December 2021 Q 3 Answers

(a) The sale of 50% of the shareholding of HTL (80% * 62.5%) results in reducing EOSL's holding in HTL to 30%. With this 30%, EOSL can appoint one director to the board of HTL. This gives EOSL the power to participate in the financial and operating policy decisions of HTL but EOSL cannot control or jointly control these policies. Accordingly, EOSL can now exercise significant influence over HTL. Therefore, the remaining investment should be accounted for using the equity method.

As EOSL loses control of HTL, EOSL should:

- Derecognise the assets and liabilities of HTL from the consolidated statement of financial position

- Derecognise NCI

- Recognise the 30% investment retained at its fair value when the control is lost

(i.e. on 31 March 2021) and subsequently using LKAS 28

- Recognise the gain or loss associated with the loss of control

EOSL has not accounted for the impairment of goodwill in the consolidated financial statements. Therefore, before derecognising goodwill, it is required to account for the impairment in the profit or loss. The carrying value of goodwill after impairment is therefore Rs. 18.939 million (75%).

Since NCI is measured based on the proportionate share of net assets, goodwill recognised in the financial statements represents only the parent's goodwill. Therefore, the impairment of goodwill does not have any impact on NCI.

Assets should be derecognised at their carrying values. It is not required to recognise this fair value increase of land and building as at 31 March 2021 as EOSL's policy is to perform a revaluation every 3 – 5 years since there have been no significant value change since the last revaluation.

(Alternatively, a candidate could have decided to incorporate the revaluation increase. Marks were awarded if the answer was justified)

EOSL may transfer the revaluation surplus of Rs. 1 million directly to retained earnings when it loses control over HTL. It does not form part of the computation shown below.

Computation of gain/loss from loss of control

Gain/loss computation		Rs. '000
Fair value of consideration received		110,000
Fair value of investment retained		51,000
		161,000
Less:		
Carrying value of net assets	168,504	
Goodwill (after impairment)	18,938	
Non-controlling interest (NCI)	(33,701)	153,741
Gain from disposal		**7,260**

The gain resulting from the disposal should be recognised in profit or loss.

From 31 March 2021 onwards, EOSL should discontinue consolidation of HTL and only the 30% retained interest should be accounted for using the equity method as explained above.

EOSL should make disclosures required by SLFRS 5 regarding discontinued operations.

The accountant's view on the calculation and recognition of the disposal gain and other adjustments is not correct based on the above explanation and calculation.

(b) Given below is the draft statement of financial position as at 31 March 2021 (subsequent to the partial disposal of HTL).

Equip Office Solution (Pvt) Ltd					
STATEMENT OF FINANCIAL POSITION					
As at 31 March 2021 **ASSETS**		**GW impairment**	**Disposal of HTL**	**Transfer of RR to RE**	**Group (after disposal)**
Non-current assets					
Property, plant and equipment	1,420,459		(80,251)		1,340,208
Right-of-use asset	12,634				12,634
Capital work-in-progress	27,625				27,625
Goodwill	25,250	(6,313)	(18,938)		-
Intangible assets	11,772		(11,250)		522
Loans receivable from related company	71				71
Investment in associate			51,000		51,000
Deferred tax asset	13,374				13,374
Total non-current assets	**1,511,185**				**1,445,434**
Current assets					
Inventories	883,634		(171,892)		711,742
Trade and other receivables	1,180,266		(178,899)		1,001,367
Cash and cash equivalents	700,032		99,224		799,256
Total current assets	**2,763,932**				**2,512,365**
Total assets	**4,275,117**		**(311,006)**		**3,957,799**
EQUITY AND LIABILITIES					
Equity					
Stated capital	60,000				60,000
Capital reserve	85,400				85,400
Revaluation reserve	738,310			(1,000)	707,310

General reserve	62,383				62,383
Retained earnings	1,849,977	(6,313)	7,260	1,000	1,881,924
Total equity attributable to holders of the parent	**2,796,070**				**2,797,017**
Non-controlling interest (NCI)	33,701		(33,701)		-
Total equity	**2,829,771**				**2,797,017**
Non-current liabilities					
Lease liability	3,324		-		3,324
Retirement benefit obligation	104,899		(15,250)		89,649
Deferred tax liability	3,142		(2,318)		824
Total non-current liabilities	**111,365**		**-**		**93,797**
Current liabilities					
Trade and other payables	824,843		(182,971)		641,872
Interest bearing borrowings	339,185		(40,525)		298,660
Current tax payable	114,101		(16,250)		97,851
Lease liabilities	11,298				11,298
Bank overdrafts	44,554		(27,250)		17,304
Total current liabilities	**1,333,981**				**1,066,985**
Total liabilities	**1,445,346**				**1,160,782**
Total equity and liabilities	**4,275,117**		**(311,006)**		**3,957,799**

(c)

Step 1: Identify the contract with a customer

A contract with a customer is within the scope of SLFRS 15 only when:

- The parties have approved the contract and are committed to carrying it out
- Each party's rights regarding the goods and services to be transferred can be identified
- The payment terms for the goods and services can be identified
- The contract has commercial substance
- It is probable that the entity will collect the consideration to which it will be entitled

EOSL has a contract with the customer which sets out the rights and obligations of each party. EOSL received the consideration on the day of entering into the contract.

Step 2: Identify the separate performance obligations

When determining whether promises in the contract with the customer are separate performance obligations, a key point is whether the promises are distinct.

A good or service is distinct if:

- It could benefit the customer either on its own or together with other resources that are readily available to the customer; and
- The promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

In this case there are three performance obligations:

(1) The obligation to deliver the machine

(2) The obligation to provide the installation service

(3) The obligation to provide maintenance services for one year

These are distinct because the customer could benefit from each on its own (if the customer obtained the other from an alternative supplier) and each is sold separately by EOSL.

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled to in exchange for transferring the promised goods or services to a customer, excluding amounts collected on behalf of third parties.

The transaction price in this case is Rs. 5.15 million.

Step 4: Allocate the transaction price to the separate performance obligations in the contract

The transaction price is allocated to each separate performance obligation in proportion to the relative standalone selling price at contract inception of each performance obligation.

Performance obligation	**Stand-alone selling price**		**Revenue**
Machine	5,000,000	(5m/5.02) * 5m	4,980,080
Installation service	20,000	(0.02m/5.02m) * 5m	19,920
Maintenance service	150,000		150,000
			5,150,000

Step 5: Recognise revenue when (or as) EOSL satisfies a performance obligation

On 1 June 2021, the machine was delivered to the customer and the installation was completed. Revenue from selling the machine and providing the installation service should be recognised on 1 June 20201 (control is transferred on this date i.e. at that point in time).

When EOSL provides maintenance services (i.e. over time as a service is provided), it recognises revenue of Rs. 150,000 over the one-year period. Revenue for the year ended 31 March 2022 is Rs. 125,000 (150,000/12 * 10).

July 2021 Q 3 answers

(a) Proposal 1

Purchase of first 20%

According to LKAS 28, if an entity holds, directly or indirectly, 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Representation of the board of directors is one of the ways that the existence of significant influence by an entity is usually evidenced. Accordingly, having a 20% shareholding together with the ability to appoint one director to the Board is sufficient to establish that the XE has significant influence over CBE. Therefore, the investment in CBE should be considered as an investment in associate and accounted using equity method.

Under the equity method, initial recognition of the investment in the associate should be recognised at cost (i.e. at Rs. 400 million and thereafter the carrying amount should be increased or decreased by the investor's share of profit or loss.

On acquisition of the investment, any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.

Accordingly the carrying amount of the investment as at 31 March 2022 is as follows.

Cost	- Rs. 400 million
Excess of NA acquired over cost / Gain on Bargain purchase (Rs. 535.9-400)	- Rs. 135.9 million
Share of profit (Rs. 360.9*20%)	- Rs. 72.18 million
Carrying value as at 31 March 2022	- Rs. 608.09 million

Excess of net assets acquired over the cost of investment should be recognised as income of XE at the date of investment.

<u>Purchase of the balance 20%</u>

As per SLFRS 10, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee

(b) exposure, or rights, to variable returns from its involvement with the investee and

(c) the ability to use its power over the investee to affect the amount of the investor's returns

With XE buying the balance 20% of CBE, the contractual arrangement facilitates XE to direct sufficient vote holders on how to vote, to enable XE to make decisions about the main activities that significantly affect CBE's profit or loss. Further, the CEO of XE will be appointed as the CEO of CBE and majority of the Board members of CBE will be appointed by XE. These give XE power to direct the relevant activities of CBE. Accordingly, XE gets the control and become the parent of CBE.

Since this is a business combination achieved in stages, XE shall remeasure its previously held equity interest in CBE at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Accordingly, Rs. 183.08 million (Rs. 425 million – Rs. 608.09 million) to be recognised as a loss in the profit or loss.

XE needs to compute goodwill or gain on bargain purchase, measured as the excess of (1) over (2) below:

1. the aggregate of:

(i) the consideration transferred measured in accordance with SLFRS 3, which generally requires acquisition-date fair value;

(ii) the amount of any non-controlling interest in the acquiree measured in accordance with this SLFRS; and

(iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

2. the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this SLFRS.

It was assumed that NCI is measured at fair value.

		Rs'mn
FV of consideration		
Cash		500
Deferred consideration		165.29
Ordinary shares (2mn*Rs. 230)		460
		1,125.29
Fair value of existing 20%		425
FV of NCI		1,400
		2,950.29
FV of net assets		
Net assets	3,040.48	
DT asset on losses	(163)	
Intangible asset	10	2,887.48
Goodwill		**62.81**

As per LKAS 12, deferred tax asset on tax losses that cannot be utilized against future taxable profits should not be recognised.

SLFRS 3 requires an acquirer to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Accordingly, fair value of the intangible asset arising from favorable terms of the franchise agreement should be separately recognised.

Plan to restructure a subsidiary following an acquisition is not a present obligation of the acquiree at the acquisition date. Therefore, a liability cannot be recognised.

Accordingly, XE is required to prepare consolidated financial statements for the year ending 31 March 2022 consolidating the results of CBE.

(b) Proposal 2

According to SLFRS 11, a joint arrangement is an arrangement of which two or more parties have joint control. A joint arrangement has the following characteristics;

- The parties are bound by a contractual arrangement

- The contractual arrangement gives two or more of those parties joint control of the arrangement.

Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. According to para 10, a party with joint control can prevent other parties from controlling the arrangement.

Analysis

There is a contractual arrangement and the arrangement requires at least 51 per cent voting rights to make decisions about the main activities of the Business School. Since each party has 50% of the voting rights, the parties have implicitly agreed that they have **joint control over the arrangement** because decisions about the main activities of the business school (which are the relevant activities) cannot be made without both parties agreeing to it.

Accordingly, the arrangement is a **joint arrangement**.

In this case the joint arrangement is structured through a separate vehicle (separate entity). According to the contractual terms, all the assets and obligations for liabilities of the business school, are of the new company and not the assets and liabilities of the parties, and each party is entitled to a share of profit or loss of the new company equivalent to each party's ownership interest in the company. Based on the above terms, the arrangement provides the parties to the arrangement with rights to the **net** assets and the contractual arrangement establishes each party's share in the profit or loss relating to the activities of the arrangement. Accordingly, this arrangement is a **joint venture**.

CBE requiring to provide guarantees to the bank. if XCBE requires additional financing does not, by itself, determine that the arrangement is a joint operation or joint venture. Since the obligation for liabilities is with the parties, CBE providing a guarantee to obtain financing does not change the above conclusion.

Financial Impact (in Rs.'mn)

SLFRS 11 requires the joint venturer to recognise its interest in a joint venture (i.e in the new company) as an investment and shall account for that investment using the equity method.

Investment (50%* 1,000,000)	= 500
Share of profit (50%)	= 351.45
Carrying value as at 31 March 2022	= 851.45

(c) Share Buyback

Paragraph 33 of LKAS 32 states that if an entity reacquires its own equity instruments, those instruments shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale or issue or cancellation of an entity's own equity instrument.

Accordingly, CBE should debit Rs. 925 million to equity and credit the same to cash.

Since, these share will be subsequently cancelled, it has an impact on EPS.

Transfer of PPE by CBE

CBEPL requires to derecognize the carrying value of the PPE transferred. Since this is a downstream transaction from the investor to its JV, the investor's share of the gain/loss resulting from the transaction should be eliminated. Accordingly the balance gain/loss should be recognised.

Computation	(Rs'mn)
FV of the consideration (i.e. value of the investment)	500
Carrying Value	500
Loss	Nil

Revaluation surplus of Rs. 30mn may be transferred to retained earnings .