insignificant.

Determine whether option to prepay the loan needs to be separated from host debt contract if entity account for host debt instrument at amortised cost.

Solution:

Option to prepay the loan needs to be separated from host debt if economic characteristics of the embedded derivative are not closely related to those of the host contract.

Ind AS 39 includes a specific "test" for put, call or prepayment options in debt contracts. The embedded option is closely related only if the exercise price is approximately equal to the amortised cost of the host debt on each exercise date or the penalty charged is equivalent to the loss of interest income because the loan was prepaid.

IAS 39 does not interpret the term "approximately equal". However, a fixed prepayment penalty would go to show that the prepayment amount and amortised cost will not be approximately equal.

b. From the below list, identify the transactions that would require separation of embedded derivatives:

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1. An investment in a bond where interest payments are indexed to the price of gold. The bond is measured at fair value through profit and loss.
2. An investment in a bond with interest is indexed to the price of silver. The bond is classified as available for sale.
3. A lease contract that has a rent adjustment clause based on inflation.

Solution:

1. Investment in a bond where interest payments are linked to the price of gold contains embedded derivative on gold. However, because the bond is already measured at fair value through profit or loss, the embedded derivative should not be separated.
2. Investment in a bond where interest is linked to the price of silver contains embedded derivative on silver. Since the economic characteristics and risks for the bond and silver are not closely related, the embedded derivative needs to be separated.
3. A lease contract that has rent adjustment clause based on inflation contains an embedded derivative on inflation. However, the embedded derivative is not separated from the lease contract because the rent adjustment clause based on inflation is considered to be closely related to host lease contract.

Question 6. Multiple element arrangements (5 marks)

Company A is engaged in the business of providing digital education content to a number of schools. Under the agreement with each school, Company A would provide (a) hardware, (b) right to use its entire content repository and (c) support services for the hardware & content update. The hardware is designed only for running of the digital content and cannot be used elsewhere. The content is ready and available with the entity.

The agreement between the school and Company A is for a period of 5 years with an option to renew for another term as mutually agreed. The schools would pay to Company A fixed amounts in quarterly instalments over a period of 5 years for hardware, content and support services.

- (a) How should hardware be accounted for in the books of Company A?
- (b) How would Company A recognize revenue in its books from hardware and digital content

Ignore time value of money for the purpose of this question.

Solution:

In case of a multiple element arrangement, in which multiple revenue generating activities are negotiated as a package, revenue should be allocated to each identifiable component at its respective fair value.

In this case, the agreement involves **three** elements i.e. (a) hardware, (b) right to use the content repository and (c) support services for hardware & content update. Revenue from the agreement should be bifurcated between goods (i.e. hardware and content) and services (i.e. support services for hardware and content) at their respective fair value to company A at the inception of the agreement.

- 1) **Provision of hardware and content:** As per Ind AS 18, revenue from sale of goods should be recorded when the substantial risks and rewards associated with the goods are transferred from the seller to the buyer. The terms of the agreement requires the schools to make

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quarterly payment over the term of 5 years. However, revenue should be recognised immediately on the date of transfer of right to use the goods even though payments are received on instalment basis.

- 2) **Support services for hardware and content:** As per Ind AS 18, revenue from rendering services is recognised if and only if stage of completion can be estimated reliably.

In this case, even though fixed quarterly instalments are paid by school on the respective due date, the revenue from the provision of services should be deferred till it is actually provided or stage of completion can be measured reliably.

Question 7. Interest free deposit paid under lease arrangement (10 marks)

A lessee is required to pay a deposit of Rs. 1 million to the lessor at the inception of an operating lease of land for which no interest is receivable. The fixed lease term is 10 years.

The market interest rate is 10% (i.e. that is the interest rate the lessor would have to pay if he borrowed Rs. 1 million for a 10 year term from a third party).

| | |
|-----------------------|---------------|
| Deposit Paid | Rs. 1,000,000 |
| PV Factor | 0.3855433 |
| Fair value of deposit | INR 385,543 |

How should the deposit be accounted for in the books of lessor and lessee in the first year? Include journal entries.

Solution:

The deposit is a financial instrument within the scope of Ind AS 39. As per the requirements of Ind AS 39.47, it should initially be accounted for at fair value. In the instant case, the fair value of the deposit is determined based on the prevailing market rate of interest for a similar loan, considering the credit worthiness of the lessor and, depending on facts and circumstances, any additional security available to the lessee.

The other aspects of accounting for lease deposit would be as below:

1. The excess of the principal amount of the deposit over its fair value is accounted for as prepaid lease expense (income) and amortised over the lease term on a straight-line basis.
2. Interest on the deposit, meanwhile, is accounted for using the effective interest rate (EIR) method.

Journal entries in the books of lessee

To recognise deposit paid

| | | |
|------------------------|-----|-----------|
| Deposit | Dr. | 385,543 |
| Deferred lease expense | Dr. | 614,457 |
| Cash | Cr. | 1,000,000 |

To recognise interest income applying effective interest rate in year 1

| | | |
|-----------------|-----|--------|
| Deposit | Dr. | 38,554 |
| Interest income | Cr. | 38,554 |

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To recognise additional rent for amortisation of deferred lease expense

| | | |
|-------------------------|-----|--------|
| Operating lease expense | Dr. | 61,446 |
| Deferred lease expense | Cr. | 61,446 |

Journal entries in the books of lessor

To recognise deposit

| | | |
|-----------------------|-----|-----------|
| Cash | Dr. | 1,000,000 |
| Deferred lease income | Cr. | 614,457 |
| Deposit payable | Cr. | 385,543 |

To recognise interest expense applying effective interest rate in year 1

| | | |
|------------------|-----|--------|
| Interest expense | Dr. | 38,554 |
| Deposit payable | Cr. | 38,554 |

To recognise additional rent for amortisation of deferred lease income

| | | |
|-----------------------|-----|--------|
| Deferred lease income | Dr. | 61,446 |
| Lease rental income | Cr. | 61,446 |