CA Final

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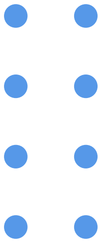

Paper 1

# Financial Reporting

May'24

SAMPLE MATERIAL

**CA ________________________________**

***(Once you print this write your name in this blank to give you the much-needed motivation. Remember what you see is what you achieve!)***

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# GETTING THE MOST FROM THIS BOOK

## A QUICK GUIDE

### 1 INITIAL READING

After your initial reading of a particular chapter in your study material, go through the questions in our 3, 5, and 11 attempt's compilations, focusing on the chapter you've just covered. Make note of challenging questions for later reference.

### 2 FIRST REVISION

During your first revision, revisit the marked questions. If you still can't answer them, highlight them in red and review the related concepts to improve your understanding. This process helps you to grasp the key concepts and address your weak points

### 3 KEEP GOING WITH THE REVISIONS

Repeat the reading and revision process as often as possible before your exams. Each iteration will enhance your confidence and knowledge.

### 4 EXAMINERS COMMENTS

Pay attention to the examiner's comments in our compilations, as they highlight common mistakes. Learning from these errors will help you avoid them in your exams

# Frequently Asked Questions

1. **Why RTP's, MTP's and PYP's?**
   RTP's, MTP's, and PYP's are extremely important to ensure that you reproduce ICAI language. These questions train you to understand what is important and what is expected of you.
   At least 41% of questions* are asked from previous RTP's, MTP's and PYP's.

2. **What is included?**
   In this compiler, all questions from the last 3, 5 or 11 attempts depending on the one you have selected will be available. There will be references to the marks and the attempt from which they were asked. Identical or similar questions have been removed and references for both attempts are mentioned.

3. **What is the benefit of Chapter-wise?**
   We have categorized each and every question from all Old RTPs, MTP's, and PYP's into chapters. This means that you don't have to wait until you've completed your entire syllabus to tackle an RTP, MTP, or past paper. You can start solving these questions to check your conceptual clarity right after finishing a particular chapter.

4. **What does amended for the latest attempt mean?**
   When we reviewed all the questions from the past 11 attempts of RTP, MTP, and PYP'S, we didn't just segregate them Chapterwise; we also updated them to reflect the latest provisions. All the answers provided in the compilation are applicable for the May 2024 examination. So, there's no need to stress about outdated or incorrect information.

5. **How are Old RTP's, MTP's & PYP's beneficial for me?**
   All old RTPs, MTPs, and PYPs have been organized according to the new syllabus issued by ICAI. This means that if a specific chapter from the old scheme is not included in the new scheme, it has been omitted. If a particular chapter in the new scheme is based on concepts from two or more chapters in the old scheme, it has been adapted to align with how the chapter should be in the new scheme. If a chapter is only partially included in the new scheme, the questions related to those specific concepts are only included in the corresponding chapter of the new scheme. A comprehensive reconciliation of the chapters between the new scheme and the old scheme is provided on the following page.

6. **What if a new attempt is added post my purchase?**
   If you have purchased materials for the May 2024 attempt, you will receive a file with the questions segregated Chapterwise specifically for that attempt.

7. **What does N/A mean?**
   It could mean any of the following:
   1. No questions from that chapter have been included in the selected attempts.
   2. The chapter is newly introduced, and as a result, no questions have been previously asked in RTP's, MTP's, or PYP's.

*This is on an average based on the last 11 attempts

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**21 MTPS: March’18, April’18, Aug’18, Oct’18, May’19, April’19, Oct’19, May’20, Oct’20, March’21, April’21, Oct ’21, Nov ’21, March ’22, April ’22, Sep ’22 , Oct ’22,March ’23 ,April '23,Sep ’23 & Oct ‘23**

**11 PYPs: May’18, Nov’18, May’19, Nov’19, Nov’20, Jan’21, July ’21, Dec ’21, May’22, Nov ’22, May ‘23**

**12 RTPs: May’18, Nov’18, May’19, Nov’19, May’20, Nov’20, May’21, Nov ’21, May ’22, Nov ’22, May ’23, Nov ‘23**

# Chapter 1

# Introduction to Indian Accounting Standards

**Question 1**

**Fresh Vegetables Limited (FVL) was incorporated on 2nd April, 20X1 under the provisions of the Companies Act, 2013 to carry on the wholesale trading business in vegetables. As per the audited accounts of the financial year ended 31st March, 20X7 approved in its annual general meeting held on 31st August, 20X7 its net worth, for the first time since incorporation, exceeded ₹ 250 crore. The financial statements since inception till financial year ended 31st March, 20X6 were prepared in accordance with the Companies (Accounting Standards) Rules 2006. It has been advised that henceforth it should prepare its financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015.**

**The following additional information is provided by the Company:**

- **FVL has in the financial year 20X2-20X3 entered into a 60:40 partnership with Logistics Limited and incorporated a partnership firm 'Vegetable Logistics Associates' (VLA) to carry on the logistics business of vegetables from farm to market.**
- **FVL also has an associate company Social Welfare Limited (SWL) that was incorporated in July, 20X5 as a charitable organization and registered under section 8 of the Companies Act, 2013. Social Welfare Limited has been the associate company of FVL since its incorporation.**

**Examine the applicability of Ind AS on VLA & SWL. (RTP May '22)**

**Answer 1**

**<u>Applicability of Ind AS in general:</u>**

- Currently Ind AS is applicable to the following companies except for companies other than banks and Insurance Companies, on mandatory basis:
  (a) All companies which are listed or in process of listing in or outside India on Stock Exchanges.
  (b) Unlisted companies having net worth of ₹ 250 crore or more but less than ₹ 500 crore.
  (c) Holding, Subsidiary, Associate and Joint venture of above.
- Companies listed on SME exchange are not required to apply Ind AS on mandatory basis.
- Once a company starts following Ind AS either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow Ind AS for all the subsequent financial statements even if any of the criteria specified does not subsequently apply to it.
- Application of Ind AS is for both standalone as well as consolidated financial statements if threshold criteria met or adopted voluntarily.
- Companies meeting the thresholds for the first time at the end of an accounting year shall apply Ind AS from the immediate next accounting year with comparatives.
- Companies not covered by the above roadmap shall continue to apply existing Accounting Standards notified in the Companies (Accounting Standards) Rules, 2006.

  Since the net worth of FVL in immediately preceding year exceeded ₹ 250 crore, Ind AS is applicable to it. The entity VLA and SWL have to be examined as they may fall in criteria (c) above.

**<u>Applicability of Ind AS on VLA</u>**

Joint arrangement can be either joint operation or joint venture. However, for the purpose of identifying the applicability of Ind AS, the Act defines Joint venture (as an explanation to section 2(6) of the Companies Act, 2013), as follows:

"The expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement".

Accordingly, if an entity is classified as joint operation and not joint venture, then Ind AS would not be applicable to such entity.

In the case of VLA, if partners conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. However, Ind AS would not be applicable on VLA in such a case since it is the case of joint operation (and not a joint venture).

Alternatively, if partners conclude that they have joint control of the arrangement and have rights to the net assets of the arrangement relating to the partnership firm, then this would be a joint venture. In such a case, Ind AS would be applicable to them.

**Applicability of Ind AS on SWL**

Social Welfare Limited (SWL) is the associate company of FVL. Accordingly, Ind AS would be applicable on SWL too irrespective of the fact that SWL has been incorporated as a charitable organization.

# Chapter 2
# Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

**Question 1**

**Explain Financial capital maintenance and Physical capital maintenance as per the Framework and differentiate it. (MTP 4 Marks March '18)**

**Answer 1**

**A. Financial Capital maintenance**

Under this concept, a profit is earned only if the financial ***(or money)*** amount of the net assets at the end of the period exceeds the financial ***(or money)*** amount of net assets at the beginning of the period, after excluding any distribution to, and contribution from, owners during the period. Financial Capital Maintenance can be measured in either nominal monetary units or units of constant purchasing power. (May 22)

**B. Physical Capital maintenance**

Under this concept, a profit is earned only if the physical productive capacity or operating capability of the entity (or resources and funds needed to achieve that capacity) (May 22) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

**C. Major differences between Physical Capital & Financial Capital**

The principle difference between the two concepts of capital maintenance is the treatment of the effect of changes in the prices of assets and liabilities of the entity. (May 22)

- The physical capital maintenance concept requires the adoption of the current cost basis as measurement whereas financial capital maintenance concept does not require the use of a particular basis of measurement.
- Financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increase in the prices of assets held over the period, conventionally referred to as holding gains are conceptually profits. They might not be recognized as such however, until the assets are disposed of in an exchange transaction.(May 22) When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and hence as part of equity. (May 22)
- Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

**Question 2**

**What is Equity, Income and Expenses as per 'Framework for Financial Reporting under Ind AS'? How the information with respect to income and expenses helps the users in understanding of the financial statements? (MTP 5 Marks , Oct'22)**

**Answer 2**

**Equity**: Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of liability.

**Income and Expenses**: Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Income and expenses are the elements of financial statements that relate to an entity's financial

performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance.

**Question 3**

**Defense Innovators Limited is a public sector undertaking and is engaged in the construction of warships and submarines. XYZ Private Limited approached Defense Innovators Limited for construction of "specially designed" ships for it, which will be used by XYZ Private Limited for transportation of specific goods. The offer was accepted by the Defense Innovators Limited and both the companies entered into an agreement for the construction and delivery of 3 specially designed ships on 'Fixed Price' basis with variable component in respect to certain items.**

**Base and depot (B & D) spares for all three ships shall be procured by Defense Innovators Limited and will be paid on the cost of the item with certain percentage.**

**The contract states that "certain equipment" out of variable cost items, will be supplied by XYZ Private Limited at 'free of cost' for installation on board of ship. It is, therefore, to be noted as under:**

**(i) Some equipment is procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.**

**(ii) There is certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. This equipment is known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship. The period required for construction of one ship was approximately four years. Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognized as revenue in its books of account? Elaborate. (MTP 6 Marks March '23 & RTP May '22 )**

**Answer 3**

Before any item can be recognized as an inventory, it should meet the definition of 'asset' as given in the Conceptual Framework for Financial Reporting under Ind AS, issued by the Institute of Chartered Accountants of India as follows:

"An asset is a present economic resource controlled by the entity as a result of past events and economic resource is a right that has the potential to produce economic benefits".

The orders in respect of Buyer Furnished Equipment's (BFEs) are directly placed by the buyer and payment in respect of them is made by the buyer. These are then supplied to the company for installing in the ship and the buyer pays installation charges which are included in the contract price. Thus, the company has neither incurred any cost on BFEs nor any amount is recoverable on account of such equipment except installation charges. Accordingly, such equipment are not 'assets' that may be considered as a part of its contract work-in progress.

In fact, after installation in the ship, BFEs are returned to the buyer after completion of the ship. Thus, these are only held by the company in the capacity of a bailee. Since, it cannot be considered as an 'asset', therefore, it can neither be considered as 'inventory' nor as 'work -in- progress'.

Further, it can also not be considered as a part of sale value or revenue of the company as no consideration would be receivable with respect to the cost of such equipment.

On the basis of the above, it can be concluded that:

(i) The BFEs cannot be considered as inventories / Work- in- progress for Defense Innovators Limited.

(ii) The BFE's cost cannot be considered as part of sales value / contract revenue to Defense Innovators Limited.

### Question 4

**Mr. Unique commenced business on 1/04/17 with Rs. 20,000 represented by 5,000 units of the product @ Rs. 4 per unit. During the year 2017-18, he sold 5,000 units @ Rs. 5 per unit. During 2017-18, he withdraw Rs. 4.000.**

- **31/03/18: Price of the product @ Rs. 4.60 per unit**
- **Average price indices: 1/4/17: 100 & 31/3/18: 120**

**Find out:**

(i) **Financial capital maintenance at Historical Cost**
(ii) **Financial capital maintenance at Current Purchasing Power**
(iii) **Physical Capital Maintenance (PYP 5 Marks May'19)**

### Answer 4

**Financial Capital Maintenance at historical costs**

| | Rs. | Rs. |
|---|---|---|
| Closing capital (Rs. 25,000 – Rs. 4,000) | | 21,000 |
| Less: Capital to be maintained | | |
| Opening capital (At historical cost) | - | |
| Introduction (At historical cost) | 20,000 | (20,000) |
| Retained profit | | 1,000 |

**Financial Capital Maintenance at current purchasing power**

| | Rs. | Rs. |
|---|---|---|
| Closing capital (Rs. 25,000 – Rs. 4,000) | | 21,000 |
| Less: Capital to be maintained | | |
| Opening capital (At closing price) (5,000 x Rs. 4.80) | 24,000 | |
| Introduction (At closing price) | Nil | (24,000) |
| Retained profit | | (3,000) |

**Physical Capital Maintenance**

| | Rs. | Rs. |
|---|---|---|
| Closing capital (Rs. 25,000 – Rs. 4,000) | | 21,000 |
| Less: Capital to be maintained | | |
| Opening capital (At current cost) (5,000 x Rs. 4.60) | 23,000 | |
| Introduction (At current cost) | Nil | (23,000) |
| Retained profit | | (2,000) |

**EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:**

Most of the examinees had not attempted this part of the question. Those who had attempted were also not able to either complete it or do it correctly.

### Question 5

**Discuss the following in the context of 'Conceptual Framework for Financial Reporting under Indian Accounting Standards':**

**(i) The cost constraint on useful financial information**

**(ii) Executory contracts. (PYP 5 Marks ,May '22)**

### Answer 5

**(i) The cost constraint on useful financial information;**

**Role of Cost:** Cost is a pervasive constraint on the information that can be provided by financial

reporting. Reporting financial information imposes costs, and it is important that these costs are justified by the benefits of reporting that information.

**Basis of Assessment of Cost:** Both the providers and users of financial information incur costs in reporting and analyzing financial information. In applying the cost constraint, ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

**Cost Perspective:** Due to the inherent subjectivity, assessments of different individuals about the costs and benefits of reporting particular items of financial information will vary. Therefore, ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

**(ii) Executory Contracts:**

**Definition:** An executory contract is a contract, or a portion of a contract, that is equally unperformed — neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

**Outcome of Executory Contract:** An executory contract establishes a combined right and obligation to exchange economic resources. The rights and obligations are inter-dependent and cannot be separated. Hence, the combined rights and obligations constitute a single asset or liability.

The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable.

**Basis of Disclosure:** Whether such an asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

**Question 6 (Also includes concepts of Chp 7.6- Ind AS 38 Intangible Assets)**

**Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition of an asset and discuss whether there are inconsistencies with the criteria in Ind AS 38. (PYP 6 Marks Nov 22 & Old & New SM)**

**Answer 6**

The Conceptual Framework defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful i.e. it is relevant as well as results in faithful representation. However, the criteria of a cost-benefit analysis always exists i.e. the benefits of the information must be sufficient to justify the costs of providing such information. The recognition criteria outlined in the Conceptual Framework allows for flexibility in the application in amending or developing the standards.

Para 8 of Ind AS 38 'Intangible Assets', defines an intangible asset as an identifiable non-monetary asset without physical substance. Further, Ind AS 38 defines an asset as a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

Furthermore, Para 21 of Ind AS 38 states that an intangible asset shall be recognized if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

This requirement is applicable both in case of an externally acquired intangible asset or an internally generated intangible asset. The probability of expected future economic benefits must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset. Further, as per Para 33 of Ind AS 38, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. If the recognition criteria are not satisfied, Ind AS 38 requires the expenditure to be expensed as and when it is incurred.

It is notable that the Conceptual Framework does not prescribe a 'probability criterion'. As long as there is a potential to produce economic benefits, even with a low probability, an item can be recognized as an asset according to the Conceptual Framework. However, in terms of intangible assets, it could be argued that recognizing an intangible asset having low probability of generating economic benefits would not be useful to the users of financial statements given that the asset has no physical substance.

The recognition criteria and definition of an asset under Ind AS 38 are different as compared to those outlined in the Conceptual Framework. To put in simple words, the criteria in Ind AS 38 are more specific, but definitely do provide information that is relevant and a faithful representation. When viewed from the prism of relevance and faithful representation, the requirements of Ind AS 38 in terms of recognition appear to be consistent with the Conceptual Framework.

**Question 7**

**Discuss with respect to 'Conceptual Framework for Financial Reporting under Indian Accounting Standards', 'faithful representation', one of the qualitative characteristics of financial information. (6 Marks May '23)**

**Answer 7**

**EITHER**

**Faithful representation**

To be useful, financial information must faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

- **Complete:** A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.
- **Neutral:** A neutral depiction is without bias in the selection or presentation of financial information. Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated, and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.
- **Free from error:** Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, being free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

# Chapter 3.1
# Ind AS 1: Presentation of Financial Statements

**Question 1.**

**Entity A has undertaken various transactions in the financial year ended 31st March, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1. Rs.**

| | |
|---|---|
| **Remeasurement of defined benefit plans** | **2,57,000** |
| **Current service cost** | **1,75,000** |
| **Changes in revaluation surplus** | **1,25,000** |
| **Gains and losses arising from translating the monetary assets in foreign currency** | **75,000** |
| **Gains and losses arising from translating the financial statements of a foreign operation** | **65,000** |
| **Gains and losses from investments in equity instruments designated at fair value through other comprehensive income** | **1,00,000** |
| **Income tax expense** | **35,000** |
| **Share based payments cost** | **3,35,000** |

**(MTP 4 Marks April '21 & March '18 & Old & New SM)**

**Answer 1.**

**Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1 (Rs.)**

| | |
|---|---|
| Current service cost | 1,75,000 |
| Gains and losses arising from translating the monetary assets in foreign currency | 75,000 |
| Income tax expense | 35,000 |
| Share based payments cost | 3,35,000 |

**Items impacting the other comprehensive income for the year ended 31st March, 20X1 (Rs.)**

| | |
|---|---|
| Remeasurement of defined benefit plans | 2,57,000 |
| Changes in revaluation surplus | 1,25,000 |
| Gains and losses arising from translating the financial statements of a foreign operation | 65,000 |
| Gains and losses from investments in equity instruments designated at fair value through other comprehensive income | 1,00,000 |

**Question 2.**

**In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual installments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable on demand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution. On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution. The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.**

(i) **As on March 31, 20X2, examine the classification of the loan to be done by the entity as per Ind AS?**

(ii) **Assume in anticipation that it may not be able to get the promoter's contribution by due date. In February 20X2, the entity approached the bank and got the compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case, examine whether the loan classification as on March 31, 20X2 be different from (a) above? (MTP 6 Marks March '18)(Old & New SM) (Similar concept but different figures -PYP May'22 5 Marks)**

**Answer 2.**

(i) Paragraph 75 of Ind AS 1, inter alia, provides, "An entity classifies the liability as non - current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 20X2, the loan will be classified as current.

(ii) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 20X2, the loan will retain its classification as non-current.

**Question 3.**

**A Limited has prepared the following draft balance sheet as on 31st March 20X1:**

**(₹ in crore)**

| Particulars | 31st March, 20X1 | 31st March, 20X0 |
|---|---|---|
| ASSETS | | |
| Cash | 250 | 170 |
| Cash equivalents | 70 | 30 |
| Non-controlling interest's share of profit for the year | 160 | 150 |
| Dividend declared and paid by A Limited | 90 | 70 |
| Accounts receivable | 2300 | 1800 |
| Inventory at cost | 1500 | 1650 |
| Inventory at fair value less cost to complete and sell | 180 | 130 |
| Investment property | 3100 | 3100 |
| Property, plant and equipment (PPE) at cost | 5200 | 4700 |
| Total | 12,850 | 11,800 |
| CLAIMS AGAINST ASSETS | | |
| Long term debt (₹ 500 crore due on 1st January each year) | 3,300 | 3,885 |
| Interest accrued on long term debt (due in less than 12 months) | 260 | 290 |
| Share Capital | 1,130 | 1,050 |
| Retained earnings at the beginning of the year | 1,875 | 1,740 |
| Profit for the year | 1,200 | 830 |
| Non-controlling interest | 830 | 540 |
| Accumulated depreciation on PPE | 1,610 | 1,240 |
| Provision for doubtful receivables | 200 | 65 |
| Trade payables | 880 | 790 |
| Accrued expenses | 15 | 30 |
| Warranty provision (for 12 months from the date of sale) | 600 | 445 |
| Environmental restoration provision (restoration expected in 20X6) | 765 | 640 |
| Provision for accrued leave (due within 12 months) | 35 | 25 |
| Dividend payable | 150 | 230 |
| Total | 12,850 | 11,800 |

**Prepare a consolidated balance sheet using current and non-current classification in accordance with**

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Ind AS 1. Operating cycle of the entity is 12 months. (MTP 10 Marks, April 22) (Old & New SM)

**Answer 3**

**A Limited Consolidated Balance Sheet as at 31st March 20X1 (₹ in crore)**

| Particulars | Note | 31st March, 20X1 | 31st March, 20X0 |
|---|---|---|---|
| ASSETS | | | |
| Non-current assets | | | |
| (a) Property, plant and equipment | 1 | 3,590 | 3,460 |
| (b) Investment property | | 3,100 | 3,100 |
| Total non-current assets | | 6,690 | 6,560 |
| Current assets | | | |
| (a) Inventory<br>(b) Financial assets | 2 | 1,680 | 1,780 |
| (i) Trade and other receivables | 3 | 2,100 | 1,735 |
| (ii) Cash and cash equivalents<br>Total current assets | 4 | 320<br>4,100 | 200<br>3,715 |
| Total assets | | 10,790 | 10,275 |
| EQUITY & LIABILITIES | | | |
| Equity attributable to owners of the parent | | | |
| Share capital | | 1,130 | 1,050 |
| Other Equity | 5 | 2,825 | 2,350 |
| Non-controlling interests | | 830 | 540 |
| Total equity | | 4,785 | 3,940 |
| LIABILITIES<br>Non-current liabilities<br>(a) Financial Liabilities<br>(i) Borrowings - Long-term debt<br>(b) Provisions<br>(i) Long-term provisions (environmental restoration) | 6 | 2,800<br><br>765 | 3,385<br><br>640 |
| Total non-current liabilities | | 3,565 | 4,025 |
| Current liabilities | | | |
| (a) Financial Liabilities | 7 | | |
| (i) Trade and other payables (Other than micro enterprises and small enterprises) | 8 | 895 | 820 |
| (ii) Current portion of long-term debt | | 500 | 500 |
| (iii) Interest accrued on long-term debt<br>(iv) Dividend payable<br>(b) Provisions<br>(i) Warranty provision<br>(ii) Provisions for accrued leave<br>Total current liabilities Total liabilities | | 260<br>150<br><br>600<br>35<br>2,440<br>6,005 | 290<br>230<br><br>445<br>25<br>2,310<br>6,335 |
| **Total equity and liabilities** | | **10,790** | **10,275** |

**Working Notes:**

| Notes | Particulars | Basis | Calculation ₹ in crore | Amount ₹ in crore |
|---|---|---|---|---|
| 1 | Property, plant and equipment | Property, plant and equipment (PPE) at cost less Accumulated (depreciation on PPE | 5,200 – 1,610 (4,700 – 1,240) | 3,590 (3,460) |
| 2 | Inventory | Inventory at cost add Inventory at fair value less cost to complete and sell | 1,500 + 180 (1,650 + 130) | 1,680 (1,780) |
| 3 | Trade and other receivables | Accounts receivable less Provision for doubtful receivables | 2,300 – 200 (1,800 – 65) | 2,100 (1,735) |
| 4 | Cash and cash equivalents | Cash and Cash equivalents | 250 + 70 (170 + 30) | 320 (200) |
| 5 | Other Equity | Retained earnings at the beginning of the year add Profit for the year less Non-controlling interest's share of profit for the year less Dividend declared by A Limited | 1,875 + 1,200– 160 – 90 (1,740 + 830 – 150 – 70) | 2,825 (2,350) |
| 6 | Long-term debt | Long-term debt less Due on 1st January each year | 3,300 – 500 (3,885 – 500) | 2,800 (3,385) |
| 7 | Trade & other payables | Trade payables add Accrued expenses | 880 + 15 (790 + 30) | 895 (820) |
| 8 | Current portion of long- term debt | Due on 1st January each year | - - | 500 (500) |

**Note:** Figures in brackets represent the figures for the comparative year.

**Question 4**

**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(MTP 5 Marks Sep'22, RTP May'21)**

**Answer 4**

a) As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realize 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.

**Question 5**

**An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.**

**(a) Will the inventory and the trade receivables be current in nature?**

**(b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different? (RTP May '22, MTP 4 Marks March '23 & Old & New SM)**

**Answer 5**

Inventory and debtors need to be classified in accordance with the requirement of paragraph 66(a) of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.

(a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

(b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

Additional information as required by paragraph 61 of Ind AS 1 will be required to be made by the entity, which provides "Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

(a) No more than twelve months after the reporting period, and

(b) More than twelve months after the reporting period."

**Question 6**

**Company A has taken a long term loan arrangement from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both company agreed that the payment will not be demanded immediately as a consequence of breach of material provision. Advise on the classification of the liability as current / non –current. (RTP May'18 & Old & New SM)**

**Answer 6**

As per para 74 of Ind AS 1 "Presentation of Financial Statements" where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements

for issue, not to demand payment as a consequence of the breach.

In the given case, Company B (the lender) agreed for not to demand payment but only after the financial statements were approved for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20x2 but could not agree before June 20X2 when financial statements were approved for issuance. Hence, the liability should be classified as current in the financial statement for the year ended March 31, 20X2.

**Question 7**

**An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.**

**(a) Should the loan be classified as current or non-current in the balance sheet of the entity?**

**(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?**

**(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?**

**(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation? (RTP Nov '19)**

**Answer 7**

Para 69 of Ind AS 1 defines current liabilities as follows:

An entity shall classify a liability as current when:

(i) it expects to settle the liability in its normal operating cycle;

(ii) it holds the liability primarily for the purpose of trading;

(iii) the liability is due to be settled within twelve months after the reporting period; or

(iv) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

Accordingly, following will be the classification of loan in the given scenarios:

a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non-current.

b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period because as per paragraph 72 of Ind AS 1, "an entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if: (a) the original term was for a period longer than twelve months, and (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue." As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.

c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.

d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

**Question 8**

**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? (RTP Nov '21 & Old & New SM)**

**Answer 8**

**(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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**Question 9**

**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? (RTP Nov'22)**

**Answer 9**

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

**Question 10**

**Mike Ltd. has undertaken following various transactions in the financial year ended 31.03.2018:**

**(Rs.)**

| | | |
|---|---|---|
| **(a)** | **Re-measurement of defined benefit plans** | **1,54,200** |
| **(b)** | **Current service cost** | **1,05,000** |
| **(c)** | **Changes in revaluation surplus** | **75,000** |
| **(d)** | **Gains and losses arising from translating the monetary assets in foreign currency** | **45,000** |
| **(e)** | **Gains and losses arising from translating the financial statements of a foreign operation** | **39,000** |
| **(f)** | **Gains and losses arising from investments in equity instruments designated at fair value through other comprehensive income** | **60,000** |
| **(g)** | **Income tax expenses** | **21,000** |
| **(h)** | **Share based payments cost** | **2,01,000** |

**Identify and present the transactions in the financial statements as per Ind AS 1. (PYP 4 Marks, May'19)**

**Answer 10**

**Items impacting the Statement of Profit and Loss for the year ended 31st March, 2018**

**(Rs.)**

| | |
|---|---|
| Current service cost | 1,05,000 |
| Gains and losses arising from translating the monetary assets in foreign currency | 45,000 |
| Income tax expenses | 21,000 |
| Share based payments cost | 2,01,000 |

**Items impacting the Other Comprehensive Income for the year ended 31st March, 2018**

**(Rs.)**

| | |
|---|---|
| Premeasurement of defined benefit plans | 1,54,200 |
| Changes in revaluation surplus | 75,000 |
| Gains and losses arising from translating the financial statements of a foreign operation | 39,000 |

| Gains and losses from investments in equity instruments designated at fair value through other comprehensive income | 60,000 |
|---|---|

**EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:**
Majority of the examinees failed to correctly identify the nature of transactions and present them either in the Profit and Loss or Other Comprehensive Income.

**Question 11**

**Entity A had obtained a long-term bank loan during January 2019, which is subject to certain financial covenants. One of such covenants states that during the tenure of the loan, debt equity ratio of 65:35 is to be maintained at all time. In case of breach of this covenant, the loan will be repayable immediately. The loan agreement also states that these covenants will be assessed at the end of each quarter and reported to the bank within a month from the end of each quarter. If the covenants are breached at this time, the loan will be repayable immediately. The entity closes its annual accounts as on 31st March every year.**

**You are required to show how the loan will be classified as on 31st March 2020, if:**

**(i) At the financial year end, Entity A determines that it is not in breach of any of the covenants;**

**(ii) At the quarter ending 31st December 2019, Entity A's debt equity ratio became 75:25 and thus breaches the covenant, however it obtains a waiver from the bank. The terms of the waiver specify that if Entity A rectifies the breach within a period of 12 months from the reporting date then the bank cannot demand repayment immediately on account of the breach during this period. Entity A expects to rectify the breach by raising additional equity capital by means of a rights issue to the existing shareholders and expects that the issue will be fully subscribed;**

**(iii) Considering the same facts as in (ii) above, except obtaining the waiver clause, what would be your answer? (PYP 5 Marks, Jan '21)**

**Answer 11**

Para 74 of Ind AS 1 'Presentation of Financial Statements', states that where there is abreach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed,after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

However, an entity classifies the liability as non-current, if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

(i) The entity has obtained a long-term loan during January, 2019. Since repayment period of the loan is not mentioned in the question, it is assumed that on 31st March 2020, the repayment period of the loan is more than 12 months. Further, the entity has not breached the covenants specified in the loan; therefore, as at 31st March, 2020, the loan will be classified as 'non-current liability.

(ii) In the second case, though there is a breach of covenant on 31 st December, 2019 i.e. before reporting date of 31st March, 2020, yet the bank had agreed to provide a period of grace for twelve months from the reporting period, within which the entity A can rectify the breach and during this period bank cannot demand immediate repayment. Also, entity A has intention to rectify the breach. Thus, entity A w ill classify the liability of bank loan as non-current liability in its books as at 31st March, 2020.

(iii) Since the covenant for the bank loan has been breached during the quarter ended 31st December, 2019 and reported to the bank within one month from the end of the quarter i.e. by 31st January, 2020, the bank loan becomes repayable immediately. Therefore, it will be presented as current liability in the books of entity A as on 31st March, 2020.

**Question 12**

**Charm Limited (the 'Company') is a manufacturing company, which is into manufacturing of wires and cables and has assessed its operating cycle to be 15 months. The Company has some trade receivables which are receivable within a period of 12 months from the reporting date i.e. 31st March 2021.**

**With respect to the following transactions, which took place during the financial year 2020-2021, give your opinion based on relevant Ind AS:**

- **The Company has received a contract of ` 10 crore on 31st March 2021. The terms of the contract require the Company to make a security deposit of 20% of the contract value with the customer. The Company made a security deposit of ` 2 crore on 31st March 2021. This contract will be completed in about 14 months. 70% of the deposit will be refunded immediately and the balance 30% of the deposit will be refunded after 3 months from the completion of the contract. The Company wants to present the security deposit of ` 2 crore as non-current. Is the management's decision correct?**
- **The Company has some trade receivables that are due after 14 months from the date of the balance sheet; the management of the Company expects to receive the amount within the period of the operating cycle. Despite the fact that these are receivables in 14 months, the management would like to present these as current. Is the management's decision correct?**
- **In the normal course of business, the Company has given 2 contracts and received a total security deposit of ` 4 crore. ` 3 crore is received from X Limited and ` 1 crore is received from Y Limited on 31st March 2021. These are repayable on completion of the contract. However, if the contract is cancelled within the contract term of 18 months, then the deposit becomes payable immediately. The Company is positive about the contract with X Limited but is in doubt about the contract received from Y Limited. The Company wants to present the amount of ` 3 crore as non-current and ` 1 crore as current in the balance sheet. Is the management's decision correct?**
- **The Company is planning to replace a machinery. It has given an advance of ` 1 crore for purchase of new machinery which will be delivered in 6 months from the date of the balance sheet. It has sold the old machinery for ` 0.5 crore, the payment of which is due in 10 months from the date of the balance sheet. The Company wants to present both these amounts as current since they will be settled within twelve months from the end of the reporting period. Is the management's decision correct? (PYP 4 Marks July 21)**

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**Answer 12**

**Operating cycle of Charm Limited = 15 months**

(i) The security deposit made by the Company with the customers be classified as current assets to the extent of 70% (` 2 crore x 70% = ` 1.40 crore) as it will be refunded immediately on completion of 14 months of contract i.e. within the operating cycle of 15 months.

However, 30% of the security deposit will be refunded after 3 months of completion of the contract (14+3 = 17 months) i.e. after 2 months of operating cycle (Operating cycle of the Company is 15 months). Hence, it will be classified as non-current. Therefore, management's decision is not correct. (Refer Para 66 of Ind AS 1)

(ii) Yes, the Company's decision of presenting the trade receivables as Current Assets is correct despite the fact that these are receivables in 14 months' time since the operating cycle of the company is 15 months and any event arising due to trade will be considered as current if its settlement is within the tenure of operating cycle. 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)

(iii) Paragraph 69(d) of Ind AS 1 states that an entity shall classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Although it is expected that X Limited will fulfil the contract and the deposit will not be refunded, but

in case of cancellation within the contract term, refund of security deposit is a condition that is not within the control of the entity. Hence, Charm Limited does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Accordingly, the deposit will have to be classified as current liability in case of both X and Y Limited.

(iv) Yes, the management decision to classify the payment of ` 0.5 crore as a current asset is correct since the payment will be realized in less than twelve months from the end of the reporting period.

Capital advances are advances given for procurement of Property, Plant and Equipment etc. Typically, companies do not expect to realize them in cash. Rather, over the period, these get converted into non-current assets. Hence, capital advances should be treated as other non-current assets irrespective of when the Property, Plant and Equipment is expected to be received.

Under Ind AS Schedule III, Capital Advances are not to be classified under Capital Work in Progress since they are specifically to be disclosed under other non-current assets.

Accordingly, advance of ` 1 crore given for purchase of machinery is 'Capital advance' which will be classified as non-current as it relates to acquisition of non-current item i.e., machinery. Hence, management decision to classify it as current is incorrect.

**EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:**

Majority of the examinees did the classification correct but were not able to substantiate the same in a crisp manner. Many examinees failed to understand the concept of capital advances; hence, wrongly classified advance of ` 1 crore for purchase of machinery as current asset. Further examinees were not able to appreciate that the lengthy operating cycle of more than 12 months also leads to classification of item as current.

**Question 13** (**Illustration)**

**An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.**

**(a) How should such loan be classified in the balance sheet of the entity?**

**(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?**

**(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?**

**(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation? (Old & New SM) (PYP 5 Marks May '23)**

**Answer 13**

(a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non-current.

(b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.

(c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this

case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.

(d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

**Question 14**

**A holding company [being the entity under consideration] gives a loan / intercorporate deposit to a subsidiary that is recoverable on demand, at a rate of interest at 10%.**

**(a) Should such loan be disclosed as a current/non-current asset in the books of the holding company? How relevant would the commercial reality of the transaction be in comparison to the legal terms of the transaction?**

**(b) How this loan / inter-corporate deposit that is repayable on demand would be classified in the books of the subsidiary? (MTP 4 Marks Oct 21)**

**Answer 14**

**(a)** Paragraph 66 (c) of Ind AS 1 provides that an asset shall be classified as current when an entity expects to realise the asset within a period of twelve months after the reporting period. To determine the expectation of the entity, the commercial reality of the transaction should also be considered. If the loans have been given with an understanding that these loans would not be called for repayment even though a clause may have been added that these are recoverable on demand, it should be classified as a non-current asset.

**(b)** Paragraph 69(c) of Ind AS 1 provides that a liability should be classified as current if the liability is due to be settled within twelve months after the reporting period. Since the loan/inter- corporate deposit would become due immediately as and when demanded and presuming that the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period, it should be classified as current liability.

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