# PRACTICE QUESTIONS

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# INDIAN ACCOUNTING STANDARD 1: PRESENTATION OF FINANCIAL STATEMENTS

## Questions

1. A Company presents financial results for three years (i.e., one for current year and two comparative years) internally for the purpose of management information every year in addition to the general-purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purposes. During the current year, management thought why not they should present third year statement of profit and loss also in the general-purpose financial statements. It will save time and will be available easily whenever management needs this in future.

   With reference to above background, answer the following:

   (i) Can management present the third statement of profit and loss as an additional comparative in the general-purpose financial statements?

   (ii) If management present third statement of profit and loss in the general-purpose financial statement as comparative, is it necessary that this statement should- be compliant of Ind AS?

   (iii) Can management present third statement of profit and loss only as additional comparative in the general-purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

2. A company, while preparing the financial statements for financial year 20X1-20X2, erroneously booked excess revenue of ₹ 10 crore. The total revenue reported in financial year 20X1-20X2 was ₹ 80 crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in financial year 20X1-20X2 which it now wants to correct in the financial statements. However, the management of the company is not sure whether it need to present the third balance sheet as additional comparative.

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With regard to the above background, answer the following:

(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?

(ii) The company wants to correct the errors during financial year 20X2-20X3 by giving impact in the figures of current year only. Is the contention of the management, correct?

3. XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e., 31st March, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2:

| S. No. | Items/transactions |
|---|---|
| (1) | The company has some trade receivables which are due after 15 months from the date of the balance sheet. So, the company expects that the payment will be received within the period of operating cycle. |
| (2) | The company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the company does not expect that it will be able to pay these payables within the operating cycle because the nature of business is such that generally projects get delayed and payments from customers also get delayed. |
| (3) | The company was awarded a contract of ₹ 100 crore on 31st March, 20X2. As per the terms of the contract, the company made a security deposit of 5% of the contract value with the customer, of ₹ 5 crore on 31st March, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract. |
| (4) | The company has also given certain contracts to third parties and have received security deposits from them of ₹ 2 crore on 31st March, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract. |

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Considering the above items/transactions answer the following:

(i) The company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

(ii) The company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the company. Does the decision of presenting the same as non-current is correct?

(iii) Can the security deposit of ₹ 5 crore made by the company with the customers be presented as current?

(iv) Can the security deposit of ₹ 2 crore taken by the company from contractors be presented as non-current?

4. Is offsetting permitted under the following circumstances?

(a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?

(b) Whether profit on sale of an asset against loss on sale of another asset can be offset?

(c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset?

5. An entity has the following trial balance line items. How should these items be classified, i.e., current or non-current as per Ind AS 1?

(a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)

(b) Advance to suppliers

(c) Income tax receivables [other than deferred tax]

(d) Insurance spares

6. As per the statutory requirements, exceptional items are required to be disclosed whereas Ind AS 1 requires separate disclosures of material items and how these are to be presented in the financial statements. Does that imply that 'exceptional' means 'material'? Give examples. How should these be presented in the financial statements?

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**7.** Find out total comprehensive income for 20X1-20X2 of V Ltd. from the following information:

| | |
|---|---|
| Profit from normal operations | ₹ 50,00,000 |
| Remeasurement gains from defined benefit plans | ₹ 5,00,000 |
| Gain on translation of foreign operations | ₹ 10,00,000 |
| Revaluation gains on property, plant and equipment | ₹ 3,50,000 |
| Fair value changes on financial assets | ₹ 4,50,000 |

## Answers

**1.** (i) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

(ii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.

(iii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

**2.** (i) No, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

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(ii) No, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period. (Refer Para 40A of Ind AS 1)

**3.** (i) Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

(ii) No, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

(iii) No, because the amount will be received after the operating cycle of the Company. (Refer Para 66 of Ind AS 1)

(iv) No, because the amount may be required to be paid before completion of the contract in case the contract is cancelled. (Refer Para 69 of Ind AS 1).

**4.** **(a)** As per paragraph 33 of Ind AS 1, offsetting is permitted only when the offsetting reflects the substance of the transaction.

In this case, the agreement/arrangement, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.

**(b)** Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be presented on net basis. However, gains or losses should be presented separately if they are material.

**(c)** Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

In accordance with the above, the receivable and payable should be offset against each other and net amount is presented in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

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**5.** **(a)** As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.

Paragraph 68 provides the guidance that current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

In accordance with above, the receivables that are considered a part of the normal operating cycle will be classified as current asset.

If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

**(b)** As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relation to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes

**(c)** Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66 (c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

**(d)** Para 8 of Ind AS 16 states that items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Accordingly, the insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spares that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

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**6.** Exceptional items have not been defined in Indian Accounting Standards (Ind AS). However, paragraph 97 of Ind AS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately.

As per Ind AS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both and it could be the determining factor.

When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Generally, items of income or expense fulfilling the abovementioned criteria are classified as exceptional items and are disclosed separately.

From the above, it appears that all material items are not exceptional items. In other words, exceptional items are those items which meet the test of 'materiality' (size and nature) and the test of 'incidence'.

Following are some examples which may give rise to a separate disclosure of items as an 'exceptional item' in financial statements if they meet the test of 'materiality' and 'incidence':

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) disposals of items of property, plant and equipment;

(d) disposals of investments;

(e) discontinued operations;

(f) litigation settlements; and

(g) other reversals of provisions.

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**7. Total Comprehensive Income of V Ltd.**

| Particulars | | ₹ |
|---|---|---|
| Profit from normal operations (A) | | 50,00,000 |
| Other Comprehensive Income | | |
| Items not reclassified to P&L | | |
| Remeasurement gains from defined benefit plans | 5,00,000 | 5,00,000 |
| Items reclassified to P&L | | |
| Gain on translation of foreign operations | 10,00,000 | |
| Revaluation gains on Property, Plant and Equipment | 3,50,000 | |
| Fair value changes on financial assets | 4,50,000 | 18,00,000 |
| Total Other Comprehensive Income (B) | | 23,00,000 |
| Total Comprehensive Income (A +B) | | 73,00,000 |

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# INDIAN ACCOUNTING STANDARD 34: INTERIM FINANCIAL REPORTING

## Questions

1. An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at ₹10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

   How the related tax charge would be calculated for the year 2019 and its quarters.

2. PQR Ltd. is preparing its interim financial statements for quarter 3 of the year. How the following transactions and events should be dealt with while preparing its interim financials:

   (i) It makes employer contributions to government-sponsored insurance funds that are assessed on an annual basis. During Quarter 1 and Quarter 2 larger amount of payments for this contribution were made, while during the Quarter 3 minor payments were made (since contribution is made upto a certain maximum level of earnings per employee and hence for higher income employees, the maximum income reaches before year end).

   (ii) The entity intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs that will be incurred for this work.

   (iii) The company has a practice of declaring bonus of 10% of its annual operating profits every year. It has a history of doing so.

3. While preparing interim financial statements for the half-year ended 30th September 20X2, an entity discovers a material error (an improper expense accrual) in the interim financial statements for the period ended 30th September 20X1 and the annual financial statements for the year ended 31st March 20X2. The entity does not intend to restate the comparative amounts for the prior period presented in the interim financial statements as it believes it

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would be sufficient to correct the error by restating the comparatives in the annual financial statements for the year ended 31st March 20X3.

Is this acceptable? Discuss in accordance with relevant Ind AS.

4. While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

## Answers

**1. Table showing computation of tax charge:**

| | Quarter ending 31st March, 2019 | Quarter ending 30th June, 2019 | Quarter ending 30th September, 2019 | Quarter ending 31st December, 2019 | Year ending 31st December, 2019 |
|---|---|---|---|---|---|
| | ₹ | ₹ | ₹ | ₹ | ₹ |
| Profit before tax | 10,000 | 10,000 | 10,000 | 10,000 | 40,000 |
| Tax charge | (2,500) | (3,000) | (3,000) | (3,000) | (11,500) |
| | 7,500 | 7,000 | 7,000 | 7,000 | 28,500 |

Since an entity's accounting year is not same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

**2.** Paragraph 28 of Ind AS 34, Interim Financial Reporting states that an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements.

Further, paragraphs 32 and 33 of Ind AS 34, Interim Financial Reporting state that for assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end

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would not qualify at interim dates either. Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised otherwise not. The Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

Considering the above guidance, while preparing its interim financials, the transactions and events of the given case should be dealt with as follows:

(i) If employer contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised using an estimated average annual effective contribution rate in its interim financial statements, even though a large portion of the payments have been made early in the financial year. Accordingly, it should work out an average effective contribution rate and account for the same accordingly, in its interim financials.

(ii) The cost of a planned overhaul expenditure that is expected to occur in later part of the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

(iii) A bonus is anticipated for interim reporting purposes, if and only if,

  (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and

  (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance in this regard.

A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements.

Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements. In the instant case, bonus liability of 10% of operating profit for the year to date may be accrued.

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In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

**3.** Paragraph 42 of Ind AS 8, inter alia, states that an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred.

Paragraph 28 of Ind AS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements).

Paragraph 15B of Ind AS 34 cites 'corrections of prior period errors' as an example of events or transactions which need to be explained in an entity's interim financial report if they are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.

Paragraph 25 of Ind AS 34, Interim Financial Statements, states as follows:

"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period."

In view of the above, the entity is required to correct the error and restate the comparative amounts in interim financial statements for the half-year ended 30th September 20X2.

**4.** Paragraph 41 of Ind AS 8, inter alia, states that financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, Interim Financial Statements, states that while judgement is always required in assessing materiality, this Standard bases the recognition

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and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

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# INDIAN ACCOUNTING STANDARD 7: STATEMENT OF CASH FLOWS

## Questions

1. During the financial year 2019-2020, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:

   - Capital gain tax of ₹ 20 crore on sale of office premises at a sale consideration of ₹ 100 crore.
   - Income Tax of ₹ 3 crore on Business profits amounting ₹ 30 crore (assume entire business profit as cash profit).
   - Dividend Distribution Tax of ₹ 2 crore on payment of dividend amounting ₹ 20 crore to its shareholders.
   - Income tax Refund of ₹ 1.5 crore (Refund on taxes paid in earlier periods for business profits).

   You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS.

2. From the following data of Galaxy Ltd., prepare statement of cash flows showing cash generated from Operating Activities using direct method as per Ind AS 7:

| | 31.3.20X2 (₹) | 31.3.20X1 (₹) |
|---|---|---|
| Current Assets: | | |
| Inventory | 1,20,000 | 1,65,000 |
| Trade receivables | 2,05,000 | 1,88,000 |
| Cash & cash equivalents | 35,000 | 20,500 |
| Current Liabilities: | | |
| Trade payable | 1,95,000 | 2,15,000 |
| Provision for tax | 48,000 | 65,000 |

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| *Summary of Statement of Profit and Loss* | | ₹ |
|---|---|---|
| Sales | 85,50,000 | |
| Less: Cost of sales | (56,00,000) | 29,50,000 |
| Other Income | | |
| Interest income | 20,000 | |
| Fire insurance claim received | 1,10,000 | 1,30,000 |
| | | 30,80,000 |
| Depreciation | (24,000) | |
| Administrative and selling expenses | (15,40,000) | |
| Interest expenses | (36,000) | |
| Foreign exchange loss | (18,000) | (16,18,000) |
| Net Profit before tax and extraordinary income | | 14,62,000 |
| Income Tax | | (95,000) |
| Net Profit | | 13,67,000 |

**Additional information:**

(i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.

(ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

3. What will be the classification for following items in the statement of cash flows of both (i) Banks / Financial institutions and (ii) Other Entities?

| S. No. | Particulars |
|---|---|
| 1 | Interest received on loans and advances given |
| 2 | Interest paid on deposits and other borrowings |
| 3 | Interest and dividend received on investments in subsidiaries, associates and in other entities |
| 4 | Dividend paid on preference and equity shares, including tax on dividend |

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| | |
|---|---|
| | paid on preference and equity shares by other entities |
| 5 | Finance charges paid by lessee under finance lease |
| 6 | Payment towards reduction of outstanding finance lease liability |
| 7 | Interest paid to vendor for acquiring fixed asset under deferred payment basis |
| 8 | Principal sum payment under deferred payment basis for acquisition of fixed assets |
| 9 | Penal interest received from customers for late payments |
| 10 | Penal interest paid to suppliers for late payments |
| 11 | Interest paid on delayed tax payments |
| 12 | Interest received on tax refunds |

4. From the following data, identify the nature of activities as per Ind AS 7.

| S. No. | Nature of transaction |
|---|---|
| 1 | Cash paid to employees |
| 2 | Cash paid for development of property costs |
| 3 | Borrowings repaid |
| 4 | Cash paid to suppliers |
| 5 | Loan to Director |
| 6 | Bonus shares issued |
| 7 | Dividends paid |
| 8 | Cash received from trade receivables |
| 9 | Proceeds from sale of PPE |
| 10 | Depreciation of PPE |
| 11 | Advance received from customers |
| 12 | Purchased goodwill |
| 13 | Payment of promissory notes |

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5. One of the subsidiaries of Buildwell Ltd. submitted to Central Finance its Summarized Statement of Profit and Loss and Balance Sheet.

**Summarized Statement of Profit and Loss for the year ended 31st March, 20X3**

| Particulars | Amount (₹) |
|---|---|
| Net sales | 2,52,00,000 |
| *Less:* Cash cost of sales | (1,92,00,000) |
| Depreciation | (6,00,000) |
| Salaries & wages | (24,00,000) |
| Operating expenses | (14,00,000) |
| Provision for taxation | (8,80,000) |
| Net Operating Profit | 7,20,000 |
| Non-recurring income – profit on sale of equipment | 1,20,000 |
| | 8,40,000 |
| Retained earnings and profit brought forward | 15,18,000 |
| | 23,58,000 |
| Dividends declared and paid during the year | (7,20,000) |
| Profit & loss balance as on 31st March, 20X3 | 16,38,000 |

**Summarized Balance Sheet**

| Assets | 31st March, 20X2 | 31st March, 20X3 |
|---|---|---|
| Property, Plant and Equipment: | | |
| Land | 4,80,000 | 9,60,000 |
| Buildings and Equipment | 36,00,000 | 57,60,000 |
| Current Assets | | |
| Cash | 6,00,000 | 7,20,000 |
| Inventories | 16,80,000 | 18,60,000 |
| Trade Receivables | 26,40,000 | 9,60,000 |
| Advances | 78,000 | 90,000 |
| **Total Assets** | 90,78,000 | 1,03,50,000 |

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| Liabilities & Equity | | |
|---|---|---|
| Share capital | 36,00,000 | 44,40,000 |
| Surplus in profit & loss | 15,18,000 | 16,38,000 |
| Trade Payables | 24,00,000 | 23,40,000 |
| Outstanding expenses | 2,40,000 | 4,80,000 |
| Income tax payable | 1,20,000 | 1,32,000 |
| Accumulated depreciation on buildings and equipment | 12,00,000 | 13,20,000 |
| **Total** | 90,78,000 | 1,03,50,000 |

The original cost of equipment sold during the year 20X2-20X3 was ₹ 7,20,000.

Prepare a statement of cashflows the year ended 31st March 20X3.

6. Following is the Balance Sheet of Mars Ltd: ₹ in Lakhs

| Particulars | 31.3.20X3 | 31.3.20X2 |
|---|---|---|
| **ASSETS** | | |
| **Non-Current Assets** | | |
| Property, Plant and Equipment | 450 | 410 |
| Intangible asset | 90 | 90 |
| Deferred Tax Asset (net) | 45 | 45 |
| Other Non-current Asset | 95 | 85 |
| Total Non-current Assets | 680 | 630 |
| **Current Assets** | | |
| Financial Asset | | |
| Investments | 100 | 60 |
| Trade Receivables | 580 | 600 |
| Cash and Cash Equivalents | 300 | 300 |
| Inventories | 800 | 700 |
| Other Current Assets | 160 | 120 |
| Total Current Assets | 1,940 | 1,780 |
| **Total Assets** | **2,620** | **2,410** |
| **Equity and Liabilities** | | |

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| | | |
|---|---|---|
| **Equity** | | |
| Equity Share Capital | 280 | 250 |
| Other Equity | 980 | 820 |
| Total Equity | 1,260 | 1,070 |
| **Non-current Liabilities** | | |
| Financial Liabilities | | |
| Borrowings | 360 | 300 |
| Other Non-current Liabilities | 90 | 80 |
| Total Non-current Liabilities | 450 | 380 |
| **Current Liabilities** | | |
| Financial Liabilities | | |
| Trade Payable | 455 | 450 |
| Bank Overdraft | 410 | 420 |
| Other current liabilities | 45 | 90 |
| Total Current Liabilities | 910 | 960 |
| Total Liabilities | 1,360 | 1,340 |
| **Total Equity and Liabilities** | **2,620** | **2,410** |

Additional Information:

(a) Profit before tax for the year is ₹ 200 lakhs and provision for tax is ₹ 40 lakhs.

(b) Property, Plant and Equipment purchased during the year ₹ 100 lakhs.

(c) Current liabilities include Capital creditors of ₹ 25 lakhs as at 31st March 20X3 (Nil – 31st March 20X2)

(d) Long Term Borrowings raised during the year ₹ 120 lakhs.

From the information given, prepare a Statement of Cash Flows following the Indirect Method. Assume that Bank overdraft is an integral part of the entity's cash management.

7. The opening balance sheet at 1st April, 20X6 of an Indian company (which account for its transactions in INR (₹), which consists of cash of ₹ 1,00,000 and share capital of ₹ 100,000. The Company borrows a long term loan on 30th September, 20X6 for US $ 2,200 when the rate of exchange is 1 US $= ₹ 87. There are no other transactions during the year. The exchange rate at the balance sheet date of 31st March, 20X7 is 1 US $ = ₹ 85.

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The summarized balance sheet at 31st March, 20X7 is as follows:

| | ₹ | ₹ |
|---|---|---|
| **Assets** | | |
| Cash (1,00,000+1,91,400) | | 2,91,400 |
| | | 2,91,400 |
| **Equity and liabilities** | | |
| **Capital and reserves** | | |
| Share capital | 1,00,000 | |
| Other Equity | | |
| Foreign Currency Translation Reserves | 4,400 | 1,04,400 |
| **Non- current liabilities** | | |
| Long -term loan | | 1,87,000 |
| **Total equity and liabilities** | | 2,91,400 |

**Required:**

How the foreign exchange difference arising from unsettled transactions will reflect in the Statement of Cash Flows?

8. A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of ₹ 2,00,000, but no trade receivables or trade payables on 1st April, 20X2. During 20X2-20X3, A Ltd. entered into the following foreign currency transactions:

   1. A Ltd. purchased goods for resale from Europe for € 1,00,000 when the exchange rate was € 1 = ₹ 105. This balance is still unpaid at 31st March, 20X3 when the exchange rate is € 1 = ₹ 100.

   2. A Ltd. sold the goods to an American client for $ 1,50,000 when the exchange rate was $1 = ₹ 85. This amount was settled when the exchange rate was $1 = ₹ 87.

   3. A Ltd. also borrowed € 1,00,000 under a long-term loan agreement when the exchange rate was € 1 = ₹ 105 and immediately converted it to ₹ 1,05,00,000.

   Recommend how cash flows arising from above transactions would be reported in the statement of cash flows under indirect method.

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9. Z Ltd. had acquired a subsidiary V Ltd. during the year 20X1-20X2. Summarized information from the consolidated statement of profit and loss and balance sheet together with some supplementary information have been provided:

Consolidated Statement of Profit and Loss for the year 20X1-20X2

| | ₹ |
|---|---|
| Revenue | 4,56,000 |
| Cost of sales | (2,64,000) |
| Gross profit | 1,92,000 |
| Depreciation | (36,000) |
| Other operating expenses | (67,200) |
| Interest cost | (4,800) |
| Profit before taxation | 84,000 |
| Taxation | (18,000) |
| Profit after taxation | 66,000 |

**Consolidated Balance Sheet as at 31st March**

| | *20X2* | *20X1* |
|---|---|---|
| | ₹ | ₹ |
| **Assets** | | |
| *Non-current assets* | | |
| Property, plant and equipment | 1,92,000 | 96,000 |
| Goodwill | 21,600 | - |
| *Current assets* | | |
| Inventories | 36,000 | 42,000 |
| Financial assets | | |
| Trade receivables | 64,800 | 60,000 |
| Cash and cash equivalents | 9,600 | 6,000 |
| **Total** | **3,24,000** | **2,04,000** |
| **Equity and Liabilities** | | |
| *Shareholders' equity* | 1,08,000 | 42,000 |

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| | | |
|---|---|---|
| *Non-current liabilities* | | |
| Long term debt | 1,20,000 | 76,800 |
| *Current liabilities* | | |
| Income tax payables | 14,400 | 13,200 |
| Financial liabilities | | |
| Trade payables | 81,600 | 72,000 |
| **Total** | **3,24,000** | **2,04,000** |

**Other information**

All of the shares of V Ltd. were acquired for ` 88,800 in cash. The fair values of assets acquired and liabilities assumed were:

| ***Particulars*** | ***₹*** |
|---|---|
| Inventories | 4,800 |
| Trade receivables | 9,600 |
| Cash | 2,400 |
| Property, plant and equipment | 1,32,000 |
| Trade payables | (38,400) |
| Long-term debt | (43,200) |
| Goodwill | 21,600 |
| Cash consideration paid | 88,800 |

Required:

Prepare a consolidated statement of cashflows for the year 20X1-20X2 under indirect method.

10. An entity invests in a 10-year bond with a face value of ₹ 6,00,000 by paying ₹ 2,31,500. The effective rate of interest is 10%. An entity recognises proportionate interest income in its statement of profit and loss over the period of bond.

How the interest income will be treated in the statement of cash flows during the period of bond?

How the maturity proceeds of ₹ 6,00,000 will be treated in the statement of cash flows?

Note: The entity is not in the business of dealing in securities.

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## Answers

**1.** Para 36 of Ind AS 7 inter alia states that when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Accordingly, the transactions are analysed as follows:

| Particulars | Amount (in crore) | Activity |
|---|---|---|
| Sale Consideration | 100 | Investing Activity |
| Capital Gain Tax | (20) | Investing Activity |
| Business profits | 30 | Operating Activity |
| Tax on Business profits | (3) | Operating Activity |
| Dividend Payment | (20) | Financing Activity |
| Dividend Distribution Tax | (2) | Financing Activity |
| Income Tax Refund | 1.5 | Operating Activity |
| **Total Cash flow** | **86.5** | |

| Activity wise | Amount (in crore) |
|---|---|
| Operating Activity | 28.5 |
| Investing Activity | 80 |
| Financing Activity | (22) |
| **Total** | **86.5** |

**2.** **Statement Cash Flows from operating activities**

**of Galaxy Ltd. For the year ended 31st March 20X2 (Direct Method)**

| Particulars | ₹ | ₹ |
|---|---|---|
| **Operating Activities:** | | |
| Cash received from Trade receivables (W.N. 3) | | 85,33,000 |

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| | | |
|---|---|---|
| *Less:* Cash paid to Suppliers (W.N.2) | 55,75,000 | |
| Payment for Administration and Selling expenses | 15,40,000 | |
| Payment for Income Tax (W.N.4) | 1,12,000 | (72,27,000) |
| | | 13,06,000 |
| Adjustment for exceptional items (fire insurance claim) | | 1,10,000 |
| Net cash generated from operating activities | | 14,16,000 |

**Working Notes:**

**1. Calculation of total purchases**

Cost of Sales = Opening stock + Purchases – Closing Stock

₹ 56,00,000 = ₹ 1,65,000 + Purchases – ₹ 1,20,000

Purchases = ₹ 55,55,000

**2. Calculation of cash paid to Suppliers**

**Trade Payables**

| | ₹ | | ₹ |
|---|---|---|---|
| To Bank A/c (balancing figure) | 55,75,000 | By Balance b/d | 2,15,000 |
| To Balance c/d | 1,95,000 | By Purchases (W.N. 1) | 55,55,000 |
| | 57,70,000 | | 57,70,000 |

**3. Calculation of cash received from Customers**

**Trade Receivables**

| | ₹ | | ₹ |
|---|---|---|---|
| To Balance b/d | 1,88,000 | By Bank A/c (balancing figure) | 85,33,000 |
| To Sales | 85,50,000 | By Balance c/d | 2,05,000 |
| | 87,38,000 | | 87,38,000 |

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**4. Calculation of tax paid during the year in cash**

**Provision for tax**

| | ₹ | | ₹ |
|---|---|---|---|
| To Bank A/c (balancing figure) | 1,12,000 | By Balance b/d | 65,000 |
| To Balance c/d | 48,000 | By Profit and Loss A/c | 95,000 |
| | 1,60,000 | | 1,60,000 |

**3.** The following are the classification of various activities in the Statement of Cash Flows:

| S. No. | Particulars | Classification for reporting cash flows | |
|---|---|---|---|
| | | Banks / financial institutions | Other entities |
| 1 | Interest received on loans and advances given | Operating Activities | Investing activities |
| 2 | Interest paid on deposits and other borrowings | Operating Activities | Financing activities |
| 3 | Interest and dividend received on investments in subsidiaries, associates and in other entities | Investing activities | Investing activities |
| 4 | Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities | Financing activities | Financing activities |
| 5 | Finance charges paid by lessee under finance lease | Financing activities | Financing activities |
| 6 | Payment towards reduction of outstanding finance lease liability | Financing activities | Financing activities |
| 7 | Interest paid to vendor for acquiring fixed asset under deferred payment basis | Financing activities | Financing activities |
| 8 | Principal sum payment under deferred payment basis for acquisition of fixed assets | Investing activities | Investing activities |

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| | | | |
|---|---|---|---|
| 9 | Penal interest received from customers for late payments | Operating Activities | Operating Activities |
| 10 | Penal interest paid to suppliers for late payments | Operating Activities | Operating Activities |
| 11 | Interest paid on delayed tax payments | Operating Activities | Financing Activities |
| 12 | Interest received on tax refunds | Operating Activities | Investing Activities |

**4.**

| S. No. | Nature of transaction | Activity as per Ind AS 7 |
|---|---|---|
| 1 | Cash paid to employees | Operating activity |
| 2 | Cash paid for development costs | Investing activity |
| 3 | Borrowings repaid | Financing activity |
| 4 | Cash paid to suppliers | Operating activity |
| 5 | Loan to Director | Investing activity |
| 6 | Bonus shares issued | Non-cash item |
| 7 | Dividends paid | Financing activity |
| 8 | Cash received from trade receivables | Operating activity |
| 9 | Proceeds from sale of PPE | Investing activity |
| 10 | Depreciation of PPE | Non-cash item |
| 11 | Advance received from customers | Operating activity |
| 12 | Purchased goodwill | Investing activity |
| 13 | Payment of promissory notes | Financing activity |

**5. Statement of Cash Flows for the year ended 31st March, 20X3 (Indirect method)**

| Particulars | ₹ | ₹ |
|---|---|---|
| **Cash flow from operating activities:** | | |
| Net Profit before taxes and extraordinary items (7,20,000 + 8,80,000) | 16,00,000 | |
| *Add*: Depreciation | 6,00,000 | |

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| | | |
|---|---|---|
| Operating profit before working capital changes | 22,00,000 | |
| Increase in inventories | (1,80,000) | |
| Decrease in trade receivables | 16,80,000 | |
| Advances | (12,000) | |
| Decrease in trade payables | (60,000) | |
| Increase in outstanding expenses | 2,40,000 | |
| Cash generated from operations | 38,68,000 | |
| *Less*: Income tax paid (Refer W.N.4) | (8,68,000) | |
| **Net cash from operations** | | 30,00,000 |
| **Cash from investing activities:** | | |
| Purchase of land | (4,80,000) | |
| Purchase of building & equipment (Refer W.N.2) | (28,80,000) | |
| Sale of equipment (Refer W.N.3) | 3,60,000 | |
| **Net cash used for investment activities** | | (30,00,000) |
| **Cash flows from financing activities:** | | |
| Issue of share capital | 8,40,000 | |
| Dividends paid | (7,20,000) | |
| **Net cash from financing activities:** | | 1,20,000 |
| **Net increase in cash and cash equivalents** | | 1,20,000 |
| **Cash and cash equivalents at the beginning** | | 6,00,000 |
| **Cash and cash equivalents at the end** | | 7,20,000 |

**Working Notes:**

**1. Building & Equipment Account**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To Balance b/d | 36,00,000 | By Sale of assets | 7,20,000 |
| To Cash / bank (purchases)(bal. fig) | 28,80,000 | By Balance c/d | 57,60,000 |
| | 64,80,000 | | 64,80,000 |

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**2. Building & Equipment Accumulated Depreciation Account**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To Sale of asset (acc. depreciation) | 4,80,000 | By Balance b/d | 12,00,000 |
| To Balance c/d | 13,20,000 | By Profit & Loss A/c (provisional) | 6,00,000 |
| | 18,00,000 | | 18,00,000 |

**3. Computation of sale price of Equipment**

| Particulars | ₹ |
|---|---|
| Original cost | 7,20,000 |
| *Less:* Accumulated Depreciation | (4,80,000) |
| Net cost | 2,40,000 |
| Profit on sale of assets | 1,20,000 |
| Sale proceeds from sale of assets | 3,60,000 |

**4. Provision for tax Account**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To Bank A/c | 8,68,000 | By Balance b/d | 1,20,000 |
| To Balance c/d | 1,32,000 | By Profit & Loss A/c (provisional) | 8,80,000 |
| | 10,00,000 | | 10,00,000 |

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

| | (₹ in lakhs) | (₹ in lakhs) |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before taxation | 200 | |
| Adjustments for non-cash items: | | |
| Depreciation [410 - (450 - 100)] | 60 | |
| | 260 | |
| Increase in inventories (800 - 700) | (100) | |
| Decrease in trade receivables (600 - 580) | 20 | |

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

**Notes:**

1. Other current liabilities are assumed to consist of provision for taxation.
2. Other non-current assets and other non-current liabilities pertain to working capital items.

**7.** The foreign currency loan, having been translated at the rate ruling at the receipt date to ₹ 1,91,400 (US $ 2,200 x ₹ 87), is translated at the balance sheet date to ₹ 1,87,000 (US $ 2,200 x ₹ 85). The exchange gain of ₹ 4,400 is recognised in the Statement of profit and loss. The cash is made up of ₹ 1,00,000 (received from the share issue) and ₹ 1,91,400 (received on converting the currency loan immediately to `).

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**Statement of Cash Flows**

| | ₹ |
|---|---|
| **Cash flows from operating activities** | |
| Profit | 4,400 |
| *Less:* Foreign exchange gain | (4,400) |
| *Net cash flow from operating activities* *A* | 0 |
| **Cash flows from financing activities** | |
| Receipts of foreign currency loan | 1,91,400 |
| *Net cash flow from financing activities* *B* | 1,91,400 |
| **Net increase in cash and cash equivalent** *A+B* | 1,91,400 |
| **Cash and cash equivalents at the beginning of the reporting period** | 1,00,000 |
| **Cash and cash equivalents at the end of the reporing period*** | 2,91,400 |

* Represents year end cash balances.

The exchange gain of ₹ 4,400 does not have any cash flow effect and is related to financing activities. Therefore, it needs to be eliminated from profit. A similar adjustment would be necessary if the loan remains outstanding at 31st March, 20X8.

**8.** An exchange gain on retranslation of the trade payable of ₹ 5,00,000 is recorded in profit or loss [€ 1,00,000 x (105 – 100) = ₹ 5,00,000].

A further exchange gain of ₹ 3,00,000 regarding the trade receivable is recorded in the statement of profit or loss [$ 1,50,000 x (87 – 85) = ₹ 3,00,000].

The loan was retranslated at 31st March, 20X3 @ ₹ 100 = ₹ 1,00,00,000, with a further exchange gain of ₹ 5,00,000 recorded in the statement of profit or loss.

A Ltd. therefore records a cumulative exchange gain of ₹ 13,00,000 (5,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.

In addition, A Ltd. records a gross profit of ₹ 22,50,000 (₹ 1,05,00,000 – ₹ 1,27,50,000) on the sale of the goods.

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**Statement of Cash Flows**

**Cash flows from operating activities (Indirect method)**

| Particulars | Amount (₹) |
|---|---|
| Profit before taxation (22,50,000 + 13,00,000) | 35,50,000 |
| Adjustment for unrealised exchange gains/losses: | |
| Foreign exchange gain on long term loan | (5,00,000) |
| Decrease in trade payables | (5,00,000) |
| Operating cash flow before working capital changes | 25,50,000 |
| Changes in working capital (Due to increase in trade payables) | 1,05,00,000 |
| Net cash inflow from operating activities | 1,30,50,000 |
| Cash inflow from financing activity | 1,05,00,000 |
| Net increase in cash and cash equivalents | 2,35,50,000 |
| Cash and cash equivalents at the beginning of the period | 2,00,000 |
| Cash and cash equivalents at the end of the period (W.N.) | 2,37,50,000 |

Note: Taxation is ignored.

**Working Note:**

**Closing Cash and Cash Equivalents**

| Particulars | Amount (₹) |
|---|---|
| Opening balance of cash and cash equivalents | 2,00,000 |
| *Add:* Received from settlement of Trade Receivables | 1,30,50,000 |
| *Add:* Received from conversion of loan | 1,05,00,000 |
| | 2,37,50,000 |

**9. Consolidated Statement of Cash Flows for the 20X1-20X2**

| | ₹ | ₹ |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit after taxation | | 84,000 |
| Adjustments for non-cash items: | | |
| Depreciation | 36,000 | |

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| | | |
|---|---|---|
| Interest paid to be included in financing activities | 4,800 | 40,800 |
| | | 1,24,800 |
| Adjustments for working capital changes: | | |
| Decrease in inventories (W.N.1) | 10,800 | |
| Decrease in trade receivables (W.N.2) | 4,800 | |
| Decrease in trade payables (W.N.3) | (28,800) | (13,200) |
| | | 1,11,600 |
| *Less:* Taxation (13,200 + 18,000 – 14,400) | | (16,800) |
| *Net cash generated from operating activities* | | 94,800 |
| **Cash flows from investing activities** | | |
| Cash paid to be acquired subsidiary (88,800 – 2,400) | (86,400) | |
| *Net cash outflow from investing activities* | | (86,400) |
| **Cash flows from financing activities** | | |
| Interest paid | (4,800) | |
| *Net cash outflow from financing activities* | | (4,800) |
| Increase in cash and cash equivalents | | 3,600 |
| Cash and cash equivalents at the beginning of the year | | 6,000 |
| Cash and cash equivalents at the end of the year | | 9,600 |

**Working Notes:**

**1. Computation of increase/decrease in inventory of the Group for the year**

| | ₹ |
|---|---|
| Total inventory of the Group at the end of the year | 36,000 |
| Inventory acquired during the year from subsidiary | (4,800) |
| Closing inventory | 31,200 |
| *Less:* Opening inventory | (42,000) |
| Decrease in inventory | (10,800) |

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**2. Computation of increase/decrease in trade receivables of the Group for the year**

| | ₹ |
|---|---|
| Total trade receivables of the Group at the end of the year | 64,800 |
| Trade receivables acquired during the year from subsidiary | (9,600) |
| Closing trade receivables | 55,200 |
| *Less:* Opening trade receivables | (60,000) |
| Closing trade receivables | (4,800) |

**3. Computation of increase/decrease in trade payables of the Group for the year**

| | ₹ |
|---|---|
| Trade payables at the end of the year | 81,600 |
| Trade payables of the subsidiary assumed during the year | (38,400) |
| Closing trade payables | 43,200 |
| *Less:* Opening trade payables | (72,000) |
| Closing trade payables | (28,800) |

**10.** Since the entity is not in the business of dealing in securities, a sum of ₹ 2,31,500 invested in a bond will be classified as investing activities. There is no cash flow of interest during bond period, as there is no cash receipt. On maturity, proceeds of ₹ 6,00,000 will be classified as receipt under investing activity with a bifurcation of ₹ 3,68,500 as interest and ₹ 2,31,500 as proceeds towards redemption of bond.

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# INDIAN ACCOUNTING STANDARD 8:
# ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

## Questions

1. While preparing the annual financial statements for the year ended 31st March, 20X3, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 20X2 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the amount was material?

2. While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

3. ABC Ltd has an investment property with an original cost of ₹ 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil.

   How should the error be corrected in the financial statements for the year ended 31st March, 20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

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4. ABC Ltd. changed its method adopted for inventory valuation in the year 20X2-20X3. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

The effect of the change in the method of valuation of inventory was as follows:

- 31st March, 20X1 - Increase of ₹ 10 million
- 31st March, 20X2 - Increase of ₹ 15 million
- 31st March, 20X3 - Increase of ₹ 20 million

Profit or loss under the FIFO valuation model are as follows:

| | 20X2-20X3 | 20X1-20X2 |
|---|---|---|
| Revenue | 324 | 296 |
| Cost of goods sold | (173) | (164) |
| **Gross profit** | **151** | **132** |
| Expenses | (83) | (74) |
| **Profit** | **68** | **58** |

Retained earnings at 31st March, 20X1 were ₹ 423 million

You are required to present the impact of change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.

5. During 20X4-20X5, Cheery Limited discovered that some products that had been sold during 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500.

Cheery Limited's accounting records for 20X4-20X5 show sales of ₹ 104,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

In 20X3-20X4, Cheery Limited reported:

| | ₹ |
|---|---|
| Sales | 73,500 |
| Cost of goods sold | (53,500) |
| **Profit before income taxes** | 20,000 |
| Income taxes | (6,000) |

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| | |
|---|---|
| **Profit** | 14,000 |
| Basic and diluted EPS | 2.8 |

The 20X3-20X4 opening retained earnings was ₹ 20,000 and closing retained earnings was ₹ 34,000. Cheery Limited's income tax rate was 30% for 20X4-20X5 and 20X3-20X4. It had no other income or expenses.

Cheery Limited had ₹ 50,000 (5,000 shares of ₹ 10 each) of share capital throughout, and no other components of equity except for retained earnings.

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

6. In 20X3-20X4, after the entity's 31st March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹ 1,00,000 of unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31st March 20X3. An additional ₹ 20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹ 5,000 of which relates to items of inventory at 31st March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹ 18,000. The accounting estimates made in preparing the 31st March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

   Analyse the above situation in accordance with relevant Ind AS.

7. In its financial statements for the year ended 31st March, 20X2, Y Ltd. reported ₹ 73,500 revenue (sales), ₹ 53,500 cost of sales, ₹ 6,000 income tax expense, ₹ 20,000 retained earnings at 1st April, 20X1 and ₹ 34,000 retained earnings at 31st March, 20X2.

   In 20X2-20X3, after the 20X1-20X2 financial statements were approved for issue, Y Ltd. discovered that some products sold in 20X1-20X2 were incorrectly included in inventories at 31st March, 20X2 at their cost of ₹ 6,500.

   In 20X2-20X3, Y Ltd. changed its accounting policy for the measurement of investments in associates after initial recognition from cost model to the fair value model as per

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Ind AS 109. It acquired its only investment in an associate for ₹ 3,000 many years ago. The associate's equity is not traded on a securities exchange (that is, a published price quotation is not available). The fair value of the investment was determined reliably using an appropriate equity valuation model on 31st March, 20X3 at ₹ 25,000 (20X1-20X2: ₹ 20,000 and 20X0-20X1: ₹ 18,000).

At 31st March, 20X3, as a result of usage of improved lubricants, Y Ltd. reassessed the useful life of Machine A from four years to seven years. Machine A is depreciated on the straight-line method to a Nil residual value. It was acquired for ₹ 6,000 on 1st April, 20X0.

Inventories of the type manufactured by Machine A were immaterial at the end of each reporting period.

Y Ltd.'s accounting records for the year ended 31st March, 20X3, before accounting for change in accounting policy and change in accounting estimate, record ₹ 1,04,000 revenue (sales), ₹ 86,500 cost of sales (including ₹ 6,500 for the error in opening inventory and ₹ 1,500 depreciation for Machine A) and ₹ 5,250 income tax expense.

Y Ltd. presents financial statements with one year of comparative information.

For simplicity, the tax effect of all items of income and expenses should be assumed to be 30% of the gross amount.

Draft an extract showing how the correction of the prior period error, change in accounting policy and change in accounting estimate could be presented in the Statement of Profit and Loss and Statement of Changes in Equity (Retained Earnings) and disclosed in the Notes of Y Ltd. for the year ended 31st March, 20X3.

8. While preparing the financial statements for the year ended 31st March, 20X3, Alpha Limited has observed two issues in the previous year Ind AS financial statements (i.e. 31st March, 20X2) which are as follows:

**Issue 1:**

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 20X2).

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**Issue 2:**

The company had charged off certain expenses as finance costs in the year ended 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X2).

What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 20X2?

9. During 20X3, T Ltd. discovered that prepayments of ₹ 680 made during 20X1 had not been recognised in profit or loss as the related expenses were incurred. The prepayments should have been recognised as an expense of ₹ 170 in 20X1; ₹ 425 in 20X2; and ₹ 85 in 20X3. The misstatement is material.

**Extract from draft 20X3 Statement of Profit and Loss before correction of error**

| | *Draft 20X3* | *20X2* |
|---|---|---|
| Revenue | 10,200 | 6,800 |
| *Less:* Expenses | (9,350) | (6,120) |
| Net profit | 850 | 680 |

**Extract from Statement of Changes in Equity**

| | *Draft 20X3* | *20X2* |
|---|---|---|
| Opening retained earnings | 24,480 | 23,800 |
| *Add:* Current-year net profit | 850 | 680 |
| Closing retained earnings | 25,330 | 24,480 |

The opening balance of retained earnings is adjusted and comparatives are restated when practicable to reflect the correction of the error. Assume there are no tax effects.

**Required:**

Draw the revised Statement of Profit and Loss (extract) and Statement of Changes in Equity (extract) after rectifying the above error.

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## Answers

**1.** As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 20X1 and liabilities as at 31st March, 20X1 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31st March, 20X2, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 20X3, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 20X2) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 20X1) wherein it should recognise the provision for bonus and restate the retained earnings.

**2.** Paragraph 41 of Ind AS 8, inter alia, states that financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, Interim Financial Statements, states as follows:

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"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding of an entity's financial position and performance during the interim period."

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

**3.** The error shall be corrected by retrospectively restating the figures for financial year 20X2-20X3 and also by presenting a third balance sheet as at 1st April, 20X2 which is the beginning of the earliest period presented in the financial statements.

**4. Profit or loss under weighted average valuation method is as follows:**

| | 20X2-20X3 | 20X1-20X2 (Restated) |
|---|---|---|
| Revenue | 324 | 296 |
| Cost of goods sold | (168) | (159) |
| **Gross profit** | **156** | **137** |
| Expenses | (83) | (74) |
| **Profit** | **73** | **63** |

**Statement of changes in Equity (extract)**

| | Retained earnings | Retained earnings (Original) |
|---|---|---|
| At 1st April, 20X1 | 423 | 423 |
| Change in inventory valuation policy | 10 | - |

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| | | |
|---|---|---|
| **At 1st April, 20X1 (Restated)** | **433** | **-** |
| Profit for the year 20X1-20X2 | 63 | 58 |
| **At 31st March, 20X2** | **496** | **481** |
| Profit for the 20X2-20X3 | 73 | 68 |
| **At 31st March, 20X3** | **569** | **549** |

**5.**

**Cheery Limited**

**Extract from the Statement of profit and loss**

| | **20X4-20X5** ₹ | **(Restated) 20X3-20X4** ₹ |
|---|---|---|
| Sales | 1,04,000 | 73,500 |
| Cost of goods sold | (80,000) | (60,000) |
| **Profit before income taxes** | **24,000** | **13,500** |
| Income taxes | (7,200) | (4,050) |
| **Profit** | **16,800** | **9,450** |
| Basic and diluted EPS | 3.36 | 1.89 |

**Cheery Limited**

**Statement of Changes in Equity**

| | **Share capital** | **Retained earnings** | **Total** |
|---|---|---|---|
| Balance at 31st March, 20X3 | 50,000 | 20,000 | 70,000 |
| Profit for the year ended 31st March, 20X4 as restated | | 9,450 | 9,450 |
| **Balance at 31st March, 20X4** | **50,000** | **29,450** | **79,450** |
| Profit for the year ended 31st March, 20X5 | | 16,800 | 16,800 |
| **Balance at 31st March, 20X5** | **50,000** | **46,250** | **96,250** |

**Extract from the Notes**

Some products that had been sold in 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500. The financial statements of 20X3-20X4 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below:

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| | Effect on 20X3-20X4 |
|---|---|
| (Increase) in cost of goods sold | (6,500) |
| Decrease in income tax expenses | 1,950 |
| (Decrease) in profit | (4,550) |
| (Decrease) in basic and diluted EPS | (0.91) |
| (Decrease) in inventory | (6,500) |
| Decrease in income tax payable | 1,950 |
| (Decrease) in equity | (4,550) |

There is no effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3.

**6.** Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were approved for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

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On the basis of above provisions, the given situation would be dealt as follows:

The defect was neither known nor reasonably possible to detect at 31st March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31st March 20X3 financial statements are not prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31st March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31st March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

**Working Note:**

Inventory is measured at the lower of cost (i.e. ₹ 15,000) and fair value less costs to complete and sell (i.e. ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

**7. Extract of Y Ltd.'s Statement of Profit and Loss**

**for the year ended 31st March, 20X3**

| | *20X2-20X3* | *Reference to W.N.* | *20X1-20X2 Restated* | *Reference to W.N.* |
|---|---|---|---|---|
| | ₹ | | ₹ | |
| Revenue | 1,04,000 | | 73,500 | |
| Cost of sales (20X1-20X2 previously ₹ 53,500) | (79,100) | 1 | (60,000) | 4 |
| Gross profit | 24,900 | | 13,500 | |
| Other income — change in the measurement policy i.e. the value of investment in associate at FVTPL | 5,000 | 2 | 2,000 | 5 |

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| | | | | |
|---|---|---|---|---|
| Profit before tax | 29,900 | | 15,500 | |
| Income tax expense | (8,970) | 3 | (4,650) | 6 |
| Profit for the year | 20,930 | | 10,850 | |

**Extract of Y Ltd.'s Statement of Changes in Equity (Retained Earnings)**

**for the year ended 31st March, 20X3**

| | *20X2-20X3* | *Reference to W.N.* | *20X1-20X2 Restated* | *Reference to W.N.* |
|---|---|---|---|---|
| | ₹ | | ₹ | |
| Retained earnings, as restated, at the beginning of the year | | | | |
| - as previously stated | 34,000 | | 20,000 | |
| - effect of the correction of a prior period error | (4,550) | 7 | - | |
| - effect of a change in accounting policy | 11,900 | 13 | 10,500 | 12 |
| | 41,350 | | 30,500 | |
| Profit for the year | 20,930 | | 10,850 | |
| Retained earnings at the end of the year | 62,280 | | 41,350 | |

**Y Ltd.**

**Extract of Notes to the Financial Statements for the year ended 31st March, 20X3**

**Note X : Change in Accounting Estimates**

Due to usage of improved lubricants the estimated useful life of the machine used for production was increased from four years to seven years. The effect of the change in the useful life of the machine is to reduce the depreciation allocation by ₹ 900 in 20X2-20X3 and 20X3-20X4. The after-tax effect is an increase in profit for the year of ₹ 630 for each of the two years.

Depreciation expense in 20X4-20X5 to 20X6-20X7 is increased by ₹ 600 because of revision in the useful life of machinery, as under the initial estimate, the asset would have

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been fully depreciated at the end of 20X3-20X4. The after-tax effect for these three years is a decrease in profit for the year by ₹ 420 per year.

**Note Y : Correction of Prior Period Error**

In 20X2-20X3 the entity identified that ₹ 6,500 products that had been sold in 20X1-20X2 were included erroneously in inventory at 31st March, 20X2. The financial statements of 20X1-20X2 have been restated to correct this error. The effect of the restatement is ₹ 6,500 increase in the cost of sales and ₹ 4,550 decrease in profit for the year ended 31st March, 20X2 after decreasing income tax expense by ₹ 1,950. This resulted in ₹ 4,550 (decrease) restatement of retained earnings at 31st March, 20X2.

**Note Z : Change in Accounting Policy**

In 20X2-20X3 the entity changed its accounting policy for the measurement of investments in associates from cost model to fair value model as per Ind AS 109. Management judged that this policy provides reliable and more relevant information because dividend income and changes in fair value are inextricably linked as integral components of the financial performance of an investment in an associate and measurement at fair value is necessary if that financial performance is to be reported in a more meaningful way. This change in accounting policy has been accounted for retrospectively. The comparative information has been restated. A new line item, 'Other income — change in the fair value of investment in associate', has been added in the Statement of Profit and Loss and Retained Earnings. The effect of the restatement has been to add income of ₹ 2,000 as a result of the increase in value of the associate during the year ended 31st March, 20X2 which resulted in ₹ 1,400 increase in profit for the year (after including a resulting increase in income tax expense of ₹ 600). This, together with ₹ 10,500 (increase) restatement of retained earnings at 31st March, 20X1, resulted in a ₹ 11,900 increase in retained earnings at 31st March, 20X2. Furthermore, profit for the year ended 31st March, 20X3 was ₹ 3,500 higher (after deducting ₹ 1,500 tax effect) as a result of recording a further ₹ 5,000 (W.N.2) increase in the fair value of the investment in an associate.

**Working Notes:**

1. ₹ 86,500 (given) minus ₹ 6,500 correction of error (now recognised as an expense in 20X1-20X2) minus ₹ 900 (W.N.9) effect of the change in accounting estimate.

2. ₹ 25,000 fair value (20X2-20X3) minus ₹ 20,000 fair value (20X1-20X2) = ₹ 5,000 (the effect of applying the new accounting policy (fair value model) in 20X2-20X3).

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3. ₹ 5,250 + ₹ 1,950 (W.N.8) + 30% (₹ 900 (W.N.9) reduction in depreciation resulting from the change in accounting estimate) + 30% (₹ 5,000 increase in the fair value of investment property — change in accounting policy) = ₹ 8,970.

4. ₹ 53,500 as previously stated + ₹ 6,500 (products sold and incorrectly included in closing inventory in 20X1-20X2) = ₹ 60,000 (that is, the prior period error is corrected retrospectively by restating the comparative amounts).

5. ₹ 20,000 fair value (20X1-20X2) minus ₹ 18,000 fair value (20X0-20X1) = ₹ 2,000 (the effect in 20X1-20X2 of the change in accounting policy for investments in associates from the cost model to the fair value model).

6. ₹ 6,000 as previously stated minus ₹ 1,950 (W.N.8) correction of prior period error + 30% (₹ 2,000 change in accounting policy) = ₹ 4,650.

7. ₹ 6,500 (products sold and incorrectly included in inventory in 20X1-20X2) – ₹ 1,950 (W.N.8) (tax overstated in 20X1-20X2) = ₹ 4,550.

8. ₹ 6,500 (products sold and incorrectly included in inventory in 20X1-20X2) x 30% (income tax rate) = ₹ 1,950.

9. ₹ 1,500 depreciation (using old estimate, that is, ₹ 6,000 cost ÷ 4 years) minus ₹ 600 (W.N.10) (using new estimate of useful life) = ₹ 900.

10. ₹ 3,000 (W.N.11) carrying amount ÷ 5 years remaining useful life = ₹ 600 depreciation per year.

11. [₹ 6,000 cost minus (₹ 1,500 depreciation x 2 years)] = ₹ 3,000 carrying amount at 31st March, 20X2.

12. (₹ 18,000 fair value of investment in associates at 31st March, 20X1 minus ₹ 3,000 carrying amount based on the cost model at the same date) x 0.7 (to reflect 30% income tax rate) = ₹ 10,500 (effect of a change in accounting policy (from cost model to fair value model)).

13. ₹ 10,500 (W.N.12) + [₹ 2,000 (W.N.5) x 0.7 (to reflect 30% income tax rate)] = ₹ 11,900.

**8.** As per paragraph 41 of Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a

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particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Accordingly, the stated issues in question are to dealt as under:

**Issue 1**

In accordance with para 41, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended March 31, 20X3, the comparative amounts as at 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1 April 20X1 in addition to the comparatives for the financial year 20X1-20X2.

**Issue 2**

In accordance with para 41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31 March, 20X3, the comparative amounts for the year ended 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1 April 20X1). Therefore, the entity is not required to present a third balance sheet.

**9.** In restating the comparatives, the adjustment will be included in the appropriate line item. In addition, the financial statements will include full disclosure regarding the error and the

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adjustments made to correct it as per para 49 of Ind AS 8. The restated comparative financial statements should be accompanied with the heading 'restated' to highlight for users the fact that the comparative financial statements are not the same as the financial statements previously published.

**Statement of Profit and Loss after correction of error (Extract)**

| | *20X3* ₹ | *20X2 (Restated)* ₹ |
|---|---|---|
| Revenue | 10,200 | 6,800 |
| *Less:* Expenses (9,350 + 85) | (9,435) | (6,545) |
| Net profit | 765 | 255 |

**Statement of Changes in Equity (Extract)**

| | *20X3* ₹ | *20X2 (Restated)* ₹ |
|---|---|---|
| Opening retained earnings as reported previously | - | 23,800 |
| Correction of an error related to previous years | - | (170) |
| Opening retained earnings (restated) | 23,885 | 23,630 |
| Current-year net profit | 765 | 255 |
| Closing retained earnings | 24,650 | 23,885 |

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# INDIAN ACCOUNTING STANDARD 10: EVENTS AFTER THE REPORTING PERIOD

## Questions

1. XYZ Ltd. sells goods to its customer with a promise to give a discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods for ₹ 5 lakhs to ABC Ltd. between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.

   State whether discount will be adjusted from the sales at the end of the reporting period.

2. Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event?

3. X Ltd. was having investment in the form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2?

4. H Ltd. constructed a warehouse at a cost of ₹ 10 lakhs in 20X1. It first became available for use by H Ltd. on 1st April, 20X2. On 29th April, 20X6, H Ltd. discovered that its warehouse was damaged. During early May 20X6, an investigation revealed that the damage was due to a structural fault in the construction of the warehouse. The fault became apparent when the warehouse building leaked severely after heavy rainfall in the week ended 27th April 20X6. The discovery of the fault is an indication of impairment. So, H Ltd. was required to estimate the recoverable amount of its warehouse at 31st March 20X6. This estimate was ₹ 6,00,000. Furthermore, H Ltd. reassessed the useful life of its warehouse at 20 years from the date that it was ready for use. Before discovering the fault, H Ltd. had depreciated the warehouse on the straight-line method to a nil residual value over its estimated 30-year useful life.

   Seepage of rainwater through the crack in the warehouse caused damage to inventory worth about ₹ 1,00,000 (cost price) and became un-saleable. The entire damaged

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inventory was on hand as at 31st March, 20X6. H Ltd. has not insured against any of the losses.

It accounts for all its property, plant and equipment under the cost model. H Ltd.'s annual financial statements for the year ended 31st March, 20X6 were approved for issue by the Board of Directors on 28th May, 20X6.

You are required to:

(i) Prepare accounting entries to record the effects of the events after the end of the reporting period in the accounting records of H Ltd. for the year ended 31st March, 20X6. Kindly ignore tax impact.

(ii) Discuss disclosure requirement in above case as per relevant Ind AS.

(iii) Will your answer be different if there was no structural fault and damage to the warehouse had been caused by an event that occurred after 31st March, 20X6?

5. The company has made sales of ₹ 60,00,000 to a customer SS LLP on 31st December 20X2. The normal credit is for one month. However, sometimes, it goes upto 2 months. The company expects to receive payment by 28th February 20X3. However, no payment has been received till 31st March 20X3. On 15th April 20X3, the sales department of the company became aware that the customer is passing through financial crisis and has major cash flow problems.

The company has agreed to allow the customer to settle the debt by 31st March 20X4, by which time the customer is confident that the cashflow problem will be resolved.

The company expects that an annual interest of 9% (i.e. effective interest rate) can be received against any money lent out, yet it allowed the customer an interest-free payment period.

Determine the amount to be shown as 'trade receivable' from SS LLP in the books of the company as on 31st March 20X3.

## Answers

**1.** As per Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

In the instant case, the condition that sales have been made exists at the end of the reporting period and the receipt of payment within 15 days time after the end of the reporting period and before the approval of the financial statements confirms that the

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discount is to be provided on those sales. Therefore, it is an adjusting event. Accordingly, XYZ Ltd. should adjust the sales made to ABC Ltd. with respect to discount of 5% on the list price of the goods.

**2.** In the instant case, the fraud is discovered after the end of the reporting period of 20X3-20X4, which related to financial year 20X1-20X2. Since the fraud took place before the end of the reporting period, the condition was existing which has been confirmed by the detection of the same after the end of the reporting period but before the approval of financial statements. Therefore, it is an adjusting event.

Moreover, Ind AS 10 in paragraph 9, specifically provides that the discovery of fraud or error after the end of the reporting period, that shows that financial statements are incorrect, is an adjusting event. Such a discovery of fraud should be accounted for in accordance with Ind AS 8 if it meets the definition of prior period error.

**3.** Since it has been detected that a fraud has been made by committing an intentional error and as a result of the same financial statements present an incorrect picture, which has been detected after the end of the reporting period but before the approval of the financial statements. The same is an adjusting event. Accordingly, the value of investments in the financial statements should be adjusted for the fraudulent error in computation of value of investments.

**4. (i)** **Journal Entries on 31st March, 20X6**

| | ₹ | ₹ |
|---|---|---|
| Depreciation expense A/c (W.N.1) Dr. | 19,608 | |
| To Warehouse or Accumulated depreciation A/c | | 19,608 |
| (Being additional depreciation expense recognised for the year ended 31st March 20X6 arising from the reassessment of the useful life of the warehouse) | | |
| Impairment loss A/c (W.N.2) Dr. | 2,47,059 | |
| To Warehouse or Accumulated depreciation A/c | | 2,47,059 |
| (Being impairment loss recognised due to discovery of structural fault in the construction of warehouse at 31st March, 20X6) | | |

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**(ii)** **(a)** **The damage to warehouse is an adjusting event** (occurred after the end of the year 20X6-20X6) for the reporting period 20X5-20X6, since it provides evidence that the structural fault existed at the end of the reporting period. It is an adjusting event, in spite of the fact that fault has been discovered after the reporting date.

**The effects of the damage to the warehouse are recognised in the year 20X5-20X6 reporting period**. Prior periods will not be adjusted because those financial statements were prepared in good faith (eg. regarding estimate of useful life, assessment of impairment indicators etc.) and had not affected the financials of prior years.

**(b)** Damage of inventory due to seepage of rainwater ₹ 1,00,000 occurred during the year 20X5-20X6. **It is a non-adjusting event** after the end of the 20X5-20X6 reporting period since the inventory was in good condition at 31st March 20X6. Hence, no accounting has been done for it in the year 20X5-20X6.

**H Ltd. must disclose the nature of the event** (i.e. rain-damage to inventories) and an estimate of the financial effect (i.e. ₹ 1,00,000 loss) in the notes to its 31st March 20X6 annual financial statements.

**(iii)** If the damage to the warehouse had been caused by an event that occurred after 31st March 20X6 and was not due to structural fault, **then it would be considered as a non-adjusting event** after the end of the reporting period 20X5-20X6 as the warehouse would have been in a good condition at 31st March 20X6.

**Working Notes:**

**1. Calculation of additional depreciation to be charged in the year 20X5-20X6**

Original depreciation as per SLM already charged during the year 20X5-20X6

= ₹ 10,00,000/ 30 years = ₹ 33,333.

Carrying value at the end of 20X4-20X5 = 10,00,000 – (₹ 33,333 x 3 years)

= ₹ 9,00,000

Revised depreciation = 9,00,000 / 17 years = ₹ 52,941

Additional depreciation to be recognised in the books in the year 20X5-20X6

= ₹ 52,941 – ₹ 33,333 = ₹ 19,608

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**2. Calculation of impairment loss in the year 20X5-20X6**

Carrying value after charging depreciation for the year 20X5-20X6

= ₹ 9,00,000 – ₹ 52,941 = ₹ 8,47,059

Recoverable value of the warehouse = ₹ 6,00,000

Impairment loss = Carrying value - Recoverable value

= ₹ 8,47,059 - ₹ 6,00,000 = ₹ 2,47,059

**5.** Ind AS 10 'Events after the Reporting Date', classify an event as adjusting if it provides additional evidence of conditions existing at the reporting date. In this case the additional information relates to evidence of impairment of a financial asset since the customer had financial difficulties prior to 31st March 20X3.

Ind AS 109 'Financial Instruments' requires financial assets to be reviewed at each reporting date for evidence of impairment. Such evidence exists here because although the customer is expected to pay the amount due the payment date has been deferred. As per para B5.5.33 of Ind AS 109, for a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's effective interest rate. Any adjustment is recognized in the profit or loss as an impairment gain or loss. Further, para B5.5.44 of Ind AS 109 provides that expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof.

In such circumstances, Ind AS 109 requires that the financial asset be re-measured to the present value of the expected future receipt, discounted (in the case of a trade receivable) using effective interest rate. Therefore, in the financial statements for the year ended 31st March 20X3, asset should be measured at ₹ 55,04,587 (₹ 60,00,000 / 1.09) and an impairment loss of ₹ 4,95,413 (₹ 60,00,000 – ₹ 4,95,413) recognised in profit and loss.

In the year ended 31st March 20X4, interest income of ₹ 4,95,413 (₹ 55,04,587 x 9%) should be recognised in the profit and loss.

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# INDIAN ACCOUNTING STANDARD 113: FAIR VALUE MEASUREMENT

## Questions

1. You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

| Particulars | ₹ in crore |
|---|---|
| Valuation as per Market Approach | 5268.2 |
| Valuation as per Income Approach | 3235.2 |
| Debt obligation as on Measurement date | 1465.9 |
| Surplus cash & cash equivalent | 106.14 |
| Fair value of surplus assets and Liabilities | 312.4 |
| Number of shares of KK Ltd. | 8,52,84,223 shares |

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.

2. Comment on the following by quoting references from appropriate Ind AS.

(i) DS Limited holds some vacant land for which the use is not yet determined. The land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

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On what basis will the land be fair valued under Ind AS?

(ii) DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market.

Under which level of fair value hierarchy will the above inputs be classified?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares?

3. On 1st January, 20X1, A Ltd assumes a decommissioning liability in a business combination. The reporting entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. The following information is relevant:

If A Ltd was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use all of the following inputs, probability weighted as appropriate, when estimating the price it would expect to receive:

a. Labour costs

Labour costs are developed based on current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability to a range of cash flow estimates as follows:

| Cash Flow Estimates: | 100 Cr | 125 Cr | 175 Cr |
|---|---|---|---|
| Probability: | 25% | 50% | 25% |

b. Allocation of overhead costs:

Assigned at 80% of labour cost.

c. The compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset. Such compensation includes both of the following:

i. Profit on labour and overhead costs:

A profit mark-up of 20% is consistent with the rate that a market participant would require as compensation for undertaking the activity

ii. The risk that the actual cash outflows might differ from those expected, excluding inflation:

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A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

d. Effect of inflation on estimated costs and profits

A Ltd. assumes a rate of inflation of 4 percent over the 10-year period based on available market data.

e. Time value of money, represented by the risk-free rate: 5%

f. Non-performance risk relating to the risk that Entity A will not fulfill the obligation, including A Ltd.'s own credit risk: 3.5%

A Ltd. concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability.

You are required to calculate the fair value of the asset retirement obligation.

4. (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ₹ 10. Entity XYZ's after-tax maintainable profits are estimated at ₹ 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii) Based on the facts given in the aforementioned part (i), assume that Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is ₹ 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

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## Answers

**1. Equity Valuation of KK Ltd.**

| Particulars | Weights | (₹ in crore) |
|---|---|---|
| As per Market Approach | 50 | 5268.2 |
| As per Income Approach | 50 | 3235.2 |
| Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%) | | 4,251.7 |
| *Less:* Debt obligation as on measurement date | | (1465.9) |
| *Add:* Surplus cash & cash equivalent | | 106.14 |
| *Add:* Fair value of surplus assets and liabilities | | 312.40 |
| Enterprise value of KK Ltd. | | 3204.33 |
| No. of shares | | 85,284,223 |
| Value per share | | 375.72 |

**2. (i)** As per Ind AS 113, 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.

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, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

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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 land is to develop a commercial complex. Although developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as Ind AS 113 does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

**(ii)** As per Ind AS 113, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, DS Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability.

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If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

**3.**

| | | Amount (In Crore) |
|---|---|---|
| Expected Labour Cost (Refer W.N.) | | 131.25 |
| Allocated Overheads | (80% x 131.25 Cr) | 105.00 |
| Profit markup on Cost | (131.25 + 105) x 20% | 47.25 |
| **Total Expected Cash Flows before inflation** | | **283.50** |
| Inflation factor for next 10 years (4%) | $(1.04)^{10}$ =1.4802 | |
| Expected cash flows adjusted for inflation | 283.50 x 1.4802 | 419.65 |
| Risk adjustment - uncertainty relating to cash flows | (5% x 419.65) | 20.98 |
| **Total Expected Cash Flows** | (419.65+20.98) | 440.63 |
| Discount rate to be considered = risk-free rate + entity's non-performance risk | 5% + 3.5% | 8.5% |
| **Expected present value at 8.5% for 10 years** | **(440.63 / $(1.085^{10})$)** | **194.97** |

**Working Note:**

**Expected labour cost:**

| Cash Flows Estimates | Probability | Expected Cash Flows |
|---|---|---|
| 100 Cr | 25% | 25 Cr |
| 125 Cr | 50% | 62.50 Cr |
| 175 Cr | 25% | 43.75 Cr |
| **Total** | | **131.25 Cr** |

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**4.** **(i)** An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

| Particulars | Unit |
|---|---|
| Entity XYZ's after-tax maintainable profits (A) | ₹ 70,000 |
| Price/Earnings ratio (B) | 15 |
| Adjusted discount factor (C) (1- 0.20) | 0.80 |
| Value of Company XYZ (A) x (B) x (C) | ₹ 8,40,000 |

Value of a share of XYZ = ₹ 8,40,000 ÷ 5,000 shares = ₹ 168

The fair value of Entity A's investment in XYZ's shares is estimated at ₹ 42,000 (that is, 250 shares x ₹ 168 per share).

**(ii)** Share price = ₹ 8,50,000 ÷ 5,000 shares = ₹ 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be ₹ 42,500 (250 shares x ₹ 170 per share).

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